

PUBLIC HEARING  
before  
ASSEMBLY COMMITTEE ON BANKING AND INSURANCE  
on  
AUTOMOBILE INSURANCE RATE INCREASES

Held:

December 17, 1974

Assembly Chamber

State House

Trenton, New Jersey

MEMBERS OF COMMITTEE PRESENT:

Assemblyman James W. Bornheimer (Chairman)

Assemblyman Herbert M. Gladstone

Assemblyman Martin A. Herman

Assemblyman Phillip M. Keegan

Assemblyman Robert M. Ruane

Assemblyman Robert C. Shelton

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JAMES W. BORNHEIMER (Chairman): Good morning. I am Chairman James Bornheimer of the Assembly Banking and Insurance Committee. Seated here with me this morning are the other members of the Committee: Assemblyman Gladstone, to my left; Assemblyman Herman; Assemblyman Ruane; and the Vice Chairman, Assemblyman Keegan.

The purpose of this public hearing is to examine the recent approval by the State Commissioner of Insurance of an increase in automobile insurance rates. It is my strong feeling that these rates come at a time when the public can ill afford increases in the cost of anything, with the inflation and the economic crisis we are now experiencing. In fact, rather than increase, we have been led to believe during the last year that automobile insurance rates would go down because of "no fault" insurance, decreased driving, and accidents, due to oil shortages. The public, therefore, deserves an explanation but this forum is not to condemn or criticize the Commissioner or anyone else associated with the increases; rather we would like some answers about the facts which led to the approval of these increases and we want to know if some mechanism should be established to provide better public analysis of an input into such important economic decisions.

We will start off this morning with our first witness, Commissioner Sheeran. Commissioner?

C O M M I S S I O N E R   J A M E S   J .   S H E E R A N:  
Thank you, Mr. Chairman. I have a prepared statement that I have given to the members of the committee, as well as the press in attendance.

Before I start with that, I would like to recall to the members of the committee my first occasion to meet all of you. I was called over to express to you my views concerning my appointment as Commissioner of

Insurance and I can recall that very vividly because I walked into your Chambers and I tried to express to you my feeling concerning my representation of the public interest. I told you at that time that I in no way perceive myself as being a representative of the insurance company interests. Those interests have been clearly defined by statutory mandate and those are very specific; they require that I, as Commissioner of Insurance, am sure that the insurance rates that are established for the people of the State of New Jersey are adequate and, yet, not excessive. I will cover that further in my opening statement.

As I see my position, if it were ever conceived that the Commissioner of Insurance, particularly in my representative capacity, represented other than the public interest, I would not wish to continue in this position.

I realize that what I have done in granting a rate increase may be of some concern - and is of some concern - to the people of this State, as it is to your committee and to your own constituents. I also realize that it is not in the best public interest to provide rates that are not adequate to continue an essential business - the business of insurance - in this State.

I will show you, during the course of the testimony, the kind of formula that we have developed in New Jersey, which I believe makes us the most progressive rate-setting State in the country. Our way of developing rates has been commended in every part of the country, since it is probably, as I say, the most progressive position in rate-making and has been supported by our own Supreme Court decisions.

I'd like to introduce my very key person in establishing these rates. I believe him to be the

finest casualty actuary in the country. His name is Philipp K. Stern. He is sitting to my right. To his immediate right is my Director of Insurance, Mr. Herman Hansler, who is also, I believe, a bulwark of defense as far as the public is concerned.

Now I'd like, if the Chairman would so permit me, to make a statement.

I welcome the opportunity to discuss with you my reasons for granting the increase in auto insurance rates that I announced on November 7. My actuary, Philipp K. Stern, will supplement my remarks with as much technical detail as you like.

I was appointed Commissioner of Insurance by Governor Byrne with the concurrence of the State Senate to serve the public interest. That is the way I conceive my responsibility and I believe I have been doing that. Because the public view of my function has been obfuscated by the mountain of misinformation that has gained currency in recent weeks, I intend to set the record straight today.

For your better understanding of the role of the Insurance Commissioner in rate-making, let me point out at the outset that the existing system is a product of legislation. In drawing up a regulatory statute, the Legislature had in mind that insurance should be sold within the framework of our free enterprise tradition and that the regulation of the insurance industry must take into account the fundamental principles of that system. Thus the Legislature, at one point, mandates that the rate-making process must provide a "reasonable profit for the insurer" and, at another, rates that are not "inadequate for the safety and soundness of the insurer."

If the Legislature wants to change the language of the statute, so that rates need not be adequate, I

can hold back on rate increases until such time as there is no market. If the Legislature wants to change the system to move away from the concept of insurance as a free enterprise endeavor, the alternative is a state insurance facility that would be subsidized by the taxpayers of this State.

But decisions affecting these matters are yours to make. At the moment, I have to deal with a private enterprise and make sure that insurance of all kinds, and particularly auto insurance, because we require it of all drivers, remains readily available to the citizens of New Jersey.

The standards that we apply in our rate-making procedure are more stringent than those employed anywhere throughout the country. I say proudly that other states are adopting our methods.

But I should also point out that other states, including two of the largest, New York and California, don't even bother to require the approval of the Commissioner in setting rates. They have what is called an open, or competitive, rating system. Rates are set and put into effect by the companies themselves and are supposed to be regulated by the laws of the free market-place. There is a bill pending in this Legislature that would introduce such a system here.

I oppose this so-called competitive rating. It is my belief that the competition is limited to the cream at the top and the less desirable risks are made to pay dearly. The total dollar volume of insurance remains the same; it's just extracted from consumers in an inequitable way.

I will deviate from my statement for one moment. I feel very strongly about that. I have met with insurance company interests. I have taken the position

that until they can show me that a competitive rating system is in the best interest of the people of this State, that is, that the total dollar volume of insurance costs to the people of this State is reduced by that so-called competition, I will not agree with it. Credibility has to be such that it is provable, in my judgment, and that it is in the best interest of the people of this state.

If we had open rating in New Jersey, the insurance companies would have gotten what they asked for in this rate increase and not what I said they could have on a take-it-or-leave-it basis, which was vastly below their own estimates of their needs. The Insurance Services Office, a rate filer for some 230 companies, wanted, for instance, a 7.4% increase. I said they could have less than half - 3.3% - which I consider a very modest increase that will produce rates that are neither excessive nor inadequate.

I would like at this point to dispel some of the misconceptions that have been bruited about concerning my action of November 7th. First, it has been suggested that I ignored the gasoline shortage and its effect on the frequency of accidents. As a matter of fact, the gasoline shortage played a major part in my determination.

Let me give you an example. The Insurance Services Office, the rating organization I referred to above, submitted data to support a 5.9% increase in bodily injury premiums. My staff, using both its own data and ISO's, found that a rate increase of only 2.2% was justified before recognition of the reduction in the use of cars because of the gasoline situation. Consequently, I refused to grant ISO an increase of any amount at all because I believed that the indicated increase was offset by the effects of the energy crisis.

Another canard that ought to be laid to rest is the notion that I rescinded the No-Fault savings. When No-Fault went into effect on January 1, 1973, it was accompanied by a 15% decrease in bodily injury premiums by mandate of the Legislature. By that I mean, it was actually accomplished and the rates were reduced by at least 15% by each and every company doing business in this State. To be more specific, the rates were reduced down to a number at least \$86 million less than the total premium before you introduced and passed the No-Fault bill. But most companies provided even greater decreases, which reflected the elimination of charges for medical coverage and the most recently available experience at the time.

For instance, the Government Employees Insurance Company (GEICO) actually reduced its bodily injury premiums 33%. The ISO bodily injury premiums are actually 30% below the cost of bodily injury liability and medical payments coverage in 1972. The other independent filers retained reductions of at least 15%, compared to the pre-No-Fault costs of the bodily injury and medical coverage.

These reductions remain in effect today. I cannot emphasize enough that the increases I granted on November 7th in no way related to No-Fault. Most of the increases that I approved related only to liability for other than bodily injury and to physical damage; in those instances where I approved an increase in the bodily injury rate, my action was based on a finding that a company's rate prior to No-Fault was inadequate.

The evidence before me on which I based my approval of the increases, which I challenge anyone to refute, was that the cost of auto repairs and replacement has been increasing at more than 7% annual rate for

the last seven years.

Again, a false report that gained some currency was that I had failed to call public hearings on the rate increases. First, let me point out that the Legislature has never considered public hearings in insurance rate cases to be important enough to require them. Nevertheless, in the exercise of my discretion, I did call public hearings - six of them; on April 2, 3 and 8, on May 15 and 16 and on June 25 - which considered both the impact of the energy crisis and the ISO application. Except for the first day, the hearings were greeted with supreme indifference by both the press and the public.

No insurance hearings were held on the applications of the five independent filers because their proposed revisions conformed to the principles developed at the ISO hearings and further hearings would have been superfluous.

