

INSURANCE

DEPARTMENT OF BANKING AND INSURANCE

OFFICE OF SOLVENCY REGULATION

Determination of Insurers in a Hazardous Financial Condition

Proposed Amendments: N.J.A.C. 11:2-27.1 through 27.4

Authorized By: Kenneth E. Kobylowski, Commissioner, Department of Banking and Insurance.

Authority: N.J.S.A. 17:1-8.1, 17:1-15.e, and 17:51A-1 et seq.

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

Proposal Number: PRN 2013-115.

Submit written comments by October 4, 2013 to:

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The agency proposal follows:

Summary

N.J.A.C. 11:2-27, originally adopted in 1992 and amended subsequently thereafter, sets forth the factors that the Commissioner of Banking and Insurance (Commissioner) shall consider

in determining whether an insurer is in a hazardous financial condition. A determination of a hazardous financial condition provides one of the grounds upon which the Commissioner may: (1) seek an order from the Superior Court to rehabilitate, liquidate the business, or conserve the assets within the State of domestic, foreign, or alien insurers pursuant to N.J.S.A. 17:30C-1 et seq. and 17B:32-31 et seq.; (2) subject an insurer to administrative supervision pursuant to N.J.S.A. 17:51A-1 et seq.; and (3) take action to revoke or nonrenew an insurer's authority to transact insurance in this State pursuant to law, including, but not limited to, N.J.S.A. 17:32-2 and 17B:23-2. The rules also set forth various corrective measures that the Commissioner may require an insurer to take to remedy or ameliorate such hazardous financial condition.

The rules are based on the Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in Hazardous Financial Condition adopted by the National Association of Insurance Commissioners (NAIC). The rules are required for a state insurance regulatory agency to obtain or maintain accreditation by the NAIC. The NAIC amended the Model in 2008. The NAIC has now required that the 2008 amendments to the Model be adopted by states to maintain accreditation effective January 1, 2014. The New Jersey Department of Banking and Insurance (Department) therefore proposes to amend the rules as set forth below to conform them to the current NAIC Model.

N.J.A.C. 11:2-27.1(a), which sets forth the purpose and scope of the rules, is proposed to be amended to revise the first sentence to track more closely the NAIC Model language. Specifically, the proposed amendment revises the purpose to provide that the rule sets forth factors the Commissioner shall consider in determining whether an insurer is in "such condition ... as to render the continuation of its business hazardous to its policyholders, creditors or the general public." The Department also proposes to delete language in subsections (a) and (b)

related to the eligibility of surplus lines insurers and to delete references to the applicability of these rules to surplus lines insurers. This reflects changes mandated by the Non-Admitted and Reinsurance Reform Act of 2010 (NRRA), 15 U.S.C. §§ 8201 et seq., effective July 21, 2011, which revises various aspects of the regulation of surplus lines insurance by the states. The Department adopted amendments to its surplus lines eligibility rules, N.J.A.C. 11:1-31, to reflect these changes in 2012.

The Department also proposes to delete the definition of “eligible surplus lines insurer” in N.J.A.C. 11:2-27.2 for the reasons set forth above.

The Department proposes to amend N.J.A.C. 11:2-27.3(a), which sets forth the factors the Commissioner shall consider in determining whether an insurer is in a hazardous financial condition, to reflect the current NAIC Model as follows:

Paragraph (a)1 is proposed to be amended to provide as a factor adverse findings reported in audit reports and actuarial opinions, reports, or summaries.

Paragraph (a)2 is proposed to be amended to delete the reference to “related reports” from the NAIC Insurance Regulatory Information System and replace that reference with “other financial analysis solvency tools and reports.”

Paragraph (a)3 is proposed to be amended to delete the current factor of “[t]he ratios of commission expense, general insurance expense, policy benefits and reserve increases as to annualized premium and net investment income which could lead to an impairment of capital and surplus.” The Department proposes to amend this paragraph to replace such factor to read “[w]hether the insurer has made adequate provision, according to presently accepted actuarial standards of practice, for the anticipated cash flows required by the contractual obligations and related expenses of the insurer, when considered in light of the assets held by the insurer with

respect to such reserves and related actuarial items, including, but not limited to, the investment earnings on such assets, and the considerations anticipated to be received and retained under such policies and contracts.”

