

INSURANCE
DEPARTMENT OF BANKING AND INSURANCE
OFFICE OF PROPERTY LIABILITY

Private Passenger Automobile Insurance Territorial Rating Plans
Territorial Rating Equalization Exchange

Adopted Amendments: N.J.A.C. 11:3-16A.1, 16A.2 and 16A.4

Adopted New Rules: N.J.A.C. 11:3-16A.10, 16A.11 and 16A.12

Proposed: January 2, 2007 at 39 N.J.R. 13(a)

Adopted: December 28, 2007 by Steven M. Goldman, Commissioner, Department of Banking and Insurance

Filed: December 28, 2007 as R. 2008 d. 31, with substantive 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, 17:1-15e, 17:29A-36, 17:29A-48 et seq., and 17:29D-1

Effective Date: February 4, 2008

Expiration Date: June 7, 2011

Summary of Public Comments and Agency Responses:

The Department of Banking and Insurance timely received written comments from the following:

1. United Services Automobile Association;
2. The Independent Insurance Agents and Brokers of New Jersey;
3. A collective submission on behalf of Palisades Safety and Insurance Association, Palisades Insurance Company, Palisades Safety and Insurance Management Corporation, High Point Preferred Insurance Company, High Point Safety Insurance Company, High Point Property and Casualty Company, High Point Safety and Insurance Management

Corporation, Twin Lights Insurance Company, and Teachers Auto Insurance Company of New Jersey;

4. The Professional Insurance Agents of New Jersey;
5. New Jersey Manufacturers Insurance Group;
6. State Farm Indemnity Company and State Farm Guaranty Insurance Company;
7. Travelers of New Jersey;
8. The Insurance Council of New Jersey;
9. Sterns and Weinroth on behalf of the American Insurance Association;
and
10. The Property Casualty Insurers Association of America

COMMENT: Several commenters supported the proposal and recognized that the Territorial Rating Equalization Exchange (TREE) plan is a proactive measure intended to help avoid potential affordability and availability problems in urban areas. Some of the commenters that supported the proposal in concept also expressed concerns with specific provisions of the rules. These comments will be noted in detail below.

RESPONSE: The Department appreciates the support of the proposal. Specific comments and concerns related to the TREE plan and the rules will be noted and addressed below.

COMMENT: Many of the commenters believed that there is no need for this proposal. The commenters noted that the TREE is intended to address affordability and availability problems

associated with private passenger automobile insurance in certain urban areas after the territorial rate caps are lifted and the take-all-eligible persons provisions no longer apply. The commenters believed that existing law already addresses these issues. Several commenters stated that, with respect to the lifting of the territorial rate caps, N.J.S.A. 17:29A-36b provides that “no rating plan or rate filling ... shall be approved by the Commissioner which creates territorial relativities which are significantly disproportionate to those in effect as of the effective date of [N.J.S.A. 39:6A-1.1 et al.]” The commenters believed that this gives the Commissioner express statutory authority to prevent large rate increases in a territory and thus directly addresses the affordability issue.

One commenter also stated that N.J.A.C. 11:3-35A.3(b) prohibits any variance of alternate underwriting rules by territory. Accordingly, the commenter stated that an insurer may not refuse to write risks in certain areas while writing risks elsewhere. This commenter, as well as others, stated that the market is now very competitive, and availability is not an issue.

The commenters believed that allowing the free market system to operate, which fosters competition, is the best means to avoid any availability or affordability issues. Another commenter suggested that if the Department believes it is necessary to put the TREE mechanism in place, the actual implementation should be delayed until closer to the time of the sunset of the take-all-eligible persons requirement and Urban Enterprise Zone (UEZ) assignments, and thus the Department would be in a position to more clearly determine any problems that require attention.

RESPONSE: The Department does not agree with the commenters that the TREE is not necessary because N.J.S.A. 17:29A-36b gives the Commissioner the statutory authority not to

approve rate filings that are significantly disproportionate to the rates currently in effect. On its own, the statutory authority cited by the commenters provides no guidance to filers or the Department in determining when a rate filing is “significantly disproportionate.” The commenters imply that the Department could establish a standard for “substantially disproportionate” and apply that in its review of rate filings, approving those that met the standard and disapproving those that did not. Such a standard would, however, be required to be promulgated as an administrative rule in that it would be of general application and continuing effect. While the Department was provided with broad regulatory authority to implement the Act, adopting a rule establishing a territorial differential cap is highly questionable (and perhaps would be subject to a successful legal challenge) in light of the Legislature specifically repealing the previous territorial differential cap. A subjectively determined, but permanent cap applied to rate filings as submitted is likewise problematic in that it would be difficult to administer and would result in costly disputes and litigation.

The fact that N.J.A.C. 11:3-35A.3(b) prohibits variance in alternate underwriting rules by territory is unlikely to prevent insurers from trying to avoid writing business in territories or parts of territories where the maximum territorial differential is lower than actuarially determined.

Finally, while the Department acknowledges that competition in the marketplace has increased the availability and affordability of private passenger automobile insurance in this State, competitive forces alone cannot eliminate the significant increases for urban insureds that will occur in the absence of the pre-1998 rate caps and a mechanism, such as the TREE, in place to mitigate such increases.

COMMENT: Several commenters believed that the proposal is unnecessary in that there are no affordability or availability issues at this time, and that the belief that such issues will arise after the expiration of the take-all-eligible person requirements is based on faulty assumptions. In addition, several commenters noted that there are already provisions in place in the existing statutory scheme to address these issues, specifically the special automobile insurance policy and the basic automobile insurance policy, which provide automobile insurance consumers with lower cost alternatives to standard automobile insurance policies.

One commenter stated that a more appropriate approach would be to focus on further development and expansion of the basic and/or special automobile insurance policy programs, both of which may be administered through the Personal Automobile Insurance Plan (PAIP). This commenter stated that when rates in certain urban territories were first capped, neither of these policies were available. The special policy provides coverage to those who meet specified income criteria and is currently handled through the PAIP. The basic policy provides much broader coverage than the special policy at affordable rates and is available in both the voluntary and residual market.

While the rate caps were lifted under the 1998 automobile insurance reform laws, the Legislature maintained the caps for the basic policy, thus signaling its intent that the basic policy would continue to serve as a viable affordable alternative to the standard policy as a means of satisfying compulsory automobile insurance requirements. The commenter stated that, currently, the majority of basic policies in the State are already written in PAIP, with approximately 50 percent of them in urban territories. The commenter stated that both the basic and special automobile insurance policies have addressed market pressures that may have been present in urban areas and that the expansion of such programs will continue to do so even after the take-

all-eligible persons requirement has been eliminated. The commenter believed that further development of these programs through marketing in capped territories may, over time, eliminate a need for urban subsidies of standard automobile insurance policies.

RESPONSE: The Department does not agree with the commenters that the basic and special automobile insurance policies represent the only alternative for urban insureds whose rates have been subsidized in the past by operation of the rating cap. The high frequency of accidents in urban areas is the result of traffic density that is caused by both urban residents and commuters from the suburbs.

The special automobile insurance policy is available only to those who qualify for comprehensive Medicaid benefits. The basic policy can be a good choice for insureds with few assets to protect. However, many residents of urban areas own homes or apartments and thus appropriately would seek the coverage afforded by the standard policy. In addition, options are limited with the basic policy and no uninsured or underinsured coverage is available.