In your inquiry here today, please remember that the product offered by the insurance industry to the public is not like the products of other industries or businesses. The automobile maker, the corner grocer, even the public utilities know what their costs are and they add a margin for profit. It's relatively simple.

Insurance is not that kind of product. It is a pooling of intangibles - of risks. Rates are not made for today, but for the days yet to come, for the future. Again, I will deviate slightly from my statement. What I mean by that is, when we fix a rate today giving what I consider a very modest increase in this inflationary trend. Since 1971, the last increase that has occurred, as far as automobile insurance is concerned, was an increase of an average of 5.8%. We know that the inflationary

trend has been much greater than that and we not only look to today, but the rate that we are setting today is for insurance that will carry people in the future. If you buy a policy today and pay today's rates, those rates will be in effect even though inflation continues next year, or until we grant another rate application or consideration for an increase.

In the belief that the immediate past experience is the best indicator of future experience, we try to devise a rate that will satisfy the statutory requirements of being neither inadequate nor excessive so that insurance will remain readily available to the people of New Jersey.

I don't have to point out to you the inflation that besets all of us. You know only too well what its effect is. Yet, in granting a rate revision to insurance companies that insure 71% of New Jersey' motorists, I held the increase to only 5.8%, overall. That means these motorists will pay \$30.7 million in additional premium. Taking into account the \$87 million savings brought about by No-Fault, their insurance bill will still be almost \$57 million less than it was in pre-No-Fault days - that is, January 1, 1973.

Even so, I granted the increases reluctantly because I know that our people are beset by price increases for just about everything. I don't like rate increases anymore than you or the public. But I had to act as I did if I were to respond honestly to the obligations imposed upon me by the Legislature.

Rates are not the only area of concern for me and my staff. We are also unhappy about the existence of a residual market in auto insurance and the Assigned Risk plan that serves it. We are unhappy about the driver classification system. And we plan to take corrective steps. I will seek, with deep compassion, the support

of the Legislature as I move to those programs because they represent in my judgment the most severe inequity - among the most severe inequity - that exists in this State, and probably most other states.

We are also unhappy about our need to rely on the industry in the gathering of statistics. Perhaps the Legislature might agree to authorize the Department of Insurance, either by itself or by joining with other states, to gather statistics on our own and give us the computers and programs needed to evaluate them. We already do it for Workmen's Compensation; we ought to do it also for automobile insurance. It would strengthen our ratemaking function and serve the public interest well.

That is the end of my prepared statement, Mr. Chairman. I thought I might, for the benefit of the Committee, speak about the kind of profits that we deal with when we deal with insurance. I do have a technician with me. As I said, I consider him to be the finest actuary, from the casualty viewpoint, that I have ever met. He is a very sensitive man, with great public interest as well. I think this might be helpful to you.

For the insurance company's business, we permit them a return from their investment of 3½%, after tax, and that is on the business written in this State.

Now, from this, you have got to remember that I said before that we are very progressive in determining what a profit margin should be for insurance companies. We look at the money that has been invested by policyholders through their advance premium, which we credit to their interest - and I will explain to you what I mean by that - and we also look at the money that is set aside by way of reserve for payment of claims in

the future - which is all policyholders' money.

Now, from the money that is held by advance premium or from loss reserves that are established, the interest that is acquired through that money that is invested in different ways, or the dividends that come from it, or the rents that are developed as a result of policyholders' money, go toward developing that profit margin that I have already talked to you about - 3½% in written premium.

Now, there is another factor, of course, that I think is of great importance, particularly today when we have a declining market. You have heard a lot of insurance companies take the position that because of the decline in the capital value there should be added consideration for increased insurance rates. We have refused to recognize the declining capital - that is, decline in their reserves because of decline in their stock investments. We have refused to recognize that in the rate that we just granted - or in any other future rates - because the IRB case, which was proved by our Supreme Court, held that capital gains are to the benefit of the companies, because if there are capital losses it is the responsibility of the companies to replenish those capital losses. That's a specific recognition in the IRB case which we believe is valid. Today we do not give the companies any consideration for their capital losses.

Now, to translate what I have just said into what insurance companies actually make from the premium that is paid, in bodily injury and property damage cases they receive a profit provision of .03 of 1% - that is in the case of ISO. That would be, in fact, less than .02, or 1% after tax. In addition, for matters such as collision, because it is a short term

investment of policyholders' money in collision as compared to bodily injury or property damage cases, they receive, before tax, a 4.8% profit margin, which translates into 2½% after tax, which totals a 3½% after-tax provision. And I think that makes it quite clear that we have not given the companies a windfall opportunity here; although, as I said before, it is imperative that companies remain financially sound and there be an available market for the people of this State, since we do mandate insurance.

I might just say in passing - and I don't reflect upon my fellow states - that I suggest that we continue in this State to watch what is happening throughout the country. In Texas, for example, increases were recommended on October 17th by the State Board of Insurance, rather than a Commissioner, of .08% for bodily injury - we gave nothing here - 21.4% for property damage, 22.3% full coverage comprehensive, 25% for 100 dollar deductible and 2.8% on medical payments. I think with the recognition of that and other inflationary trends, we have done a commendable job.

Again, as I said before, we are most interested, not only from the point of my appointment here - which I believe to be absolutely in the public interest, and I would have it no other way - but for my staff, whom I feel are not only trained but accustomed to dealing with the insurance needs of this State in the public interest, I believe that it is most important that we retain that kind of an image with the public. Thank you.

ASSEMBLYMAN BORNHEIMER: Thank you, Commissioner. Are there any questions from the members of the committee? Assemblyman Herman?

ASSEMBLYMAN HERMAN: Yes. Commissioner, you

mentioned the fact that what would appear to be the primary culprit in rate increases is property damage. What is your office doing to provide incentives through use of a pre-safety equipment by way of rate reduction to discourage these types of large claims?

COMMISSIONER SHEERAN: Well, we are actually not doing that. As a matter of fact-- But, I must say that I stay very closely in contact with trends - accident trends, etc. - and I have watched, for example, the type of legislation which is providing funds for the purpose of eliminating highway hazards. We can take any particular intersection, for example, and see that hundreds of thousands of damages occur at a particular intersection and that that can be improved.

We are very close to that and I have asked to sit in on any meetings. I have corresponded with the Federal Government Highway Department concerning our interests there. I, at one time, as an individual, was Mayor of West Orange and fought very hard - some of you may remember - to keep the East-West Freeway from having a 6% grade and to reduce the noise levels there. We had the first noise study and that kind of thing. I watch now and I see a very poorly designed highway. It is unfortunate that that kind of vision wasn't used at that time. We have a highway-- Look at any snowstorm. I see some of the Assemblymen from Essex County and I know they are concerned about it.

However, if you look at any snowstorm or any fog, you will see hundreds and thousands of dollars worth of property damage and bodily injury occurring there - unfortunately.

ASSEMBLYMAN HERMAN: I see. Basically, bringing it down to its lowest common denominator, New Jersey does nothing to given incentive or rate reductions for

use of increased safety equipment in cars?

COMMISSIONER SHEERAN: Well, again, we look at only the trends. If the safety equipment is there, and the loss factor trends - which is what we have to evaluate rates on-- For example, if you provide for safety equipment, mandated on a car, if that, in fact, does reduce the cost of meeting policy obligations to the companies - which is what we study and are the trend factors that we use - then it will eventually lead to a decrease in insurance.

ASSEMBLYMAN HERMAN: But we don't do it now?

COMMISSIONER SHEERAN: Well, I don't know. That is not a function of this Department. Our Department, again, is an insurance department; it fixes rates and policy obligations, etc.

ASSEMBLYMAN HERMAN: I don't want to belabor a point but your Department could, as an incentive, give, or set up, a rate structure which would furnish mandated rate reductions for increased use of safety equipment in cars.

COMMISSIONER SHEERAN: Only if that safety equipment were shown to give a corresponding reduction in cost.

ASSEMBLYMAN HERMAN: I thought your Department was undergoing a study with Federal money for that.

COMMISSIONER SHEERAN: No, we don't have any Federal money. I might say for everyone here, our Department is probably the only one in the State of New Jersey that does not have 5¢ of Federal money. So, everything you give us is all we work on.

I must say - I was in error - we do have bumper discounts on insurance. But these are provided through a system the companies adopt in their rating system because of mandated legislation, or whatever it may be.

May I just speak on that for a moment?

ASSEMBLYMAN HERMAN: Yes.

COMMISSIONER SHEERAN: I perceive, very frankly, it to be my job to require that companies give us what we pay for, once we have a rate. I have before the Legislature, now, a fair claims practice act that I am most anxious to see passed so that we can require the companies, now that we have an adequate rate, to give a dollar value for a dollar earned. By that I mean, not to gyp the public by prohibiting or not giving them their money if they are involved in a collision. If there is a collision I don't want a company not to pay a legitimate claim because of, say, \$150 or \$200 - and we know our people would have to pay more for legal services. I want the kind of fair claims practice act that makes them respond to their public responsibility as insurers of the State of New Jersey. I would appreciate that.