Paragraph (a)5 is proposed to be amended to change the reference to “company’s remaining surplus” to “insurer’s remaining surplus.”

A new paragraph (a)7 is proposed to be added to provide as a factor “[a] finding that the insurer’s operating loss in the last 12-month period or any shorter period of time, excluding net capital gains, is greater than 20 percent of the insurer’s remaining surplus as regards policyholders in excess of the minimum required by law.”

Existing paragraph (a)7 is proposed to be recodified as paragraph (a)8, and to be amended to delete the reference to “parent, affiliate, subsidiary or reinsurer,” and to add language to track the current NAIC Model as follows: “[a] finding that a reinsurer, obligor or any entity within the insurer’s insurance holding company system is insolvent, or in the opinion of the Commissioner, is threatened with insolvency, or is delinquent in the payment of its monetary or other obligations, and which in the opinion of the Commissioner may affect the solvency of the insurer.”

Existing paragraphs (a)8 through 10 are proposed to be recodified as paragraphs (a)9 through 11 without change.

Paragraph (a)11 is proposed to be recodified as paragraph (a)12 and to be revised to refer to a finding that the management of an insurer fails to possess and demonstrate the competence, expertise, and reputation deemed necessary by the Commissioner “to serve the insurer in such position.”

Paragraph (a)12 is proposed to be recodified as paragraph (a)13 without change.

A new paragraph (a)14 is proposed to provide as a factor: “[a] finding that the insurer has failed to meet financial and holding company filing requirements established by law in the absence of a reason satisfactory to the Commissioner.”

Paragraphs (a)13 through 28 are proposed to be recodified as paragraphs (a)15 through (a)30. Recodified paragraph (a)17 is proposed for amendment to replace “company” with “insured,” and, in recodified paragraph (a)30, “and” at the paragraph’s end is relocated to new paragraph (a)32. Existing paragraph (a)29 is proposed to be recodified as paragraph (a)34 without change.

The Department proposes to provide new factors to be codified at N.J.A.C. 11:2-27.3(a)31 through 33 as follows:

(1) A finding that management has established reserves that do not comply with minimum standards established by State insurance laws, rules, statutory accounting standards, sound actuarial principles, and standards of practice;

(2) A finding that management persistently engages in material under-reserving that results in adverse development; and

(3) A finding that transactions among affiliates, subsidiaries, or controlling persons for which the insurer receives assets or capital gains, or both, do not provide sufficient value, liquidity, or diversity to assure the insurer’s ability to meet its outstanding obligations as they mature.

The Department also proposes to amend N.J.A.C. 11:2-27.3(d)2, which sets forth actions that the Commissioner may take to adjust assets and liabilities if a finding of hazardous financial condition is present, to provide that any adjustments to asset values in an insurer’s investment portfolio or attributable to investment and or transactions with parents, subsidiaries, or affiliates

may include the disallowance of such adjustments, and to provide that such adjustments will be consistent with the NAIC Accounting Practices and Procedures Manual, and State laws and rules. The Department notes that all insurers are required to utilize the NAIC Accounting Practices and Procedures Manual in filing their financial statements pursuant to N.J.S.A. 17:23-1 and 17B:21-1.

The Department proposes to amend N.J.A.C. 11:2-27.4(a) to reference “creditors” with respect to determinations that the continued operation of an insurer may be hazardous to its policyholders, or, as amended, the “general” public, and thus the insurer may be subject to administrative supervision pursuant to N.J.S.A. 17:51A-1 et seq.

The Department also proposes to amend N.J.A.C. 11:2-27.4(a) to include the following as additional corrective actions the Commissioner may order insurers to take: (i) correct corporate governance practice deficiencies, and adopt and utilize governance practices acceptable to the Commissioner; (ii) provide a business plan to the Commissioner in order to continue business in this State; and (iii) notwithstanding any provision of the law limiting the frequency or amount of premium rate adjustments, adjust rates for any non-life insurance product written by the insurer that the Commissioner finds is necessary to improve the financial condition of the insurer.