Although the basic policy has been available since 1999 and the special automobile insurance policy since 2003, as of the end of 2006, only 22,691 basic policies and 17,832 special policies were in force, together comprising less than one percent of the entire market. Moreover, as one commenter notes about half of the basic policies are written in the PAIP, which means that the insureds do not meet the definition of an “eligible person.” The small number of inforce basic and special policies indicates either that these products are not suitable or attractive to the low and moderate income drivers for whom they were designed, or that no insurer to date has undertaken to make them widely available to the targeted population. Regardless of which is the case, these alternative policies cannot at this time be considered a viable and sufficient

alternative means of providing affordable mandatory auto insurance coverage to the entire spectrum of insureds within these populations.

COMMENT: One commenter stated that, as the burden of the take-all-eligible persons requirement ultimately ends, competition will be fostered. In addition, the commenter asserted the Urban Zone Assignment Program (UZAR), scheduled to sunset in April 2009, impairs competition and its cessation will not leave a gap in the protections provided to consumers, but will more likely encourage carriers to write in urban areas.

Another commenter specifically stated that since the enactment of the last two automobile insurance reform laws, the number of vehicles in the residual market has dropped dramatically because of competition. The commenter believed that these competitive forces will continue to remain in play even with the elimination of the territorial caps. The commenter stated that the State should learn from past experiences that the establishment of these types of mechanisms does not promote a healthy insurance market place. The commenter cited the New Jersey Automobile Full Insurance Underwriting Association (NJAFIUA), which made up one-third of the national residual market and ultimately insured over 40 percent of the private passenger automobiles in New Jersey. The commenter stated that now over 98 percent of the vehicles in New Jersey are insured in the voluntary market, where the public is benefiting from lower rates and refunds.

Another commenter cited as an alternative to the TREE that the State could provide funding to subsidize premiums in high cost territories from general funds, or from the insurance premium taxes that are already paid. This commenter also stated that it is premature to establish the TREE because the UZAR and take-all-eligible persons requirements remain in effect and

accomplish many, if not all, of the policy objectives set forth for the TREE. Until these programs expire, the commenter believed that there is no need for the TREE.

Another commenter stated that the implementation of TREE is based on negative assumptions about how the current market will react to the repeal of existing rate caps and the use of new territorial rating maps for the first time in more than 50 years, as well as the anticipated sunset of the UZAR and the take-all-eligible persons requirements. The commenter believed that the implementation of the TREE is thus premature. If the Department's assumptions prove to be correct, the commenter believed that there may be validity in the implementation of some mechanism in order to sustain a competitive market in all regions of the State. The commenter, however, believed that it would be a mistake to make negative assumptions that may never come to fruition that also will have an adverse impact on the continued growth in the competitive market. In addition, the commenter was concerned that the TREE could unintentionally undermine current efforts to promote New Jersey as a healthy environment in which to do business and dampen competition among companies, thereby creating problems in the market. The commenter thus requested that the Department delay the implementation of TREE until there has been an opportunity to examine the reaction of the market to the pending regulatory changes.

RESPONSE: The Department recognizes that the New Jersey automobile insurance market is very competitive for the first time in many years and understands the concerns of insurers about regulatory action that may interfere with the health of the current marketplace. However, the Department does not believe that the competitive market alone can meet the statutory

requirement that the rates under the new territorial map not be significantly disproportionate to those in effect now.

All of the alternatives to the TREE mechanism set forth above as suggested by the commenters would require the Department to ignore N.J.S.A. 17:29A-36 when reviewing and approving insurers' rating systems. As noted above, the law in effect at the time the territorial rating cap was repealed required a maximum territorial differential of 1.35 or 135 percent of the Statewide average. The Territorial Rating Advisory Commission, established pursuant to N.J.S.A. 17:29A-48, initially recommended two alternate maps, one assuming the TREE mechanism is in place and one without it. The maximum territorial differential on the map with the TREE territories is 1.57, which the Department finds is not substantially disproportionate to the 1.35 differential in place in 1998. The maximum territorial differential on the other map, however, is 2.18, which the Department finds is substantially disproportionate to the 1.35 differential in place in 1998. The Department would be unable to approve rating systems that utilize that differential in the absence of the TREE mechanism to moderate the differential.

COMMENT: Several commenters stated that the Department lacks the statutory authority to establish and implement the TREE program. The commenters noted that the Department cited N.J.S.A. 17:29A-36b and 17:29D-1 as its authority for the proposal. The commenters noted that N.J.S.A. 17:29A-36b relates only to approval or disapproval of rate filings or rating plans, in that it directs the Commissioner to disapprove a filing or plan if it causes rates to be significantly disproportionate to those in effect in 1998. There is nothing in this statute authorizing the Department to create a mandated system of assessments on some insurers and payment of

subsidies to other insurers. The statute directs that the disproportionate relativities be addressed through the Commissioner's authority to disapprove rate filings or rating plans as filed.

The commenters also stated that the TREE program is not a residual market mechanism in that it operates entirely in the voluntary market. Thus, the Department's residual market authority under N.J.S.A. 17:29D-1 does not apply. With regard to this comment, one commenter specifically stated that N.J.S.A. 17:29D-1 relates to establishing a plan for providing an apportionment of insurance coverage for applicants who are in good faith entitled to, but are unable to procure same through ordinary methods. The commenter could not find any basis for the Department to use this authority for the creation of the TREE program. The latest publicly available data from the Department indicates that over 98 percent of the total private passenger automobile insureds in this State are insured in the voluntary market. As of June 30, 2006, the PAIP insured only 1.3 percent of the private passenger automobiles insured in this State. The commenter stated that these figures do not support the position that there is an automobile insurance availability issue at this time. The commenter stated that it appears that the Department is trying to address an alleged affordability issue in a way that that does not appear to be within the authority of this statute.

Another commenter also noted that the TREE plan does not apportion coverage, as recognized under N.J.S.A. 17:29D-1, but assesses monies from some insurers and grants monies to others. In addition, N.J.S.A. 17:29D-1 et seq. contains a number of specific requirements for any plan established under that section, none of which are included in the TREE proposal, including, for example, the creation of a "rating system which shall produce rates for each coverage" and a "limited assignment distribution system."

Another commenter noted the Commissioner's cited authority of N.J.S.A. 17:29A-48 et seq., which grants the Commissioner authority to promulgate rules for the purpose of establishing standards governing the establishment of new rating territories. The commenter stated that the creation of a mandatory, unincorporated association capable of assessing insurers is not a "standard governing the establishment of new rating territories." In addition, the commenter stated that the TREE program is prohibited under N.J.S.A. 17:29A-48g, which states that "territories shall be defined in a manner which does not result in an unfair inter-territorial subsidization among territories with significant differences in driving environments, population density, traffic density, mix of driver classifications, including classifications capped pursuant to the provisions of [N.J.S.A. 17:29A-36] and comparative degree of severity of loss." The commenter stated that the TREE proposal will result in unfair subsidization of a select few urban territories or zip codes by drivers in all other territories of the State. The commenter stated that drivers in non-urban territories, including drivers in the most rural and least populated territories in this State, will be required to pay premiums that include an equalization amount for drivers in territories that have significantly different driving environments, population density and traffic density, among other factors.