I also have an adjusters bill that will permit us to license adjusters and to weed out those who do not do their job well. It is most important to us to get that - that is another factor.

ASSEMBLYMAN HERMAN: Commissioner, you mentioned legal costs and things of that nature, I know that your bodily injury claims, through Mr. Stern's analysis on trend factors, only show an average rate of 1.8% and property damage shows an increase of 4.8%. Now, isn't it true that in the State of New Jersey the majority of claims paid in dollars, as well as number, are for property damage and not bodily injury?

COMMISSIONER SHEERAN: I will consult with Mr. Stern on that.

ASSEMBLYMAN HERMAN: Total dollars, Mr. Stern.

ASSEMBLYMAN BORNHEIMER: Commissioner, you can let Mr. Stern answer that if you wish to.

COMMISSIONER SHEERAN: Yes, I will ask Mr. Stern if he will answer that.

MR. STERN: The actual dollars paid on bodily injury and property damage are, of course, in relation to the rates because the rates follow the losses. Actually the property damage rate is about half of what the bodily injury rate is. So, you may say that of the total insurance bill for the compulsory coverage combined, two-thirds goes for bodily injury and one-third for property damage liability.

ASSEMBLYMAN HERMAN: Yet, the rate of increase over the last seven years has been about 7% per year for property damage and the trend, as shown in your chart, shows a 1.8% increase for bodily injury and a 4.8% increase for property damage, correct?

MR. STERN: No, that is not correct.

ASSEMBLYMAN HERMAN: I am reading right from your chart.

MR. STERN: The numbers you are looking at are the combined effect of the increase in claim costs and the decrease in claim frequency.

By the way, we did not allow - ISO - that 1.8% trend on bodily injury because our own examination showed that there is no noticeable trend on bodily injury - so they got zero on trend. The fact is that the loss cost trend on bodily injury is less pronounced than property damage and it is probably the result of some of the safety features you just mentioned, Assemblyman Herman - seat belts, better constructed cars, probably some improvement in highway safety.

The bodily injury claim frequencies have been going down for many years and that frequency reduction is fully reflected in the rates approved for the companies, including ourselves.

ASSEMBLYMAN HERMAN: In reference to the collision, the number of collision claims, do you know, Mr. Stern, the number of total dollars that are paid out in collision loss in the State of New Jersey?

MR. STERN: Yes, we know that.

ASSEMBLYMAN HERMAN: And what is that, sir?

MR. STERN: I don't have it here. I'd have to get that.

ASSEMBLYMAN HERMAN: Is it more or less in total dollars than bodily injury claims?

MR. STERN: I can check that from the figures we have here.

ASSEMBLYMAN HERMAN: I will proceed with another question, and I'll hold that. Has your office, Mr. Commissioner, done a review as to what the effect of binding arbitration of claims under \$5,000 or \$10,000 means in the way of savings to the consumer by the reduced policy costs?

COMMISSIONER SHEERAN: We have not made that study, but I believe it's a valid suggestion for an area of study for many reasons. It would probably make the dollars available to the consumers at a quicker rate, yes.

ASSEMBLYMAN HERMAN: While Mr. Stern is looking for that information, I'll pass. Thank you.

ASSEMBLYMAN GLADSTONE: Commissioner, I had the opportunity to see you on Channel 13 last night. As I listened to you I wondered, in view of your remarks regarding the difficulty of your Department coming to rates except dependent upon the input from insurance companies and their computer programings, what would be available to the State of New Jersey at the present time that would allow you that sort of independent capability. And my concern was with regard to the possibility of the use of existing State operated computers, particularly the Rutger's computer, as well as

the information which is delivered to the Motor Vehicle Department with regard to casualties?

COMMISSIONER SHEERAN: To be very candid about that problem, I believe that years ago we opened the door to the chicken coop, so to speak, when we permitted the companies to be the gatherers of statistics and to develop the programs that are used for determining rates and so on; therefore, we lost a lot of capability. We did not in this State do that in the area of Workmen's Compensation.

As you know, we have our own Compensation Rating Bureau which may not be the epitome of control, but it certainly is a step in the right direction. Right now for us to become the statistical agent for insurance, it would probably take some time to develop enough statistics to be of value. And I do think you would have to concentrate the job. It's a tremendously large job and I don't think we would have the capabilities with our equipment to do it.

We have some four hundred and sixty companies that are involved in the casualty business in this State, which means that they would be constantly coming in with statistical data that would have to be developed and formed, and we would need actuarial assistance as well. What I have suggested is the potential of a multi-state agreement where -- like the Waterfront Commission, or whatever, the New York Port Authority -- by state agreement where we can develop the capability to handle our own and be in control of the statistics as they develop. That would be helpful. That would be a costly project and probably one that would take some time to develop.

ASSEMBLYMAN GLADSTONE: Are you actively pursuing that course?

COMMISSIONER SHEERAN: As you probably read, I met with two other Commissioners, one from Michigan and one from Arkansas. We discussed the -- not a break with the

National Association of Insurance Companies, but a deviation in opinion as to how we should develop our legislative or regulatory matters without the tremendous input from the companies that we seem to get through the National Association of Insurance Commissioners. We met out in Missouri just about a week and a half ago, and at that time we briefly discussed that issue.

I think we have to be free of the domination and control of the industry in order to improve our regulatory function. That is a pure, definite statement, and that's my judgment as to our best way to improve regulations, free ourselves from some of the domination and control that's developed over the years and through history by the industry.

ASSEMBLYMAN GLADSTONE: Thank you.

ASSEMBLYMAN BORNHEIMER: Do you have the answer, Mr. Stern?

MR. STERN: Yes.

COMMISSIONER SHEERAN: Mr. Stern suggested that I bring to your attention that on January third I called a hearing of the statistical agents. They are the ones hired through the company interest to gather statistics, such as the ISO; and the purpose of that hearing is for them to show cause why they should not be discontinued as statistical agents if they cannot supply us the kind of information that we are requiring; for example, the NAIC, National Association of Insurance Commissioners, has just now taken the position that the fast track monitoring system that watches the effects of the economy or the gasoline shortage, on accident frequency and so on and automobile usage will be discontinued. We think that should continue. We think we should continue to monitor that, and we're requiring that of our statistical agents, and if they can't supply us with that information; then we say we will go elsewhere to develop that kind of information.

I think that that is important. We believe that -- both the economy and the cost of gasoline are having an absolute effect on the use of vehicles, particularly in the poorer areas where people used to take a Sunday drive as their weekend pleasure; they are not doing it anymore, because the cost of gasoline is so high. It is probably more than double as we knew it a year ago.

I was just up in New York State and it was 66¢ for a gallon of gas. I mean that's incredible. But we are doing that now.

MR. STERN: Your question is the number of dollars expended for physical damage coverage compared with liability. You must realize, of course, that while every car has to have liability coverage, not every car has physical damage.

Taking the ISO figures for the one year we have here --

ASSEMBLYMAN HERMAN: What year is that?

MR. STERN: 1972. The incurred losses for bodily injury and property damage combined amount to one hundred and eighteen million dollars. For collision and comprehensive combined it was forty-five million dollars. Now we can take ISO as a typical sample because it represents approximately 40% of the overall business.

ASSEMBLYMAN HERMAN: I believe my question was the breakdown between property damage and bodily injury.

MR. STERN: I'm sorry. I thought you talked about collision. On bodily injury the incurred losses were seventy-six million dollars, and property damage, forty-three million dollars.

ASSEMBLYMAN HERMAN: I believe I understood the Commissioner to say that the average rate for property damage was approximately one-half of what the bodily injury rate was?

MR. STERN: Let me correct that. I just talked in very broad, average terms. The rate for the two coverages

separately will be exactly in proportion to the relativity of the losses. The final rate will have to be in the same proportion as the losses are to each other. We don't determine in advance how much one will be in relation to the other. The answer comes right from the statistics.

ASSEMBLYMAN HERMAN: I understand that. I'm not putting the Commissioner on the spot, whether the Commissioner is correct or incorrect, but in the past, notwithstanding what these losses or payouts showed, was the bodily injury rate approximately double what the property damage was?

MR. STERN: I gave the Commissioner that quick off-the-cuff estimate, because I did not know that you wanted the dollar accuracy. If you want dollar accuracy I'll have to go through these exhibits.

ASSEMBLYMAN HERMAN: All right. Thank you.

COMMISSIONER SHEERAN: I think to be very clear, it is not precisely accurate, but it is theoretically accurate because of the relationship of the two loss factors.

ASSEMBLYMAN HERMAN: It just appears to me just off-the-cuff that the relationship to total dollars paid out comes closer on property damage than it does on bodily injury which would lead me to think that there's more room for a reduction in the bodily injury premium.

COMMISSIONER SHEERAN: We deal with a profit margin that is three-tenths of one percent, and after taxes about two-tenths. Mr. Stern wants to say something.