Existing N.J.A.C. 11:2-27.4(a)10 is proposed to be recodified as paragraph (a)13, to reference “creditors” with respect to such other actions as the Commissioner may deem necessary in a particular case to protect the insurer's policyholders, or, as amended, the “general” public.

The proposed amendments reflect the national standard for determining whether an insurer is in a hazardous financial condition as set forth in the current NAIC Model, provide

more detailed bases upon which the Commissioner may determine an insurer is in a hazardous financial condition, and set forth additional actions that the Commissioner may order an insurer found to be in such a condition to take to remedy such a circumstance. The Department notes that under the Administrative Supervision Act, N.J.S.A. 17:51A-1 et seq., the Commissioner may order an insurer to take such actions as needed to address the reasons for which the insurer was placed in administrative supervision. By providing a more detailed framework by which the Commissioner may determine hazardous financial condition and order remedies thereto, the Commissioner may be in a better position to help prevent an insurer's condition from deteriorating to such an extent that it must be placed under rehabilitation or liquidation, with the resulting disruptions to the public, policyholders, the insurer involved, and the insurance market generally.

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

Social Impact

As set forth in the Summary above, the proposed amendments provide additional factors by which the Commissioner may determine whether an insurer is in a hazardous financial condition as well as provide additional actions that the Commissioner may order an insurer to take to remedy or ameliorate such condition. As set forth above, the standards reflect the current NAIC Model, which is required for a state to obtain or maintain accreditation beginning January 1, 2014. The standards reflect the national standard with respect to such determinations and remedial actions. As noted above, the proposed amendments will have a positive social impact

by enhancing the Commissioner's ability to prevent an insurer's condition from deteriorating to the point where it must be placed in rehabilitation or liquidation, thereby avoiding the disruptions to the insurance market, policyholders, and the public that can result from such an action.

Economic Impact

There will be no negative economic impact imposed by these proposed amendments. As set forth above, the proposed amendments merely establish additional factors the Commissioner may consider in determining whether an insurer is in a hazardous financial condition. The proposed amendments also set forth actions the Commissioner may order an insurer that is placed in administrative supervision to take to remedy such hazardous financial condition. Insurers that are found to be in a hazardous financial condition will be required to incur any costs associated with complying with any order of the Commissioner issued pursuant to these rules and N.J.S.A. 17:51A-1 et seq. to remedy such condition. The services required to comply with such an order would include financial, actuarial, and legal. Insurers should already employ those services in-house or already have contracted for such services in the normal course of business. Moreover, as set forth above, the purpose of the proposed amendments is to reflect the current national standard regarding such determinations and remedial actions, and are intended to prevent situations where insurers will be required to be placed in rehabilitation or liquidation, with the significant disruptions not only to the insurer involved, but to the insurer's policyholders, the insurance buying public, as well as the insurance market generally. The benefits of avoiding such disruptions far outweigh any potential additional costs that insurers may incur as a result of the proposed amendments.

Federal Standards Statement

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

Jobs Impact

The Department does not anticipate that any jobs will be generated or lost as a result of the proposed amendments. The Department invites commenters to submit any data or studies on the potential jobs impact of the proposed amendments together with their comments on other aspects of the proposal.

Agriculture Industry Impact

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

Regulatory Flexibility Analysis

The proposed amendments will apply to few, if any, “small businesses” as that term is defined in the Regulatory Flexibility Act, N.J.S.A. 52:14B-16 et seq. To the extent that the proposed amendments apply to small businesses, they will apply to domestic insurers and entities subject to rehabilitation or liquidation by the Commissioner. The financial impact on small businesses as well as professional services required related thereto are set forth in the Economic Impact above.