RESPONSE: The Department does not agree that it does not have statutory authority for the TREE program. N.J.S.A. 17:29A-36 was amended in 1998 by P.L. 1998, c. 21 to repeal the 1.35 territorial rate cap as part of the creation of new rating territories. It was replaced by N.J.S.A. 17:29A-36b, which directs the Commissioner to disapprove a filing or plan if it causes rates to be significantly disproportionate to those in effect in 1998. N.J.S.A. 17:29A-36b does not define "significantly disproportionate" nor provide any guidance as to how the Department should

implement this statutory provision. The TREE program implements the directive of N.J.S.A. 17:29A-36b in a way that is consistent with its rulemaking authority in N.J.S.A. 39:6A-1.2 and which meets the requirements of the Administrative Procedure Act that Department actions of general applicability and continuing effect or that interpret law or policy should be promulgated as administrative rules. See N.J.S.A. 52:14B-2.

With regard to the comment that N.J.S.A. 17:29D-1 cannot be used as authority for the TREE because the TREE operates entirely in the voluntary market, the Department does not agree. N.J.S.A. 17:29D-1 gives the Department authority to set up market assistance programs in addition to residual market mechanisms. An example is the Windstorm Market Assistance Program, N.J.A.C. 11:2-41. The requirement of N.J.S.A. 17:29A-36b that the rates in the new territories not be significantly disproportionate to those in effect in 1998 suggests that absent such a restriction, the rates in some urban areas might be so high as to make coverage unavailable to persons seeking insurance coverage. Therefore, the fact that the residual market for automobile insurance is currently very small in New Jersey is irrelevant. For the same reasons, the parts of N.J.S.A. 17:29D-1 referred to by a commenter that provide that, “any plan established pursuant to this section to provide insurance coverage for automobiles, as defined in N.J.S.A. 39:6A-2....” also have no relation to the TREE plan, which is not providing coverage to insureds.

The Department also does not agree that the TREE program violates N.J.S.A. 17:29-48g, which prohibits unfair inter-territorial subsidization among territories with significant differences in driving environments or other underwriting factors. The rules of statutory construction require that N.J.S.A. 17:29A-48g must be read in conjunction with N.J.S.A. 17:29A-36b. As noted in the Response to another Comment, absent the 1.35 territorial cap or something like the TREE

mechanism, the rates in urban territories will be substantially disproportionate to those in effect in 1998. Another alternative, as embodied in the non-TREE map filed by the Territorial Rating Commission, is to create territories that combine the urban and inner ring suburban zip codes. The Department believes that this would create unfair subsidization by putting most of the burden on the suburban areas closest to the urban centers. N.J.S.A. 17:29-48g did not prohibit all subsidization; it prohibited unfair subsidization. The Department believes that the TREE program is a fair equalization of risk between urban, suburban and rural areas that meets the requirement of both statutory provisions.

COMMENT: Several commenters stated that the TREE program should only be implemented if the market does not perform. Accordingly, these commenters suggested that the TREE program have a “trigger” mechanism to turn the program on and off. One commenter stated that the purpose of the TREE is to: assure availability of insurance in the designated areas; and assure that rates are not “significantly disproportionate.” The commenter stated that because all carriers are required by law to have rates that are not “significantly disproportionate,” the second prong could be accomplished without the existence of the TREE. The commenter stated that currently availability is not an issue in the rated territories. However, the TREE is based on concerns about the future market after the take-all-eligible persons and the UZAR automobile insurance programs expire. While the commenter believed that the level of competition should be sufficient to assure availability, the commenter is concerned that volatility inherent in a Statewide insurance market for a line of insurance could cause a hard market where availability will once again become an issue in certain areas for a number of years. This commenter stated that a reverse trigger would address these concerns. Annually, the Department could assess

competition in the designated areas and if there is adequate competition, the TREE could be turned off for a year. The commenter suggested that the tests be as follows: (1) is PAIP's market share in the designated area less than 10 percent (the commenter added that in light of the volatility of PAIP market share in a smaller territory, a 15 percent standard would work better); and (2) are there a variety of insurers with a variety of marketing systems currently actively writing in the designated areas with a pledge to continue in the absence of the TREE. The commenter stated that the Department would be permitted to collect data from carriers to determine their marketing plans, and the individual carrier responses would be protected from public disclosure as trade secrets. The commenter stated that the reverse trigger would have the advantage of reducing "gaming" the system or entry of marginal carriers into New Jersey who are doing so only for the equalization amount. With the reverse trigger, the commenter believed that a carrier has to be in and committed to writing in New Jersey for the long term. In this case, the commenter stated that the equalization amount would become a reward for serving difficult areas in New Jersey during hard times, rather than an integral part of carrier survival.

Similarly, another commenter stated that there should be an objective trigger before the TREE would be implemented, that is, there should be a determination that a competitive market does not exist based on the criteria set forth in existing law. This commenter stated that the Legislature specifically contemplated that there might come a time when there would no longer be a competitive market, and allowed for the reinstatement of take-all-comers in that event. N.J.S.A. 17:33B-15d(3)(a) sets forth a rebuttable presumption that a competitive market exists if PAIP is insuring less than 10 percent of the aggregate number of automobile non-fleet exposures being written in the total market. With PAIP writing less than two percent of the private

passenger market today, a healthy competitive market clearly continues and the proposed implementation of TREE at this time would be inappropriate and imprudent.

Another commenter suggested that actual implementation be tied to when a competitive market no longer exists, and if implemented, be evaluated at least annually to determine if it continues to be necessary.

RESPONSE: The Department does not agree with the commenters that there should be a “trigger” mechanism related to the competitiveness of the market that would cause the TREE program to be implemented. The TREE program is designed to address the statutory requirement that rates under the new territorial rating system not be significantly disproportionate to those in effect when the law was passed. The determination of what constitutes a significantly disproportionate change needs to be made when companies file their rating plans to implement the new territorial map. The goal of the TREE program is to minimize significantly disproportionate territorial rate differences. Thus, the issue of availability, while important, is not the sole goal of the program.

COMMENT: One commenter noted that the Department is relying on language in N.J.S.A. 17:29A-36 relating to the elimination of the 1.35 percent territorial cap on an insurer’s Statewide average base rate for each coverage, and the provision that any new territory relativities not be significantly disproportionate to those in effect in 1998 in the capped territories. The commenter stated that the Department assumes that the elimination of the territorial caps will create a need for the TREE equalization amount mechanism being proposed. The commenter alleged that the Department has failed to provide any data in the Summary of the proposal to indicate that the

lifting of the territorial rate caps and the establishment of the territorial rating commission map, or new maps submitted by individual companies, will result in base rates significantly disproportionate to those base rates in effect in 1998. The commenter stated that, in fact the industry trend is to introduce more sophisticated and segmented rating plans that rely less on geographic location than in the past. Based on the industry move to these new rating plans, the commenter did not see a need for this type of mechanism at this time. However, the commenter stated that if particular geographic areas face disproportionate increases in rates, the Department has the authority to disapprove any such filing until this concern is addressed.

RESPONSE: As noted above in response to another Comment, since the rule amendments were proposed, the Territorial Rating Commission has completed its work. As part of that process, the Department determined that the industry-wide territorial differentials filed by the Territorial Rating Commission for some urban areas are significantly disproportionate to those in effect in 1998. Also as noted above in response to another Comment, the Department believes that it needs to define the “significantly disproportionate” standard in a uniform way for all companies.