MR. STERN: The two coverages are subject to different economic influences. The property damage rate reflects the cost of automobiles, the cost of repairs to automobiles, the wages which go into automobile repair.

The cost of bodily injury reflects the cost of medical treatment, hospital costs, and wage loss.

As you probably know, there is quite a difference in the trends in today's economy. You know that, for example, the auto makers today advertise this on TV, "You'll be surprised how much you can get for your old car when you trade it in. You know, for example, that old cars hardly depreciate." What does it mean?

When an old car is damaged -- and most cars are old cars, only about 15% of the cars are new cars -- the cost of the repair is determined by the increase in the cost of cars; therefore, you are dealing with entirely different trends in the two coverages. And they are reflected in our very detailed rate making mechanics.

ASSEMBLYMAN HERMAN: Thank you very much.

ASSEMBLYMAN GLADSTONE: Mr. Stern, will you spell out what you just said? The cost of repair is determined by the increase in the cost of cars?

MR. STERN: Yes, sir.

ASSEMBLYMAN GLADSTONE: Will you spell that out a little bit?

MR. STERN: There's a relationship between the cost of the car and the cost of the parts. As a matter of fact, a study was made several years ago by the DOT, the Federal Government's Department of Transportation, and it was then calculated that if you take -- in those days if you took all the parts that go into a car, a medium-priced car, and you wanted to buy them separately, the cost would be about five times as much. At that time they said a \$3,000 car, if you bought the car separately, it would cost \$15,000.

The fact is that the auto makers make a very good profit on parts, as you know. Now, as the cost of cars goes up, the cost of parts goes up. I have statistics which compare the cost of a car, taking various model years, and it shows the increase in cost.

That is, for example, if you compare a fender on a 1968 or a 1969 car, and so on, it keeps going up every year. And you know that if you take your car to the mechanic today how much it costs to do the smallest type of work. Mechanics' wages have gone up. We cannot change the economy with our rates. We can only react to the economy. We see what the figures are, and these figures have to produce the appropriate rate.

ASSEMBLYMAN BORNHEIMER: Mr. Stern, I happen to be in the automobile business, and you say the cost of parts have gone up. But most of the insurance companies buy them at a discount-wholesale price; they are not paying the retail price; they are paying the wholesale price. Is this reflected in your actuary?

MR. STERN: The data we use for rate making are the actual aggregate amounts of money paid or reserved for the repair in the case of property damage and collision. We do not inquire of the companies how much they pay for their various parts. They just record it as the accident occurs. But I would say this, it seems logical to me that if the retail price went up the wholesale price probably also went up. I doubt that the wholesale price would remain stable while retail prices went up. I think it works the other way.

ASSEMBLYMAN BORNHEIMER: So you use actual repair bills in your statistics?

MR. STERN: The repair bills are reflected in the amount of money the insurance companies paid to their insureds or on behalf of their insureds, and these figures are reported to the statistical agencies and we receive them in the aggregate.

ASSEMBLYMAN BORNHEIMER: How are you able to take and compare the accuracy of these figures given to you or given to your agent? Do you have a formula whereby you can compare the accuracy?

MR. STERN: Sir, the answer to your question is closely related to what the Commissioner just said to you about having control of our own data. It is a fact that we have to accept from the companies what they report.

Now, you develop a gut feeling for right and wrong data, and I think I have it. If I see that some figures are overall wrong I am able to spot them and raise questions. For example, right now I have a filing sitting in our office and I had a question on the very first page, and I wrote to the company and they are still trying to get an answer. Because it seems to me that there is a discrepancy.

But we have no way of determining in each individual case whether the reported figures are actually what the companies paid. However, over the years I have found that clerical errors occur, but I do not believe that statistics are deliberately falsified by anybody. We have made spot checks. As a matter of fact, we have probably made more spot checks in company statistics than any other State. We have found errors, and we have produced corrections. But I have no reason to assume that data are falsified.

ASSEMBLYMAN BORNHEIMER: In other words, you have the authority of the Commissioner, your office has the authority to go out to these various companies and verify these statistics by an audit; am I correct?

COMMISSIONER SHEERAN: We have the authority.

MR. STERN: Yes, sir, we have the authority to do it, but we don't have the manpower.

ASSEMBLYMAN BORNHEIMER: Now, are there any Federal statistics available that you can use as a comparison or an average, that you compare with these rates?

MR. STERN: No, sir, because whatever the Federal Government has -- to my knowledge, they have overall statistics, overall samples. The Cost of Living Index, for example,

contains broad averages. But insurance rates vary by State. And a countrywide average of what happened to wages would not necessarily be applicable to New Jersey; therefore the use of the Consumer Price Index and other indices prepared by the Federal Government has only limited validity in rate making. However, I would say we do not close our eyes to these figures, and we know what they are. If we find a discrepancy between what the countrywide trend indicates and what we get, we raise questions.

By the way, in all these filings on which we had hearings, ISO did produce New Jersey as well as countrywide data.

ASSEMBLYMAN BORNHEIMER: Does any other member of the Committee have a question for the Commissioner?

COMMISSIONER SHEERAN: May I just ask you one question, Mr. Chairman? Is there any question, or have we left any doubt as to whether or not these rates were reflective of No Fault or in any way diminish the value of the No Fault legislation?

ASSEMBLYMAN BORNHEIMER: I think, Commissioner, in your opening statement you clarified a lot of the points that we had questioned. One of the points that you did clarify was that when you do establish a rate you take into consideration the earnings of the company's investments, which was a question I had. And you don't consider their losses as far as capital gains are concerned. Does that just mean the money that's invested in New Jersey, or does that take into consideration the money invested nationwide, and do we get a proportional share of that?

COMMISSIONER SHEERAN: No, we only consider the New Jersey investment, because that's our regulatory authority. That's the capacity of our authority. Many of the Commissioner's -- for example, I have a letter here from

Commissioner Monroe of Arkansas in which he said that for the first time they applied our theories and our formulas which never gave consideration to that before, and as a result the people of his state did suffer a large benefit, one that has been realized by the people in this State since 1971.

ASSEMBLYMAN BORNHEIMER: Isn't it possible for the Insurance Department to try and interject a proportionate share of the money invested out of the State into the rate-making factor?

COMMISSIONER SHEERAN: My judgment is that the other states should have that benefit, just as we would object very strongly to any other state getting the benefit of the money invested by the people of our state. But I must say this, it is of interest probably to you, we do not permit the same expense factor that other states permit, because the cost of the insurance in New Jersey since we are a more congested state is higher than in many of the more rural states.

We do not permit the companies as much of an expense factor as some other states, so that they do not take advantage of our basically higher premium in New Jersey.

ASSEMBLYMAN BORNHEIMER: If there's no other question, we thank you, Commissioner.

COMMISSIONER SHEERAN: Thank you for the opportunity.

ASSEMBLYMAN BORNHEIMER: All those people in the audience, the next person to speak to the Committee will be the Public Advocate, Mr. Van Ness. But if anyone else wishes to testify before the Committee, please register with the Committee Aide, Mr. Tom Leach.

S T A N L E Y   V A N   N E S S: I am here at the request of the Chair, and I am very pleased to be here. I would start by saying that I am not an insurance expert, and I certainly do not purport to have any divining rod that would enable me to determine the public interest in a better manner than Commissioner Sheeran has. If I could offer anything of assistance to you, I think it would be in the area of procedures. If I may, I would observe that the procedures followed in this case were in full compliance with the statute. The statute does not require public hearings, does not require notice to the Public Advocate or notice to any other party, nor does the statute require that the Commissioner submit findings of fact or conclusions of law. In that regard, I am in total agreement that everything that should have been done was done under the present statutory procedures.

I would suggest, though, that with the active cooperation of the Commissioner of Insurance we are about to engage in an experiment with a different procedure which I hope might prove successful, and which in that event we would suggest to the legislature certain changes in the statute. As of tomorrow, we will be participating in a hearing called by the Commissioner on his own initiative, and two days thereafter and perhaps for a longer period of time after that, wherein we will have for the first time available to the Public Advocate an independent actuary, and where we will have attorneys attempting to see whether the model of the Public Utility Commission is adaptable to the insurance industry. Hopefully we might be able to expand the record to give the Commissioner additional information beyond that which is presently available and be of some assistance to him in making judgment on the facts.

I am concerned that we, as the Commissioner is, will be very much the victim, if you will, of the industry statistical

gathering mechanism. Absent some independent way to gather statistics, anyone delving into this area is going to find themselves captured by the information provided, and that is indeed the basic information which is going to determine the outcome. There is no doubt in my mind that our involvement in a hearing type arrangement will slow up the process. I hope not too much. But I think it will give the public hopefully a greater feeling that their interest has been at least expressed in a public fashion and that the results which will be reached thereafter might have a higher level of credibility. I do not criticize the Commissioner in any way, shape or form for any action he has taken now on the procedural grounds and I cannot criticize it on a substantive ground.

With that observation, I am open to your questions.

ASSEMBLYMAN BORNHEIMER: You stated that at this public hearing that you're going to have, you're going to have an actuary of your own?