The proposed amendments provide no differentiation in compliance requirements based on business size. As set forth above, the proposed amendments conform the current rules to the

current NAIC Model. Neither the current rules, their enabling statutes, nor the prior or current NAIC Model provide for differentiation based on business size. In addition, as noted above, the purpose of the proposed amendments is to set forth additional factors the Commissioner shall consider in determining whether an insurer is or may be in a hazardous financial condition, and the actions that the Commissioner may order an insurer to take to remedy such situation. The purpose of these rules and the amendments is to help the Commissioner take preemptive action to prevent an insurer's financial condition from deteriorating to such an extent that it is required to be placed in rehabilitation or liquidation, with the resulting disruptions to the public, policyholders, and the market generally. The import of these policy considerations does not vary based upon the size of the insurer. Thus, no variation is made in the proposed amendments based on insurer size.

Housing Affordability Impact Analysis

The proposed amendments will not have an impact on housing affordability in this State in that the proposed amendments relate to the regulation of insurers and other entities subject to rehabilitation or liquidation by the Commissioner.

Smart Growth Development Impact Analysis

The proposed amendments will not have an impact on smart growth in this State and there is an extreme unlikelihood that the rules would evoke a change in housing production in Planning Area 1 or 2 or within designated centers under the State Development and Redevelopment Plan in New Jersey in that the proposed amendments relate to insurers and other entities subject to rehabilitation or liquidation by the Commissioner.

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

SUBCHAPTER 27. DETERMINATION OF INSURERS IN A HAZARDOUS FINANCIAL CONDITION

11:2-27.1 Purpose and scope

(a) The purpose of this subchapter is to set forth the factors which the Commissioner shall consider in determining whether an insurer is in [a hazardous financial] **such** condition as defined herein **as to render the continuation of its business hazardous to its policyholders, creditors, or the general public.** A determination of hazardous financial condition provides one of the grounds upon which the Commissioner may seek an order from the Superior Court to rehabilitate, liquidate the business, or conserve the assets within this State of domestic, foreign, or alien insurers pursuant to N.J.S.A. 17:30C-1 et seq. and 17B:32-31 et seq., or upon which an insurer may become subject to administrative supervision pursuant to N.J.S.A. 17:51A-1 et seq., and provides one of the grounds upon which the Commissioner may take action to revoke or nonrenew an insurer's authority to transact insurance in this State, [or withdraw the eligibility of an eligible surplus lines insurer to insure surplus lines risks in the State] pursuant to law, including, but not limited to, N.J.S.A. 17:32-2[,] **and** 17B:23-2[, and 17:22-6.46].

(b) This subchapter shall apply to all domestic, foreign, and alien insurers and all other entities subject to N.J.S.A. 17:30C-1 et seq., 17B:32-31 et seq., or N.J.S.A. 17:51A-1 et seq.[]; and to all eligible surplus lines insurers.]

11:2-27.2 Definitions

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

...

["Eligible surplus lines insurer" means an unauthorized insurer in which an insurance coverage is placed or may be placed pursuant to N.J.S.A. 17:22-6.40 et seq.]

"Hazardous financial condition" means that, based on its present or reasonably anticipated financial condition, an insurer, although not yet financially impaired or insolvent, is unlikely to be able:

1. To meet obligations to **its** policyholders, certificate holders, and other insureds with respect to known claims and reasonably anticipated claims; or
2. (No change.)

...

11:2-27.3 Determination of hazardous financial conditions; factors

(a) The Commissioner shall consider the following factors, either singly or in a combination of two or more, in determining whether an insurer is in a hazardous financial condition:

1. Adverse findings reported in financial condition and market conduct examination reports, **audit reports, and actuarial opinions, reports, or summaries;** and/or failure to comply with recommendations contained therein;
2. Adverse findings from the NAIC Insurance Regulatory Information System and its [related reports] **other financial analysis solvency tools and reports;**

3. [The ratios of commission expense, general insurance expense, policy benefits and reserve increases as to annualized premium and net investment income which could lead to an impairment of capital and surplus;] **Whether the insurer has made adequate provision, according to presently accepted actuarial standards of practice, for the anticipated cash flows required by the contractual obligations and related expenses of the insurer, when considered in light of the assets held by the insurer with respect to such reserves and related actuarial items, including, but not limited to, the investment earnings on such assets, and the considerations anticipated to be received and retained under such policies and contracts;**

4. (No change.)