COMMENT: One commenter stated that for the TREE or any other market mechanism designed to deal with high loss areas to not disrupt the rest of the market, the number of such areas must be kept to a minimum. The current 12 percent of the automobile insurance market which is now in the auto insurance UEZs is far too large for current market conditions. The commenter believed that this could be cut to under four percent of the market for the TREE program or an extended UEZ program. The commenter, similar to another commenter, noted that the statute mandates this minimization. While rate filings may not contain territorial rates

that are “significantly disproportionate,” unfair inter-territorial subsidization is also barred pursuant to N.J.S.A. 17:29A-48g. Inter-territorial subsidization in excess of the minimum required to not be “significantly disproportionate” would be unfair. To meet both of these statutory requirements, a territorial rating plan must have only a minimum number of areas that do not reflect their true rate. In addition, the commenter stated that keeping the number of such areas to a minimum will simplify the administration of whatever plan is adopted, in that smaller plans are easier to administer, and will lessen the impact of the plan on other territories (for example, a one percent of premium inter-territorial subsidy is far less burdensome on consumers outside of the exceptional areas than a three to five percent subsidy). The commenter also stated that it would have the advantage of providing flexibility in the administration of the plan. If the plan has problems, or changes are needed, then the problems and changes will not have a significant impact on the rest of the market.

Another commenter also stated that there should be some limitation of the subsidies under the plan. The commenter believed that careful consideration should be given to assure that subsidies from other areas of the State do not cause insurance in the higher loss areas to become more profitable to insurers than the insurance policies in the remaining areas of the State. The commenter stated that there should also be consideration given to assure that affluent urban risks are not subsidized at the expense of consumers in other areas of the State.

Another commenter stated that if the TREE program goes to a large portion of the market, there will be massive subsidies flowing from better risks to worse risks. As the TREE program grows, the incentives to politically manipulate the results through legislation and litigation will be “too tempting to resist” if the history of the automobile insurance market in New Jersey is indicative of future actions.

RESPONSE: The commenters' concerns about how many areas will be designated TREE territories and the amount of the subsidy are outside the scope of the proposed new rules and amendments, which establish the framework for a TREE mechanism. These issues will be addressed in the TREE Plan of Operation. The Department has already created a TREE Technical Working Group, the majority of which is comprised of industry representatives, to obtain input from interested parties on how the TREE mechanism should work.

COMMENT: One commenter expressed concern that the proposal will be very difficult to implement and may provide anti-competitive incentives. The 2003 reform legislation fostered an array of different and diverse approaches to rating and rate segmentation that have provided consumers with a wide variety of choices when they shop for automobile insurance. These segmentation plans tend to reduce the overall importance of territory. Moreover, the relative importance of rate adequacy at the territorial level now varies widely from company to company. As a result, it will be very difficult to calculate a single dollar value that correctly reflects the extent to which rates are inadequate in an area where an insured will receive payments for writing business. The commenter believed that any single number will be inadequate for some insurers, so that the objective of the mechanism is not accomplished, but will compensate other insurers for business that would have been written profitably without any compensation. A mechanism that compensates insurers for business that they would have written anyway at the expense of other insurers may create the potential for manipulation that could threaten the gains in the market achieved over the past three years. This commenter writes business in Massachusetts and had experience with mechanisms that internalize subsidies in this fashion.

The commenter stated that the system in Massachusetts has created a market comprised of only 19 insurers. The commenter urged the Department to “proceed with caution” before it adds a new and potentially disruptive mechanism to the market.

RESPONSE: The Department appreciates the concerns of the commenter. While territory is less important as a rating factor than it was before more sophisticated rating systems were introduced, the adoption of a new territorial rating system without rating caps would, absent the TREE mechanism, result in significant increases in the territorial differentials applicable to many insureds in urban areas, which would be inconsistent with N.J.S.A. 17:29A-36.b. Further, as noted previously, comments regarding the amount of the subsidy are outside the scope of the proposal, and will be addressed in the Plan of Operation.

COMMENT: One commenter, a producer trade association, requested the opportunity to participate in the TREE governing board if TREE is adopted, as its member agencies are active throughout the State in affording automobile insurance coverage to New Jersey consumers. Another commenter that is a producer trade association suggested that a representative of its agency be selected to serve as one of the producer members in that it has a long history of providing the Department with knowledgeable individuals that have assisted the Department and served on various committees dealing with automobile insurance reform issues.

RESPONSE: The Department appreciates the offers of the commenters to serve on the TREE governing committee.

COMMENT: One commenter stated that the text of the rule is devoid of any specifics, thus making it difficult, if not impossible, to provide meaningful public comment. Without details, the commenter cannot measure the full impact of the program on its policyholders.

RESPONSE: The Department recognizes that the proposal only provides the outlines of the TREE program. However, the details will be set out in the TREE plan of operation that will be considered by the TREE governing committee, which is primarily composed of members of the industry. This is similar to other mechanisms, such as the Property Liability Insurance Guaranty Association (PLIGA) or the Automobile Insurance Risk Exchange (AIRE) that are funded by insurer assessments.

COMMENT: One commenter stated that if any market subsidy structure is selected, it should not provide for subsidies to urban policyholders who drive luxury vehicles and maintain high coverage levels because they live in a capped territory. The commenter believed that such an urban driver should be charged market rates and should not be subsidized at the expense of suburban drivers.

RESPONSE: The comment is outside the scope of the rule since the equalization amounts are not set by the rule. However, the Department is aware of the issue raised by the commenter and it has been discussed in the meetings of the TREE technical working group.

COMMENT: One commenter objected to the establishment of a mandated government mechanism such as the TREE, particularly in light of prior experience with entities such as the

NJAFIUA and the Market Transit Facility (MTF), which ultimately resulted in major market disruptions and significant costs to the system. Like the mechanism being proposed here, the NJAFIUA and the MTF were meant to operate on a no profit-no loss basis, but ultimately they did not. The commenter believed that a subsidy program will only lessen the market incentive to operate efficiently, raising the overall cost of private passenger automobile insurance in this State. The commenter stated that the failure of such mechanisms demonstrates the necessity for careful monitoring of any future mechanism to ensure that effective cost controls and antifraud measures are developed and maintained.

RESPONSE: The Department does not agree with the commenter that simply because the TREE program is mandated by the Department by rule it is destined to fail and cause market disruption. The TREE program is not a residual market mechanism, as were the NJAFIUA and the MTF. The existing territorial subsidy can cause market distortion because insurers have an incentive to avoid writing urban business. The commenter did not suggest any alternative to the TREE mechanism to implement the statutory requirement that the rates under the new territorial map not be significantly disproportionate to those in effect when the statute was passed.

COMMENT: One commenter stated that with the TREE mechanism in place, companies utilizing precise underwriting and rating criteria are likely to write only the most desirable urban risks, reducing availability for poorer risks. The commenter stated that, with the robust basic and special policy programs administered through the PAIP, insurance would be readily available to consumers in all areas of the State. The commenter stated that insurers could choose to take

assignments directly or have their assignments handled by a servicing carrier without the need for a complicated market subsidy system.

RESPONSE: The Department does not believe that the situation described by the commenter under the TREE mechanism would be more harmful to urban risks than the current situation where insurers lose money insuring urban risks. Insurers compete for the best business wherever they write, but the TREE mechanism is intended to permit insurers to receive the correct rate for the risk while not making the premium unaffordable for the insured. Further, as noted previously, while the basic and special policies are appropriate for some insureds, insureds who do not qualify for the special policy and who have significant assets to protect should be able to obtain standard policies at rates that are not significantly disproportionate to those currently in effect as is required by statute.