MR. VAN NESS: Yes, we have found a gentleman from the Temple School of Insurance who will be available to our attorneys to assist them in evaluating the evidence or the information.

ASSEMBLYMAN BORNHEIMER: He will be evaluating the data that are presented by the insurance carrier?

MR. VAN NESS: Basically that is it. And that is the fly in the ointment in the final analysis. I echo strongly Commissioner Sheeran's request for consideration by the legislature for the resources to enable him to develop at least the kind of information that could be used to cross-check in a regularized fashion.

ASSEMBLYMAN RUANE: Could I ask you if the insurance companies refuse you any information?

MR. VAN NESS: No. We have not requested of any insurance company directly any information. We have

been getting all the information that is available to the Commissioner through the Commissioner. I have no reason to suspect that the insurance companies would not provide that information.

ASSEMBLYMAN HERMAN: Mr. VanNess, just as a matter of curiosity, the cost of the actuary hired by your staff to aid and assist in the preparation, how much is that going to be? Where are those funds going to come from? Is it going to work in this instance the way it works with the Public Utility hearings, that the company reimburses or foots the bill?

MR. VAN NESS: Yes. Our jurisdiction in the whole insurance area is tied into the Division of Rate Counsel which the legislature established when it enacted the Public Advocate Act. There is a provision in that statute which permits us to assess the affected industry for the cost of expert witnesses and for the cost of attorneys. There is no State appropriation associated with our Rate Counsel activities.

ASSEMBLYMAN HERMAN: Notwithstanding the fact that the insurance company is going to pick it up, and I think that's good, just as a matter of curiosity, how much do you anticipate that that independent audit or evaluation will be?

MR. VAN NESS: We have agreed with the expert to honor his bills up to a total of \$3,000 at this point. If he demonstrates a greater need, I will consider that. But we have a ceiling of \$3,000. I hope we don't go to \$3,000.

ASSEMBLYMAN BORNHEIMER: Thank you, Mr. VanNess. There are no other questions.

Our next witness to testify will be Assemblyman Stewart.

H. DONALD STEWART: Mr. Chairman and Members of the Committee: My name is Don Stewart. I'm the

Assemblyman from Salem and Gloucester Counties. I had the honor of serving on the Insurance Committee the last two years. I also served on that Committee at the time that the No Fault Bill that is in effect now was promulgated. I hear some of the same alibis, I guess, today that I heard during the weeks and months that we considered No Fault. I was the prime sponsor of the amendment to the No Fault Bill that mandated the 15% rate reduction. And I can recall when we were proposing that amendment in the Committee, people from the Department of Insurance telling us that we should wait two or three years because we didn't have adequate statistics to back up the reduction of rates, and I can recall people from the Governor's Office at that time telling us to wait. And no one could supply us with any figures as to exactly what the loss ratio was going to be. The sponsor of the Bill at that time was Assemblyman Raymond. He was going around predicting 25% reduction in rates based on the threshold of suit in the Bill.

Some of us on the Committee at that time and some of us in the legislature at that time thought that the Bill was totally ridiculous and some of us said on the floor that day when it was passed, that if it had not been for the 15% reduction in rates the Bill would be a complete sham on the insurance buying public in the State. And I think that statement has pretty much borne up. The rates are being proposed to be increased now. I have asked over the past two years several times, "How is No Fault doing? Is the threshold that we enacted of \$250 adequate? If it's not, let's raise it." And everybody keeps telling me that we don't have enough statistical information to come to a conclusion.

We have had two years of No Fault now. I cannot believe somewhere along the line we don't have six months'

experience, twelve months' experience, eighteen months' experience, something to go by so that we can see whether the No Fault Bill that this legislature enacted two years ago is working. And if it's not, let's amend it, let's change it.

I personally feel that the threshold that we established in that Bill is much too low. And I said so the day it was passed here. If that plan isn't working, I would hope that you fellows would ask to see some of those statistics. Every insurance company in the State supplies its agents at the end of the year with a loss ratio figure, its income and its losses by casualty line. I would hope that you would want to see those figures and possibly the Committee would consider some amendments to that No Fault Bill, so that we could -- if indeed the insurance companies are losing money under this present plan, well then let's change it and let's tighten it up the way it should have been two years ago.

I would hope also that possibly Mr. Van Ness could obtain some of those figures that our Commissioner and the statisticians in the Department feel are too premature to pass judgment on. I certainly think we can get some kind of an indication from those **figures**, and I would hope that you would agree that two years of figures or twelve months of figures are certainly enough to give you some indication of the trend that is occurring under the bodily injury portion of the No Fault Plan.

I would hope very much that you fellows would take it upon yourselves to solicit some of this information from the Department and possibly draw up some Committee suggestions for amending the No Fault Proposal.

ASSEMBLYMAN BORNHEIMER: Thank you. Commissioner, would you like to respond?

COMMISSIONER SHEERAN: I would respond in this way, I'm not sure that the Assemblyman realizes or was here at the outset of my discussion before the Committee, but this

rate increase that we're talking about in no way reflects upon the matter of No Fault. It deals with property damage increases. And I must say that we do have statistical data, and I can show a file, and I do not need the Public Advocate to do my job. I have a total file of pursuit of the Insurance Service Office that has requested the kind of data that we believe is necessary to make that evaluation.

I'd like Mr. Stern, if he would, to just briefly tell you what we have pursued in that direction.

MR. STERN: We made advance plans to enable us to compare pre-No Fault and No Fault statistics even before the legislature was finished and ready for action. We have available on a comparable basis 1972 data and 1973 data, and Commissioner Sheeran issued a press release in March of this year giving a comparison of the first six months.

I must say that when you deal with relatively immature green statistics you have to be very cautious about it in order not to mislead the public. It is a fact that insurance statistics take time to mature before they have any significance. But in the press release in March Commissioner Sheeran was able to say it seems from the first six months that the No Fault system produced what it was designed to produce; namely, more people are getting paid; they are getting paid more quickly than under the old system, and there appears to be a reduction in the number of cases under which injureds are proceeding under the tort -- bodily injury and liability.

We are now getting the full 1973 data, and I must explain to you again that it takes more time to mature the data for a whole year, because on that basis you deal with losses lost in addition to paid losses.

As a matter of fact, one segment of the experience is in the mail now. I got a call yesterday from Chicago. They are late, but it is in the mail. We already have another part. We have many more parts to come. It will take us some time to evaluate

this experience, but we have it. And we have it also on the basis of being able to compare 1972 and 1973.

But I must mention to you one thing, if you look at the experience for 1973, it will not spell out in the losses that this much is due to No Fault and this much is due to other conditions, such as driving, economy, inflation and so on. They have to compare on an overall basis, and see whether overall the loss level is the same or different.

ASSEMBLYMAN HERMAN: I'd just like to point out -- I've been listening carefully to both Assemblyman Stewart and Mr. Stern. I find Mr. Stern's comments interesting in the light of the last paragraph on a document which was prepared by the Department of Insurance, and I quote from page 19, "From the above it is evident that the revisions at hand did not in any way nullify or weaken the expectations as to the cost of insurance under No Fault. The estimated 15% savings are retained throughout."

I'd like to make one additional comment in reference to Assemblyman Stewart's representation, that without the active participation of the legislature over what appeared to be the opposition of the Department of Insurance and the Governor's Office at that time, if the Assembly and the Senate exercised the same type of caution that Mr. Stern is talking about now and perhaps the Department was talking about then, the insurance companies would have been 174 million dollars richer and the public 174 million dollars poorer.

ASSEMBLYMAN BORNHEIMER: Do you have anything further you wish to add, Assemblyman Stewart?

ASSEMBLYMAN STEWART: Yes, I just wanted to comment on the statements of the Commissioner and Mr. Stern. First of all, I was not here through their entire presentation, but I did read it. I think an interesting question you

would want to know the answer to would be what percentage are we talking about as far as the experience in 1973? What percentage was the difference between 1973 and 1972, which was prior to No Fault?

ASSEMBLYMAN BORNHEIMER: Percentage of what?

ASSEMBLYMAN STEWART: Okay. We're talking about bodily injury claims, the money paid out. How much did we pay out in 1973 as opposed to 1972? What's the difference? I think Mr. Stern said it was a little better. A little better is not a very good explanation. I'm sure he has those figures and we can see those figures.

I also want to point out that the insured, the policyholder, the citizen of the State, does not look at his bodily injury rate or his property damage rate; he looks at his bill, his overall bill. If we can make some inroads on the bodily injury rate to offset the increase in the property damage rate, I think we can do that consumer a big favor. That's one point.

The second point is I think that if the property damage section is the problem and we're having increases in that particular cost, possibly it's time that we looked at extending our No Fault Plan to include physical damage in the State of New Jersey, and possibly that would be a remedy for that particular problem.