5. A finding that an assuming reinsurer is not able to meet the obligations being assumed or that the insurer's reinsurance program does not provide sufficient protection for the [company's] **insurer's** remaining surplus, after taking into account the insurer's cash flow and the classes of business written as well as the financial condition of the assuming reinsurer;

6. (No change.)

7. **A finding that the insurer's operating loss in the last 12-month period or any shorter period of time, excluding net capital gains, is greater than 20 percent of the insurer's remaining surplus as regards policyholders in excess of the minimum required by law;**

[7.] **8.** A finding that **a reinsurer, obligor, or** any [parent, affiliate, subsidiary or reinsurer] **entity within the insurer's insurance holding company system** is insolvent, or, in the opinion of the Commissioner, is threatened with insolvency, or is delinquent in payment of

its monetary or other obligations, **and which in the opinion of the Commissioner may affect the solvency of the insurer;**

Recodify existing 8. – 10. as **9. – 11.** (No change in text.)

[11.] **12.** A finding that the management of an insurer, including officers, directors, or any other person who directly or indirectly controls the operation of such insurer, fails to possess and demonstrate the competence, expertise, and reputation deemed necessary by the Commissioner **to serve the insurer in such position;**

[12.] **13.** (No change in text.)

14. A finding that the insurer has failed to meet financial and holding company filing requirements established by law in the absence of a reason satisfactory to the Commissioner;

Recodify existing 13. - 14. as **15. - 16.** (No change in text.)

[15.] **17.** A finding that, in the opinion of the Commissioner, the [company] **insurer** has experienced or will experience in the foreseeable future cash flow and/or liquidity problems;

Recodify existing 16. – 27. as **18. – 29.** (No change in text.)

[28.] **30.** A finding that the insurer does not follow a policy on rating and underwriting standards appropriate to the risk; [and]

31. A finding that management has established reserves that do not comply with minimum standards established by State insurance laws, rules, statutory accounting standards, sound actuarial principles, and standards of practice;

32. A finding that management persistently engages in material under-reserving that results in adverse development;

33. A finding that transactions among affiliates, subsidiaries, or controlling persons for which the insurer receives assets or capital gains, or both, do not provide sufficient value, liquidity, or diversity to assure the insurer's ability to meet its outstanding obligations as they mature; and

[29.] **34.** (No change in text.)

(b) – (c) (No change.)

(d) In making a determination of an insurer's financial condition pursuant to this subchapter, the Commissioner may adjust assets and liabilities as necessary to accurately reflect the insurer's financial position in any manner including, but not limited to, the following:

1. (No change.)

2. Make appropriate adjustments **including disallowance** to asset values in its investment portfolio or attributable to investments in or transactions with parents, subsidiaries, or affiliates **consistent with the NAIC Accounting Practices and Procedures Manual, and State laws and rules;**

3. – 4. (No change.)

(e) (No change.)

11:2-27.4 Determination of hazardous financial condition; corrective action

(a) If the Commissioner determines that the continued operation of an insurer may be hazardous to [the] **its** policyholders, **creditors**, or **the general** public in this State, the Commissioner may, upon such a determination, subject the insurer to administrative supervision pursuant to N.J.S.A. 17:51A-1 et seq. and may issue an order requiring the insurer to take such actions as the Commissioner deems necessary to abate such determination, including, but not limited to:

1. – 8. (No change.)

9. File, in addition to regular annual statements, interim financial reports on the form adopted by the NAIC or in such format as prescribed by the Commissioner; [or]

10. Correct corporate governance practice deficiencies, and adopt and utilize governance practices acceptable to the Commissioner;

11. Provide a business plan to the Commissioner in order to continue to transact business in this State;

12. Notwithstanding any other provision of law limiting the frequency or amount of premium rate adjustments, adjust rates for any non-life insurance product written by the insurer that the Commissioner considers necessary to improve the financial condition of the insurer; or

[10.] **13.** Take such other actions as the Commissioner may deem necessary in a particular case to protect the insurer's policyholders, **creditors, or** [and] the **general** public.

(b) – (c) (No change.)