COMMENT: One commenter stated that, to the extent a subsidy mechanism is considered necessary by the Department, it should be based on income criteria and territory to ensure that only the most needy are subsidized. As with the special and basic policies, such a program could be administered through the PAIP. The commenter believed that a PAIP program would provide accessibility for all low income, urban drivers, as opposed to the proposed program, which the commenter believed would encourage cherry picking of the best urban risks.

RESPONSE: The Department does not agree with the commenter. The requirement that rates under the new territorial map not be “significantly disproportionate” to those in effect when the statute was passed does not refer to the income level of the insured. Therefore, the Department

has not set income requirements for participation in the TREE mechanism. The Department intends that the TREE equalization amount be a flat dollar amount by coverage. This will represent a relatively larger proportion of premium for insureds who buy lower limit coverages or have less expensive cars.

COMMENT: One commenter stated that other rules governing private passenger automobile insurance ratemaking will have to be amended to address the implementation of the TREE program. The commenter stated that New Jersey has detailed rules governing the methodology for automobile insurance ratemaking and excess profits reporting at N.J.A.C. 11:3-16, 16B and 20. The TREE proposal provides no guidance as to how TREE subsidy income and TREE subsidy payments by insurers are to be incorporated into rates for territories, overall rates and excess profits reports. The commenter also questioned how expected future or unexpected past changes in market share in a core urban area subject to TREE subsidies are to be incorporated into ratemaking methodologies. The commenter questioned what rates an insurer that will be making a rate filing shortly after TREE goes into effect would file. The commenter concluded that the Department must make many new rule proposals very quickly if it decides to go ahead with the TREE.

RESPONSE: The meetings of the TREE Technical Working Group have identified and discussed many of the issues raised by the commenter. The Department does not believe that it will be necessary to amend its rules on ratemaking and excess profits to implement the TREE. The specific issues raised by the commenter are outside the scope of the proposal and will be addressed in the TREE plan of operation.

COMMENT: One commenter stated that because companies have different rating and underwriting practices, it would be extremely difficult to determine what each company should pay into the TREE and what each company should take out. The commenter stated that the allocations may need to be calculated on a policyholder by policyholder basis, raising questions of practicality, expense and expertise.

RESPONSE: The Department does not agree with the commenter that it will be necessary to make decisions on TREE charges and payments at the policyholder level. As set forth in N.J.A.C. 11:3-16A.13, the Department, in consultation with the TREE governing committee, will make a determination as to the amounts of the TREE charge and payments. The Department recognizes that the effect of the TREE payments on premium will vary by company. However, the overall effect will be to prevent changes in premium based upon the new territory maps that are significantly disproportionate to the rates in effect when the law was passed.

COMMENT: Several commenters expressed concern that the activities conducted under the rules could violate State anti-trust law. One commenter expressed concern that the operation of the TREE Working Group (TWG), which is developing a draft plan of operation for the TREE, must be carefully managed so as to avoid anti-trust issues. TWG is a group of competitors meeting with others to decide who should receive money to sell in certain areas. The TWG structure could be influenced by a competitor interested in marketing in certain areas and not in others and desiring the subsidy to be provided in the areas in which they market. Others may be interested in paying subsidies so that they do not have to write in certain areas. Without an anti-

trust exemption, this would be considered a meeting by competitors to divide the market, which the commenter believed would be a clear per se violation of Federal anti-trust laws. This commenter stated that the TWG is operating under no statutory or regulatory authority so that the usual state action anti-trust exemption would not apply. TWG's discussion of rates and market conditions must be a theoretical framework only in order to avoid anti-trust issues. This commenter stated that once the TREE is effective, the governing committee will be covered by the state action exemption to the extent that the TREE is not held to be beyond the Department's statutory authority. Discussion of individual insurer marketing, rates or plans should be avoided, though discussion of specific market conditions in a designated area without naming individual insurers in order to adopt and administer the plan of operation can be done. The TREE would operate the same as the PAIP in discussing voluntary territorial writing credits, or the WindMAP in discussing what areas it should cover. The commenter expressed concern that, should the TREE be held to be beyond the statutory authority of the Department, the discussions by the governing committee may lose the state action anti-trust exemption.

Another commenter stated that N.J.A.C. 11:3-16A.11 sets forth the make-up and duties of the TREE governing committee. Among the responsibilities of the governing committee is to assess member insurers and distribute to member insurers such amounts as it finds necessary and appropriate to equalize significantly disproportionate territorial rating differentials. This commenter stated that a board comprised of competitors is given authority by the rules to fix the prices of their competitors, without clear statutory authority to do so. The commenter believed that this raises issues regarding the exposure of the governing committee members to anti-trust actions brought by one or more insurers. The commenter thus urged that the rules not be adopted. If they are adopted, the commenter requested a "hold harmless" letter from the State's

Attorney General. The commenter stated that the issue is not completely addressed by the indemnity language in N.J.A.C. 11:3-16A.11(f)10. The commenter stated that while this provision is helpful, it contains the exception for “willful misconduct” that might be construed to apply to actions later deemed to be anti-trust violations.

RESPONSE: The Department does not agree with the commenters that the proposal should not be adopted because of concerns about violations of the anti-trust statutes by the Technical Working Group (TWG) or the TREE Governing Committee. The activities of the TWG are outside the scope of the proposal. The Department disagrees with the commenter’s assertion that, under the TREE program, the governing committee will be given the authority to fix prices of competitors. The TREE Governing Committee will have no authority to prescribe or approve rates filed by individual insurers and the Department does not believe that its activities as authorized by the rules and as will be described in the plan of operation will violate any anti-trust provisions.

COMMENT: One commenter stated that any subsidy system for a designated area, whether expressed as a dollar subsidy or a percentage of premium, would only be an average for all carriers. The amount of subsidy in a designated area needed to cover a particular carrier’s losses will vary by carrier. Each company’s projected “uncapped” territorial rate relativities will be different from other carriers, as will its projected dollar premium differential between “capped” and “uncapped” premiums. A TREE subsidy that is an average of all carriers may be insufficient for one company and excessive for another. The carrier for whom the TREE subsidy is insufficient will be discouraged from writing in the designated areas. The result is that a portion

of the market will have an incentive to reduce or cease writing in the designated areas. This reduces choice and competition in the designated areas. If the remaining carriers are insurers with generally higher levels of premiums, the residents of the designated areas will have fewer options and potentially higher costs.

The commenter cited as an example the state of Michigan, where a system of territorial rate caps that existed from 1981 to 1996 resulted in fewer insurers competing in the core urban area of Detroit. Because a statewide insurer could not have adequate and not excessive rates both in the core urban areas and the rural areas, insurers tended to choose where they wanted to market. The non-urban writer had competitive rates in non-urban areas and inadequate rates in the urban areas, but had little or no marketing outlets in urban areas and thus almost no writings in urban areas. Conversely, the urban writer had excessive rates in rural areas and adequate rates in urban areas and thus had almost no writings in rural areas. Accordingly, the commenter stated that the core urban area had fewer insurers actively marketing. The possible entry of an urban specialty writer into the New Jersey market will not offset this reduction of choice and competition in designated areas. Also, “narrow writing” carriers tend to have small capital bases and are very vulnerable to changes in the urban market or subsidy. The commenter concluded that fewer writers will defeat the purpose of the TREE to create availability in core urban areas.