I certainly feel that there is no legitimate excuse under our present structure of No Fault Coverage to just say, "Okay, these premium increases are all warranted. Let's not bother with our No Fault Law, because it's too soon to tell." I don't think it is too soon to tell. I think we can look at some of those statistics and draw some conclusions from them.

ASSEMBLYMAN BORNHEIMER: Mr. Gladstone?

ASSEMBLYMAN GLADSTONE: Mr. Chairman, I think it's proper for us to be able to put this into the correct perspective for us to have the input that Mr. Stewart has

just given us, and I would be obliged if there is anything that you would care to add to it, that you might put it in the form of a note to the Committee, so that we can add this to the transcript and give us the perspective of what you were facing two or three years ago when this was first promulgated.

ASSEMBLYMAN BORNHEIMER: Is there anything else, Mr. Stewart?

ASSEMBLYMAN STEWART: No, sir.

ASSEMBLYMAN BORNHEIMER: Is there anyone else who wishes to testify? Commissioner?

COMMISSIONER SHEERAN: Yes, before Assemblyman Stewart leaves, I don't want to have any controversy, and I'm sure we don't. But Mr. Stern was with the Department at the time of the 15% reduction and again I will say that every insurance company doing business in this State right now has applicable anywhere from a 15% reduction to a 33% reduction for bodily injury which is the only relationship as to the PIP benefits that were supplied through the legislative action in 1973, as effective January 1st.

But Mr. Stern would like to express the fact that he did not object to a 15% reduction. That would be a misunderstanding of the Department's position at that time, of which I cannot speak because I was not in the Department.

MR. STERN: I served as a technical advisor to the Insurance Study Commission. As you know, that Commission was created by the legislature and the Governor and represented various interests and various groups of people. I supplied the Commission with estimates which I had made of the probable effect of the \$200 threshold in addition to other calculations. And my estimate was approximately a 20% reduction may result from the threshold alone.

We also have to take into account the other elements of the legislation. The Insurance Department never objected to a reduction in rates. As a matter of fact, we knew that rates had to be reduced to reflect No Fault.

The Study Commission's position was that it was their function to propose legislation and not to propose rate making. The Study Commission recommendation was to leave the determination of a reduction rate to the Commissioner. Now, the legislative committee -- and I also met with the committee -- had the same numbers as were given to the Commission. I never personally expressed any objection to a reduction in rate. The only question was whether it should be by mandate or whether it would be done by the Commissioner in his exercise of his authority under the statute.

ASSEMBLYMAN BORNHEIMER: Thank you. If there's no one else wishing to testify, then I will close the hearing. Thank you, Commissioner.

(HEARING CONCLUDED)

STATE OF NEW JERSEY - DEPARTMENT OF INSURANCE

SUMMARY OF FINDINGS AND DETERMINATIONS

PERTAINING TO

REVISION OF PRIVATE PASSENGER INSURANCE RATES

NOVEMBER 1974 REVISIONS

INTRODUCTION

The normal form of Department action on rate filings approved by the Commissioner is a notification, by letter, to the filer of the approval including the approved effective date, and a statement to the effect that the proposed rates meet the statutory requirements. The basis for the approval for the record is the Department's file, consisting of the filing, subsequent correspondence, any amendments of the filings and additional information, and internal memos from the Actuary to the Commissioner. Unless the filing requires a more extensive write-up, the attached standard form is used describing the filing, submitting a recommendation and providing for the recording of the Commissioner's action.

Frequently, a filer amends the filing if, through correspondence or conference, the filer concludes that the filing would not be approved as filed. Consequently, there are many more approved than disapproved filings.

Reasons for the Commissioner's action on a filing are only set forth in writing when a filing is disapproved.

This procedure is in accordance with the requirements of Chapter 29A of Title 17 of the New Jersey statute and in accordance with past administrative practice not only in New Jersey but generally in states having a similar prior approval type of rating law.

Formal findings of facts and determination are deemed necessary if action on a filing is based upon the record of a public hearing.

2.

In the case of the present ISO rates, the Commissioner ordered a public hearing with an order to ISO to either revise or justify continuation of the present rates, specifically giving recognition to the then existing energy crisis. In response, ISO submitted a filing in March 29, 1974, proposing rate increases. Testimony by expert witnesses on behalf of the Department and ISO was taken in five (5) days of hearings, ending about the middle of June. Based on the hearing record, the Commissioner made preliminary findings as to rate changes that would be supported by the record and that would produce rates that would not be excessive or inadequate. These findings were communicated to ISO informally where-upon ISO amended its filing with a letter dated October 23, 1974 to conform with these findings and conclusions. A copy of that letter as well as a copy of the letter of October 11, 1974 referred to therein is attached. By this action, the filing of March 29, 1974, which had been the central issue of the hearing had become moot and the amended filing was now dealt with in the usual manner as described at the on-set of this memo.

The filings of the individual companies dealt with in the November announcement were either submitted in conformity with the Commissioner's formula developed in connection with the ISO rate revision or were subsequently amended to conform and, thus, were also processed as set forth above.

All supporting information pertaining to these filings is on the record and available in the files of the Department. Thus, all requirements as to documentation as to rate action had been complied

with, in accordance with statute and past administrative practice. However, there is hereby presented a summary of findings and determinations pertaining to these rate revisions in order to assist the Office of the Public Advocate in the performance of its statutory functions. The Office of the Public Advocate has been furnished a 39\* page paper that explains in a rather non-technical manner the concept of ratemaking for private passenger cars which should be helpful to rate counsel in the comprehension of the following description of the major points of differences between the formula used by the various rate filers and that used by the Commissioner.

#### THE ISO RATE FILING

Below are shown the state-wide average rate level changes approved for ISO compared with those requested in the March 29, 1974 ISO rate filings; the ISO filings already reflected modification in the usual ISO ratemaking formula proscribed for use in New Jersey on the basis of prior rate revisions because of certain restraints imposed in the then applicable cost of Living Council Regulation. Since the date of the filing, these regulations have been repealed. Consequently, it is more appropriate to compare the approved rate changes which do not reflect any Cost of Living Council restraints with the changes indicated by the usual ISO method.

From the above it can be seen that New Jersey motorists would have had the total cost of insurance increased by 17.2 million dollars more than was approved, if ISO had followed its usual rate-making method without the Cost of Living Council restraint. The difference between what they filed and what was approved amounts to 9.8 million dollars.

The concepts on which the approved rate level changes differ

4.

DEPARTMENT OF INSURANCE  
PRIVATE PASSENGER AUTOMOBILE  
LIABILITY & PHYSICAL DAMAGES

RATE SITUATION

<u>COVERAGE</u>	<u>PERCENT CHANGE</u>		
	<u>ISO METHOD</u>	<u>REQUESTED</u>	<u>APPROVED</u>
B.I. LIAB	+ 10.4 %	+ 5.9 %	+ 0.0 %
PROP. DAM.	+ 17.2	+ 14.3	+ 10.2
PIP	+ 10.4	+ 5.7	+ 0.0
SUB-TOTAL	+ 12.9	+ 9.0	+ 3.8
COMPREN.	+ 13.6	+ 11.7	+ 7.4
#100 DED. COLL.	+ 2.5	+ 1.1	+ .2
SUB-TOTAL	+ 5.9	+ 4.3	+ 2.4
<b>COMBINED</b>	<b>+ 10.6</b>	<b>+ 7.4</b>	<b>+ 3.3</b>

	<u>ISO PREMIUMS (IN \$1,000)</u>	<u>DOLLAR CHANGE</u>		
B.I.	\$ 84 677	+ 8 206	+ 4 996	-0-
P.D.	58 763	+ 10 107	+ 8 403	+ 5 994
PIP	14 115	+ 1 468	+ 805	-0-
SUB-TOTAL	157 555	+ 20 381	+ 14 204	+ 5 994
COMP.	24 293	+ 3 304	+ 2 842	+ 1 798
COLL.	55 054	+ 1 376	+ 606	+ 110
SUB-TOTAL	79 347	+ 4 680	+ 3 448	+ 1 908
<b>COMBINED</b>	<b>236 902</b>	<b>+ 25 061</b>	<b>+ 17 652</b>	<b>+ 7 902</b>

PERCENTAGES & PREMIUMS EXTRACTED FROM PAGE 15 OF MATERIAL SENT UNDER LETTER OF NOVEMBER 11, 1974 WHICH WAS MADE PART OF ISO FILING PP-74-1 - DEPT FILING NO. 405 - APPROVED AS OF 11-27-74

from those reflected in the ISO ratemaking procedure are set forth below.

#### TREND FACTORS

Ratemaking relies on past loss and expense experience based on the expectation that the most recent past is the best indicator of the immediate future requirements to cover the cost of insurance. However, in times of dynamic change, this past experience must be adjusted to present cost level as well as prospectively to the cost levels expected to prevail during the period of coverage under the new rates. This adjustment is accomplished by trend factors that measure observed changes in average paid claim cost and average paid claim frequencies. The sources of this information are paid losses, number of claims and number of insured cars filed by the companies under a continuous reporting system. A generally accepted statistical method is used to determine from these data the annual rate of change in claim cost and claim frequencies.