This commenter further stated that the TREE will accelerate a move by certain insurers to focus only on designated subsidized areas, at higher prices to consumers. The commenter stated that the best way to get around the “significantly disproportionate” territorial rate caps would be for a carrier to be a primary urban writer. Its rates for rural and outer suburbs would be kept artificially high, which would mean that it would have few such risks, which would comport with the carrier’s intent to be an urban writer. As a result, its “uncapped” territorial rate

relativities between its highest urban rating territories and much of the rest of the State would be much lower than a Statewide writer, and, thus, the urban writer's Statewide average rate would be much higher. The result would be that premiums that this carrier could charge in the higher urban rated territories would be much higher than the Statewide carriers, which would cost the residents of these areas more money, without being "significantly disproportionate." The commenter stated that to date, the urban markets have been too difficult for a specialty carrier to try this scenario. However, the commenter believed that the TREE program will add a very large subsidy to the equation and may provide an incentive for these types of operations. The higher rates will defeat the purpose of the TREE to cap premiums in core urban areas at affordable rates. Subsidies are also a powerful incentive for carriers to be creative in order to "game" the system to maximize the amount of subsidy dollars they would receive. The results of this gaming cannot be predicted and may have results that are contrary to the intent of the TREE.

RESPONSE: The Department does not agree with the commenter's analysis of the effect of the TREE program. The commenter stated that "[T]he carrier for whom the TREE subsidy is insufficient will be discouraged from writing in the designated areas. The result is that a portion of the market will have an incentive to reduce or cease writing in the designated areas. This reduces choice and competition in the designated areas." The commenter does not appear to understand how the TREE program will work. First, the current territorial rating caps give carriers an incentive to reduce writings in capped territories since they lose money there. The TREE mechanism eliminates this disincentive by giving the same equalization amount to each policy written by every company in a TREE territory. So, for example, in TREE territory A, Company X's approved indicated rate for a policy is \$1,200 and Company Y's rate for the same

coverage is \$1,500. Assume that the TREE equalization amount for TREE territory A is \$300.00. An insured would pay Company X \$900.00 and would pay Company Y \$1,200. Each company would collect the \$300.00 from the TREE and receive the full amount of its approved rate and thus should not have a disincentive to write in TREE territories. The Department recognizes that the same equalization amount will have a different effect on the premium of each insurer. Some insurers may be more competitive in the TREE territories than others, but no insurer will be required to lose money on each policy they write in TREE territories, as is currently the case.

In addition, the commenter's concern that some insurers may "game" rating caps by charging very high suburban rates, so that its urban rates could be even higher but still meet the cap, is misplaced. It is unlikely that an insurer could support such higher rates in its rate filing. Furthermore, since their rates would be much higher than other carriers, they would likely attract little business.

COMMENT: One commenter stated that the TREE program may generate significant litigation from carriers based on assessments paid or payments received. The commenter noted that the individual health insurance program (IHC) has a subsidy system between the IHC writers. The result is that the IHC has seven lawsuits over its assessments, with the 1993 and 1994 assessments are still in litigation.

RESPONSE: The Department does not believe that the threat of possible litigation should deter it from implementing what it believes is the correct way to meet the requirements of the statute. The Department also notes that if it does not determine what conforms to the not "significantly

disproportionate” requirement in the statute, there is also likely to be litigation since insurers and the Department will disagree about whether an individual filing meets the standard.

COMMENT: One commenter stated that the TREE program will mandate new data collection and reporting as well as the support of a new organization to administer the system. The commenter noted that this will add additional costs and increase the expense component for all insurers. The commenter stated that the purpose of the 1998 and 2003 automobile insurance reforms was to save consumers money, not to add expenses.

RESPONSE: The Department believes that the costs for the additional data collection and reporting required by the TREE program are primarily one-time programming costs and should not be excessive. The commenter has not suggested any lower cost method of implementing the not “significantly disproportionate” standard.

COMMENT: One commenter stated that the TREE system was modeled after the current Automobile Insurance Risk Exchange (AIRE) mechanism. However, the commenter believed that the two are very different. The commenter stated that AIRE eliminates the imbalance in loss payments by insurers caused by the system under which the number of policyholders who choose no limit threshold in an insurer’s book of business can be different between insurers. If the proportion of no-threshold choosers in an insurer’s book of business is larger than the average, that insurer receives the higher no-threshold third party liability premium, but does not pay their third party non-verbal threshold liability claims. That insurer will pay non-verbal threshold third party liability claims reflecting the average proportion of no-threshold choosers in the entire New

Jersey automobile insurance market. The commenter stated that the laws of probability and statistics make this true because an insurer cannot control whether a person with a third party liability claim will be a verbal threshold chooser or a no-threshold chooser. The AIRE mechanism determines this difference and transfers funds between insurers to pay for it. The commenter also noted that this mechanism is expressly authorized by statute.

The commenter stated that the TREE purports to eliminate the imbalance in loss payments caused by rates being artificially held below loss costs in certain designated areas. However, the amount of the imbalance of loss payments is not just a function of market share in the designated area, but is also a function of: (1) the insurer's Statewide average rate (upon which the cap is based) that can vary widely by insurer, especially if carriers decide to become urban New Jersey specialty writers; and (2) the experience of the carrier in the territory, which also can vary widely by insurer. The insurer, through marketing and underwriting, has some control over how high a rate it can charge in a designated area and what its losses will be. The laws of probability and statistics that allow the AIRE mechanism to work do not function here because the insurer has some control over its rates and experience. Random chance does not occur when the player has some control over the outcome. Unlike AIRE, the commenter believed that a TREE subsidy amount that is a dollar amount or percent of premium for all carriers for a designated area will be too much for half of the carriers and too little for the other half.

RESPONSE: The Department acknowledges that there are differences between the AIRE mechanism and the TREE. The Department does not agree with the commenter that the fact that insurers have some control over the rates charged in urban areas means that the TREE

mechanism will not work. The commenter suggests that a TREE payment that is uniform among companies will result in half the insurers receiving too much as a subsidy and half the insurers too little. The Department does not understand the comment. The TREE program is designed to replace the current intra-company subsidy with an industry-wide system. Companies compete now with different rating systems. As illustrated in the example in the response to another comment above, the TREE equalization amount will represent a different percentage of the premium for each insurer. The result will be that different insurers are more or less competitive in the TREE territories just as they are in non-TREE territories. However, insurers will not lose money on every policy that they write in the areas that will be designated as TREE territories. The purpose of the TREE is not to make every insurer “whole” for its losses, but to provide a payment that reduces what a purchaser pays for coverage in order to avoid the potential premium impact of substantially disproportionate territorial rating differentials.

COMMENT: One commenter believed that the automobile insurance UEZ program is a superior alternative to the TREE program. The commenter stated that even if the Legislature fails to reauthorize the UEZ program in 2009, the Department has the authority to extend it with only minor modifications under its current statutory residual market powers. The commenter stated that eligible persons who are declined automobile insurance under an insurer’s alternate underwriting rules are PAIP eligible in the voluntary rating tier pursuant to N.J.S.A. 17:29D-1j. Effective in 2009, all insurers will be using alternate underwriting rules so long as the market is competitive, as it is currently. The commenter believed that the UEZ mechanism may be adopted by the Commissioner to determine assignments of these declined risks that originate in the UEZs. If the market is deemed non-competitive, then the take-all-eligible persons

requirement again applies and these risks will be able to find insurance in the voluntary market without the UEZ. In addition, the commenter stated that the UEZ plan does not have many of the other problems that the TREE proposal has, which have been set forth in comments above. The threat of forced placement will encourage all carriers to write, not just a portion of the carriers with various issues or separate agendas. The UEZ plan also cannot be gamed, is simple to administer and will not be a magnet for litigation. In addition, there are no anti-trust questions with the UEZ. The commenter suggested that if the UEZ plan is extended, the alternate underwriting rules should be amended to allow a carrier to write risks in UEZs that it would not write elsewhere in the State. A carrier that is growing too fast Statewide but is still under its UEZ quota may want to use alternate underwriting rules to slow Statewide growth, but not in the automobile insurance UEZs. The current rules bar any variance of alternate underwriting rules by territory even if the variation is to write more risks in the UEZs.

RESPONSE: The Department does not agree with the commenter. While the UEZ requires that insurers write business in urban areas, it does not address the requirement in the statute that the rates under the new territorial map not be substantially disproportionate to those in effect in 1998. Also, the provision for UEZ assignments is currently set to expire at the end of March, 2009. Finally, the TREE eliminates the reason that insurers are required by statute to write business in urban areas – the fact that under the current rating cap, insurers lose money on every policy they write in an urban area, which deprives urban areas of the full benefits of competition.

COMMENT: One commenter suggested that the rules be revised to provide an exemption from the TREE for companies that have filed a plan of withdrawal; are experiencing financial difficulties; or are insolvent.

RESPONSE: The Department does not agree with the commenter that the rules need to be amended as suggested in the comment. Depending on the actual circumstances of an insurer, the Department has other authority to address such situations.

COMMENT: One commenter stated that N.J.A.C. 11:3-16A.11(a)1, which provides that eight members of the TREE governing committee shall be salaried employees of insurers that write private passenger automobile insurance in this State, seems to provide that the appointment follows the employee rather than the insurer who had employed him or her at the time of the appointment. Accordingly, the commenter believed that if the appointed person subsequently switches jobs to another insurer, then the original insurer would no longer be represented and the new insurer would be represented. The commenter believed that the intent of the rule is to allocate the insurer's positions on the governing committee to insurers of different types. The commenter believed that the rule should be amended to provide that when an insurer employee leaves his or her job at an insurer, the employee is deemed to have resigned, and a successor will be nominated in accordance with the nomination rules. Accordingly, the commenter suggested that the rule be amended to add a new sentence reading as follows: "Should a salaried employee appointed to the governing committee pursuant to this section leave the employment of the particular insurer group that he or she was employed by when he or she was appointed, then the

employee is deemed to have resigned from the governing committee and the nomination provisions of this section shall be followed to determine a successor.”

Another commenter similarly suggested that the governing committee membership outlined in the rules should be company specific, not person specific, so that a person’s position on the governing committee would be forfeited if that person accepts employment with another insurer and the original insurance company would retain the position on the TREE governing committee.

RESPONSE: Upon review of the commenter’s concerns, the Department has determined not to change the language of the rule. The language for this part of the rule was based on those of the New Jersey Personal Automobile Insurance Plan (PAIP) and the New Jersey Commercial Automobile Insurance Plan (CAIP). The Department does not believe that there has been problem in those governing committees with movement of appointed individuals from one company to another. If problems do occur, the Department will make appropriate amendments to the rule.

COMMENT: One commenter noted that, pursuant to N.J.A.C. 11:3-16A.11(d)1 and 2, the American Insurance Association and the Property Casualty Insurers Association of America each nominate two members to represent insurers. The commenter recommended that the Insurance Council of New Jersey, the only State trade association in New Jersey, which represents companies that insure 93 percent of the automobile insurance market in this State, also be provided the opportunity to nominate two members to the governing committee, on par with the national trade associations. The commenter stated that these two seats would be in addition to

the appointments that are already included in the proposal. The commenter believed that these additional two seats on the governing committee will ensure that a full range of companies are represented on the committee and that a full and diverse dialogue takes place.

RESPONSE: The Department does not agree with the commenter that such a change is necessary. The composition of the governing committee is modeled after other governing committees such as those for the PAIP, CAIP, PLIGA and AIRE. The Department sees no need to add another two members to the TREE governing committee when most member companies of the ICNJ are also members of one of the trade organizations currently listed in the rule.

COMMENT: One commenter suggested that N.J.A.C. 11:3-16A.11(f)7 be revised to define “qualified non-members” as companies who are not serving on the TREE governing committee.

RESPONSE: Upon review of the commenter’s concerns, the Department has determined not to change the language of the rule. It is clear that in the context of the rule, “member” refers to members of the TREE governing committee. Therefore, it is not necessary to amend the rule to define “qualified non-members.”

COMMENT: One commenter recommended that N.J.A.C. 11:3-16A.11(f)9 be amended to read as follows: “Assess member insurers and distribute to member insurers such amounts as it finds necessary and appropriate to [equalize] **adjust for** significantly disproportionate territorial rating differentials” (proposed additions are underlined, suggested deletion is in brackets). The

commenter believed that the word “adjust” would be more appropriate and more in line with the stated goals of the TREE.

RESPONSE: Upon review of the commenter’s concerns, the Department has determined not to change the language of the rule. “Equalize” as used in the rule does not mean that rates will be equalized among companies. Rather, the amounts distributed to insurers by TREE are intended to equalize the territorial differentials so that rates in the TREE territories are not significantly disproportionate to those in effect in 1998.

COMMENT: One commenter suggested that N.J.A.C. 11:3-16A.12(a)2 be amended to provide that the TREE governing committee would have the authority to annually review eligible zip codes for reimbursement to determine if those zip codes should be removed from the list. The commenter stated that the review of the zip codes in these high-risk areas and any subsequent determination of their eligibility should be based on objective data. This annual review will be beneficial to policyholders and a competitive market.

RESPONSE: Upon review, the Department has determined that no change to the rule is necessary. First, the plan of operation will provide for periodic filing of data, and the appropriate review and adjustment based upon that data. Secondly, the long process of implementing the 1998 law requiring that new territories be created has demonstrated that the loss ratios of individual zip codes change very slowly. The statute requires that the territories created in response to the 1998 law be reviewed at least every five years. The Department believes that it

will be appropriate to determine if TREE territories need to be adjusted in accordance with that schedule.

COMMENT: Several commenters expressed concern with the timeframes for the governing committee to act pursuant to N.J.A.C. 11:3-16A.12(b). The rule requires that the governing committee approve a plan of operation for the TREE within 60 days of the effective date of this rule or a new plan that is acceptable to the Commissioner within 30 days after the disapproval of the proposed plan, or the Commissioner may promulgate his or her own plan of operation. The commenters noted that there is no governing committee for the TREE at this time and there cannot be one until the rules have been adopted and become effective. The nomination process and the convening of the first governing committee will take some time and may require the entire 60 days for the governing committee to act. The plan of operation will be complex and take more than 60 days for the governing committee to send to the Commissioner, once the governing committee starts to meet. While the unofficial actions of TWG will be helpful, the TWG is not necessarily representative of all interested parties involved and the legal responsibility for the plan of operation is the governing committee's. Rewriting the plan of operation to meet any objections of the Commissioner also will take more than 30 days. The commenters believed these short timeframes are arbitrary. The commenters thus believed that the rule should be revised to provide that the governing committee shall submit to the Commissioner a plan of operation within 120 of the governing committee's appointment. In addition, the commenters suggested that N.J.A.C. 11:3-16A.12(b)1 should be revised to reflect the proposed 120-day deadline and to extend the 30-day time to submit a new plan to the Commissioner to 60 days.