ISO used average claim cost data for a three year period to measure the increases in these claim costs (6.7% for bodily injury and 6.9% for property damage per year), but it used a six year period to measure the decrease in claim frequencies. Further, ISO then limited the frequency decrease by using country-wide data which show a smaller annual decrease in frequencies than New Jersey experience produces. By this method, ISO calculated for its usual ratemaking formula an annual increase in loss cost of 1.8% for bodily injury and 4.8% for property damage for the combined effect of increases in claim cost and decreases in claim frequencies.

6.

The Department formula rejected this method of measuring trend. It was decided that a more reasonable method of measuring the change in loss cost is to combine New Jersey actual claim cost and actual claim frequencies data for the same years to determine an actual paid loss cost per car for each experience period (by using 12 months periods ended at subsequent quarters), and then to fit the resulting values to a straight line by a statistical method referred to above. This method produced no indicated trend on bodily injury liability but it produced a 5.3% increase for property damage liability. (When the Department's calculations were made, additional two-quarters of experience had become available and they did show a continued worsening in the area of property damage claim cost). It is also noted that country-wide claim cost and claim frequency data were used on bodily injury in order to avoid any possible bias in the use of 1973 trend data due to the introduction of the no-fault coverage.

The next point of disagreement is the point of time to which the past experience is adjusted. ISO adjusted to July 1, 1975 but the Department calculations only adjusted past experience to the loss level of December 31, 1974. This is done in recognition of the fact that by this time the experience for the complete accident year 1973, and actual later trend data should be available against which the rate level approved in the rate revision at hand could be tested promptly.

Similar modifications in the trend factors, were used for the comprehensive and collision coverages which produced annual increments of 4.4% by the Department method compared with 4.9% for comprehensive and 5.9% for collision resulting from the usual ISO method.

ISO submitted, at the Department's request, a review of the expense experience pertaining to the "general administration" "other acquisition" and "unallocated loss adjustment" expense items.

For the general administration item, the experience supports a 6.5% provision, but ISO, following an old concept pertaining to the allocation of expenses to expense categories, transferred to this item another one-half percentage point to make it 7.0%. There was lengthy testimony proving this transfer unjustified and it was disallowed in the Department's calculations of the approved rate level changes. Further, the application of the remaining 6.5% provision was challenged on the basis of the attachee exhibit introduced in the hearing record. By the Department's method of interpreting expense requirements the general administration and the other acquisition items are reduced, and the expected loss and loss adjustment ratio was increased from .706 to a .727. This results in a 2.9% reduction of the required premium level for the liability coverages. A comparable adjustment will be made in the future on the physical damage coverages. It was not made at this time because the discontinuation of the \$50. deductible collision in New Jersey at the present time injects question as to the validity of comparing New Jersey and country-wide data in this respect.

12-0  
4/2/74 D/A

STATE OF NEW JERSEY  
DEPARTMENT OF INSURANCE

Expense Provisions  
General Administration & Selling Cost Other Than Commission

	<u>Countrywide*</u>	<u>New Jersey*</u>
Earned Premiums	\$1,554,974,281	\$113,433,002
Earned Cars	14,692,712	880,792
Average Rate	105.80	128.70
General Expense:	6.5% of Average Rate = \$6.90	\$6.90 = 5.4% of N.J. Average Rate.
Other Acquisition:	3.0% of Average Rate = \$3.20	\$3.20 = 2.5 of N.J. Average Rate.

\* Private Passenger - Voluntary Risks; Bodily Injury & Property Damage Combined.

## LOSS DEVELOPMENT FACTORS

Recent loss development data for New Jersey show that the under-estimation in loss reserves from the early stage of maturity to a later stage of maturity is decreasing. ISO uses a three year un-weighted average to predict the loss development for the latest year. The Department gave greater weight to the most recent year of develop-ment and lesser weight to the preceeding years, changing the loss development factor from 1.062 used by ISO to 1.051 for property damage liability. A similar adjustment was not made for bodily injury liability at this time because it was not believed that the change of pattern is as convincing as for the property damage coverage.

Further, the trend and loss development factors were not applied to the unallocated loss adjustment expenses since these expenses are not susceptible to the changes which are measured by these factors.

## ENERGY CRISIS

There are available data, those compiled by the Department staff as well as data collected by the insurance industry, which show that bodily injury accident frequencies in New Jersey have been reduced since the beginning of the energy crisis. Most of that frequency decrease is already reflected in the frequency adjustment of the trend factor discussed above. Energy crisis data show that there was an acceleration in the frequency decrease during the months of the accute crisis covering approximately the last quarter of 1973 and the first quarter of 1974.

It must be recognized that the data hurriedly compiled to measure the effect of the energy crisis do not allow an exact quantitative measure of its effect. It is also noted that gasoline consumption

in the State of New Jersey has decreased even after the end of the acute phase of the crisis. While some of this reduction in gasoline consumption must be due to greater economy in driving at reduced speeds and greater use of smaller automobiles, there is obviously some reduction in the road exposures of automobiles in general.

The Department calculations for the bodily injury liability coverage produced an indicated increase in rate level of 2.2%. The Commissioner took into consideration the effect of the energy crisis by ordering no change in bodily injury rates in lieu of the 2.2% increase. In terms of the ISO bodily injury premium of close to one hundred million dollars, this is a saving of better than two million dollars. The same principle applied explicitly or implicitly in the evaluation of all other rate filings amounting to approximately five million dollars of savings to the New Jersey motorists due to the recognition of the energy crisis. This is considerably less than was expected when the question of windfall profits for the companies was raised because of the energy crisis, when it was believed that the January and February shortages will last for a long time. Fortunately, the acute crisis ended on April 1, 1974.

#### ASSIGNED RISKS

A discussion of ratemaking for private passenger cars in New Jersey would be incomplete without pointing out what rate treatment Assigned Risks receive in this State. This is a large group of motorists who are shunted into the Assigned Risk Plan, euphemistically referred to as the Automobile Insurance Plan, and are generally referred to as "high risks" insureds. This designation properly applies only to less than one-third of the Assigned Risks who are motorists

who are surcharged under the Plan for accidents or violations of the Motor Vehicle Law. But, even among that group, many are in the surcharged category for minor violations, such as two Stop Signs in a three year period for the entire household which may include several drivers and several cars.

There is a hard core of accident prone drivers who properly belong in such Plan because a sufficiently large premium could never be collected from these insureds to cover the losses they cause. The remainder of the Assigned Risk population consists of people who are placed in the Plan for reasons beyond their control, such as occupation, age, and place of residence. Needless to say, our cities contribute most of the population to the Plan because of the reluctance of insurance companies to serve the population in those areas.

In most States, the total Assigned Risk population pays higher premiums than people on the voluntary market and thus carries the whole burden of subsidizing the hard core of accident prone motorists. This is not the practice in New Jersey. The burden of subsidy is shared by all motorists, those in the Assigned Risk Plan as well as those on the voluntary market.

Prior to 1973, there was in existence another pool of so-called high risk insureds who had agreed to pay higher than normal premiums under a Statute providing for a Consent to Higher Rate Agreement. They were basically the same type of insureds who are in the Assigned Risk Plan. About 60,000 policyholders were involved. Early in 1973, the commissioner, by regulation, placed a ceiling on these charges, and from that time on no more than what the Assigned Risk Plan would charge could be charged to those insureds. That regulation dried up this Consent market, most likely because the high commissions pre-

viously paid to producers were no longer available. This increased the population of the Assigned Risk Plan and, since this group of insureds also included some "bad drivers", it increased the required subsidy, because prior to 1973, the experience on this block of insureds did not enter into ratemaking.

The Department's policy in dealing with Assigned Risks is the fairest method of treating a group susceptible to unfair discrimination, but it does tend to increase rates for insureds on the voluntary market. This fact is probably reflected not so much in the data used by ISO as in the rate filings of the other companies, some of which included 1973 experience, as will be set forth later on.

#### THE INA FILING

Insurance Company of North America, prior to this revision, used rates which were approximately 15% below the rates prevailing among stock agency companies represented by ISO. Unlike the direct writer competition whose lower rates to a great extent reflect lower expenses, the INA differential was based upon an optimistic outlook on the ability to achieve loss savings through high selectivity. This expectation apparently did not materialize and the experience now indicates that the INA book of business is very similar to that of the other stock agency companies.

INA based the revision upon the experience for accident years 1971 and 1972. The original filing was amended to comply with the ratemaking formula set forth above regarding the ISO filing. The rate level changes originally requested and those approved for the amended filing were as follows:

	<u>ORIGINAL FILING</u>	<u>APPROVED</u>
Liability Package	+19.7	+15.0
Comprehensive	+ 6.3	+ 3.0
Collision	+28.4	+24.5
Total	+20.5	+16.1

It is clearly in the public interest that companies make insurance available without undue underwriting restrictions directed at "creaming". If a company's loss experience is affected by such broadening of its underwriting, the company's price must conform with the market it serves.