RESPONSE: The Department agrees with the commenters' concerns that 60 days from the effective date of the rule may not be sufficient time for the governing committee to produce a plan of operation. The Department will change the rule upon adoption to require that the plan of operation be submitted to the Commissioner within 60 days of the date that six of the 10 voting members of the governing committee have been appointed. In addition, the Department can begin the preliminary steps in the appointment process after notice of adoption is filed with and approved by the Office of Administrative Law but before it is published. The Department, however, does not agree with the commenters that it should take the governing committee 120 days to produce a plan of operation

COMMENT: One commenter suggested that N.J.A.C. 11:3-16A.12(c) be revised to add the following sentence after the first sentence: "The Commissioner shall have 60 days to review and approve or reject the proposed amendments." The commenter also suggested amending N.J.A.C. 11:3-16A.12(d) to permit the Commissioner additional time to review and analyze the proposed amendments submitted by the governing committee from 30 days to 60 days as follows: "The Commissioner may review the plan of operation at any time and may propose amendments to the governing committee. If the governing committee does not adopt the amendments [acceptable] **proposed by** [to] the Commissioner within [30] **60** days of their receipt by the committee, the Commissioner may certify the amendments and their effective date to the governing committee." (proposed additional language is underlined, proposed language to be deleted is in brackets). Similar to other comments, the commenter believed that the increased period of time is justified

in light of the complexity of the issues involved and extensive review required of any proposed amendments by the committee.

RESPONSE: The Department does not agree with the commenter that the rule should be amended upon adoption to extend the time period for the governing committee to review amendments to the plan of operation proposed by the Commissioner. In an era of electronic communication, the proposed amendments can be disseminated very quickly. In cases where the governing committee demonstrates that additional time for review is necessary, the Department can delay certification of amendments.

COMMENT: One commenter requested that the Department clarify whether the adoption of amendments to the plan of operation would be retroactive or prospective in nature. In addition, the commenter questioned that if there is not unanimity in the amendment adoption process, what recourse would the governing committee have to appeal the decision.

RESPONSE: The commenter's concerns are outside the scope of the rule. The Department cannot respond about how it would act in hypothetical situations. Plans of operation typically have an appeal mechanism that provides that challenged final decisions by the organization first go to the Commissioner to render a final agency decision which may then be appealed to the Appellate Division of the New Jersey Superior Court.

COMMENT: One commenter suggested that N.J.A.C. 11:3-16A.12(d)1 be revised to provide that for "emergent" cause shown, rather than for "good" cause shown, the Commissioner may

certify proposed amendments two days after copies of the proposal are provided to the governing committee. The commenter believed that this more appropriately underscores the importance of certifying proposed amendments on an expedited basis.

RESPONSE: The Department does not agree with the commenter's suggestion. "Good cause" has been the standard used in the Department's rules with similar provisions and the Department has not been made aware of any problems with the use of this standard.

COMMENT: One commenter supported the implementation and adoption of the TREE program, but believed that the following items should be considered in the development of the TREE rules, or plan of operation, as follows:

(1) The UEZ program should end coincident with the implementation of TREE. The commenter believed there is no remaining public policy reason for the existence of the UEZ and the existence of two conflicting mechanisms aimed at the same public policy goal would prevent TREE from being successful.

(2) The regulation of how rating territories are defined should be substantially reduced. With TREE, there is no public policy purpose to restrict the physical definitions of territories, so long as they are supported by data.

(3) Insurers should be able to set their own territory rates to reflect their own loss costs. With TREE, certain zip codes will receive rates that are lower to the consumer, but the net premium collected by the company must be equal to what the company files.

(4) Companies should be free to set territory rates at the same level of detail as the equalization payouts in TREE. In other words, if the TREE applies rate equalization funds at the

zip code level, companies must be able to set territorial boundary definitions and territorial rates at the zip code level.

RESPONSE: The Department appreciates the commenter's support of the TREE program. However, the issues raised by the commenter are outside the scope of the proposal. Assignments under the UEZ program are set to end by statute in 2009. The Department has not proposed amendments to the territory rules, N.J.A.C. 11:16A, other than the current proposal that sets up the TREE mechanism.

COMMENT: One commenter, while supporting the implementation of TREE, suggested that companies should file rates independent of TREE, according to their own loss costs, and then subtract out TREE equalization amounts and add the TREE charge, collecting the net amount from the customer. The difference would then be settled up with the TREE. In this fashion, insurers need only maintain a table in their rate calculations containing the TREE equalization amounts and charges for each zip code and coverage combination. If the TREE amounts change, the company would simply update the table and would not have to file new territory rates. This will accomplish the objectives of the TREE without creating a costly process for both companies and the Department.

RESPONSE: The Department appreciates the commenter's support of the TREE. Although the commenter's suggestions about how the TREE charge and payment would be implemented are outside the scope of the proposal, they have been discussed in the TWG. The technical details of the administration of TREE will be contained in the plan of operation.

COMMENT: One commenter believed that the total charges to fund the TREE could be reduced by considering the following: (1) lower equalization amounts for voluntary coverages; (2) lower equalization amounts for bodily injury coverages over a certain limit; and (3) applying equalization amounts at the zip code level rather than at the current large and outdated territory level. In this fashion, the commenter believed that the equalization amounts can be directed more accurately to those who need it, and reduce the costs of supplying equalization funds to those who do not.

RESPONSE: The commenter's suggestions are outside the scope of the proposal. The amounts of the TREE payments and how they will be made will be included in the TREE plan of operation.

COMMENT: One commenter believed that the decisions on which zip codes should receive an equalization amount and how much each zip code should receive is something in which insurers should have no role unless it is simply in the context of implementing an objective model. The commenter stated that these are public policy decisions that should not be influenced by insurers, agents or industry associations. The commenter suggested that there be an objective analytical model by which the zip codes and amounts are determined.

RESPONSE: The commenter's suggestions are outside the scope of the proposal. The text of the adopted rules simply provide that the methodology for determination of the zip codes eligible for TREE reimbursement and the determination of the amount of the equalization charge shall be

included in the TREE Plan of Operation. The rules do not state how or by whom the methodology is developed. The Department notes that it has already made the determination of which zip codes are eligible to receive TREE reimbursement as part of the work of the Automobile Territorial Rating Advisory Committee.

Federal Standards Statement

A Federal standards analysis is not required because the adopted amendments and new rules 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]*):

11:3-16A.12 TREE Plan of Operation

(a) (No change from proposal.)

(b) The governing committee shall, within 60 days of the *[effective date of this subchapter]* ***appointment by the Commissioner of six members of the governing committee***, submit to the Commissioner for his review and approval, a proposed plan of operation.

1. If the governing committee does not submit a Plan of Operation within 60 days of the *[effective date of this rule]* ***appointment by the Commissioner of six members of the governing committee***, or a new Plan that is acceptable to the Commissioner within 30 days after the disapproval of the proposed Plan, the Commissioner may promulgate a Plan of Organization and certify same to the governing committee.

(c) – (d) (No change from proposal.)

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