THE GEICO FILING

Government Employees Insurance Company first submitted a review of the experience producing indicated rate level changes for New Jersey and reflecting entirely GEICO's country-wide ratemaking procedure. After a conference on that material, GEICO submitted a filing on September 26, 1974 which was amended with letter of November 1, 1974. The latter contained calculations of the Statewide rate level changes in conformity with the ratemaking formula described above for ISO. The changes first submitted and the amended percent changes were as follows:

	<u>ORIGINAL FILING</u>	<u>APPROVED</u>
Liability Package	+22.0%	+10.4%
Physical Damage	+18.6%	+19.4%
Total	+20.6%	+13.8%

GEICO's rates remain to be well below other companies' rates because it sells entirely through the mail which reduces the expense portion and allows 80% of the premium to go for losses and lossadjustment expenses.

## THE FILING OF CHUBB

Before making the filing, Chubb inquired and received information from the Department on all points of difference between the ISO ratemaking formula and that of the Department. There upon Chubb filed for statewide changes as follows:

Property Damage	+25.0%
Comprehensive	No Change
Collision	+20.0%

The filing used the experience for 1971, 1972 and 1973. The property damage change reflects a limitation proposed by Chubb; the Department's formula would produce +27.1%.

On comprehensive and collision, the experience points in different directions, a 16% reduction for comprehensive and a 24% increase for collision. In view of the present price situation, particularly with respect to automobile repair costs, the company proposes to limit the reduction for comprehensive to 10% but limits the indicated increase for collision to 20% so that the combined effect on the company's revenue is close in line with the indications.

## THE ALLSTATE FILING

Allstate Insurance Company first presented its interpretation of the experience based on the 1973 data. That experience indicated increases for the bodily injury and the personal injury protection coverages so high that any modification of the formula by the strictest criteria would still have produced very substantial required rate increases. Even though the experience of Allstate, representing approximately 20% of the private passenger volume in the State by itself has substantial credibility by all reasonable standards of

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ratemaking, Allstate was informed that no changes in bodily injury rates can be made on the basis of experience developed under the no-fault system until the entire industry experience is available for review, because a very careful evaluation has to be made of the effect of the changes in coverage on the normal method of interpreting bodily injury liability data.

However, Allstate also produced bodily injury experience for the year 1972, which is experience developed under the old system, and that also indicated the need for a substantial increase. The company also submitted its own paid loss costs per car which showed that the company's costs have gone up substantially, unlike the data submitted by ISO, which as noted above, showed almost no change in bodily injury loss cost per year over a three year period. One element that explains the different behavior of the Allstate Loss cost experience is the substantial increase in volume by Allstate in New Jersey. For example, during 1972 Allstate insured 564,000 cars and in 1973 it insured 620,000 cars. This continues a development that has been going on for many years. It is apparent from this growth and the loss experience that Allstate is no longer the highly selective company it used to be when its rates were consistently lower than prevailing bureau rates. It is axiomatic that a company's book of business tends to approximate the average type of business as its share of the total market increases. Another contributing factor to this development is the fact that Allstate no longer writes business in New Jersey under its running mate, National Emblem Insurance Company, which used to operate as a "non-standard" company with higher rates.

Allstate showed the following "formula indications" and proposed changes:

<u>Coverage</u>	<u>Indicated Change</u>	<u>Proposed Change</u>
Bodily Injury	+33.5%	+16.3%
Basic Personal Injury Protection	+84.5%	
Excess Personal Injury Protection	+92.3%	+19.7%
Property Damage	+11.8%	+11.8%
Uninsured Motorists	+50.0%	0
Collision	+ 1.8%	0
Comprehensive	- 4.2%	0
Towing	<u>+108.3%</u>	<u>+50.0%</u>
Total	+22.8%	+ 9.6%

In the above table the no change for uninsured motorist coverage as compared to Allstate's indication of a .50% increase was made at the Department's request because uninsured motorist rates are uniform for all companies and are based upon the combined experience of all companies. In this connection, the present rate is \$2.00. The towing change in the above table likewise applies to a small dollar charge of \$3.00. No change was made for collision and comprehensive because the two rate level changes, one up and one down, offset each other.

The change for the bodily injury coverage (including the personal injury protection) was limited at the Department's request such that the new rate on the average remains to be 15% below the average charge for the comparable package of coverages prior to no-fault.

The excess personal injury protection coverage is available to insureds whose income is more than \$100. per week.

In the case of Allstate, it was appropriate to use the 1973 bodily injury experience, supported by the 1972 experience for the bodily injury rate change because of other changes Allstate made, as set forth below.

The cost of no-fault coverage, particularly after subrogation will be terminated with accidents occurring on or after January 1, 1975, is expected to be lower for the young drivers than for the adult drivers, because the youthful operators are more likely to produce lower medical expenses and lower wage losses. There are no exact data available which would permit the separate pricing of the residual bodily injury liability and the personal injury protection coverages. The old bodily injury rate reduced by 15% was divided into these two portions on the basis of sampling data obtained primarily from a study by the United States Department of Transportation. In this revision, Allstate is reducing the relativity for the young drivers on the personal injury protection coverage. This is a move in the right direction because it reduces the inherent inequity in the present classification system which produce very high rates for young drivers. Consequently, cars in the youthful operator classifications will be less affected by the increases resulting from this revision than cars in the adult classifications.

A proposal in the Allstate filing to change the Safe Driver Insurance Plan was withdrawn at the Department's request because of the Commissioner's declared intention to deal shortly with the entire problem of private passenger classifications on a broad basis.

THE AETNA FILE

Aetna last revised its rates on January 1, 1973 at which time the company not only introduced the mandated 15% reduction for bodily injury and the elimination of the medical payments premium charge but further reduced its rates for an average effect of approximately 28%. Subsequent experience indicates that the reductions in excess of the mandated No Fault reductions are not supported. Aetna's 1973 bodily injury experience prior to any adjustment for trend indicates an increase in excess of 25%. Because the company had been informed by the Department that bodily injury rates, including the personal injury protection coverage, will be reviewed only after the industry experience for accident year 1973 is available, Aetna limited the increase to 10% for this coverage.

For the other coverages, Aetna's ratemaking formula is reasonably close and produces reasonably similar results as the Department formula, viz.:

<u>Coverage</u>	<u>Aetna Proposed</u>	<u>Department Calculation</u>
Property Damage Liability	+17.3%	+21.8%
Comprehensive	-12.3	-16.8
Collision	+14.9	+16.7

Therefore, it was not necessary to modify the rate level changes proposed by Aetna. In this connection, Aetna also submitted a calculation which indicates that this revision will produce an average rate for the present bodily injury package (residual bodily injury liability plus personal injury protection plus uninsured motorists coverage) below the average rate for the comparable package prior to January 1, 1973 by 23.4% for the Family Automobile Policy and 14.4% for the "AUTO-RITE" Policy.

## THE NO-FAULT COVERAGE

With the exception of the partial relief given youthful operators through the Allstate action, these revisions have no effect on the no-fault coverage and do not reflect no-fault experience.

When the no-fault coverage became effective January 1, 1973, bodily injury rates were reduced at least 15% by every company in conformity with the legislative mandate to reflect the anticipated reductions in the cost of the new coverage compared with the cost of the prior coverage.

In addition to this 15% reduction, all companies eliminated the charge for the medical coverage which was purchased prior to 1973 by approximately 85% of the insureds. This represented an approximate additional 10% reduction of the bodily injury total premium. Also, charges for limits in excess of the required basic limits were reduced proportionately.

In addition, individual filers introduced reductions based upon the then available experience, generally that for accident year 1971. That was done on the basic expectation underlying all insurance rate-making that future experience will be as favorable as the immediate past experience. With respect to ISO, this assumption was largely confirmed by 1972 experience (except for the 2.2% indicated change which was off-set by energy crisis consideration). This also holds for some of the other rate filers, while for some it does not. Where the 1972 experience did not show that rates were adequate as of that year, increases are in order so that they may meet the statutory standards as to adequacy and non-excessiveness.

Comparing the cost of the pre-no-fault coverage (bodily injury

liability, medical payments and Uninsured Motorists) with the cost of the present coverage which is bodily injury liability above the Tort exemption limit, Uninsured Motorist, and the personal injury protection coverage ("no-fault" coverage) the following are the facts:

ISO rates remain approximately 30% below 1972 rates - 15% mandated reductions, 5% reductions based on past experience, 10% saving due to substitution of the automobile medical payments coverage by the unlimited medical coverage under no-fault.

Allstate revised rates for the company's package were limited to retain the 15% mandated reduction.

Aetna revised rates, for comparable coverage, are 23% below pre-no-fault costs for the Family Policy and 14% below for "Auto Rite" policy.

Federal Insurance Company - Chubb Group rates for bodily injury follow exactly the ISO pattern.

Government Employees Insurance Company's cost of the bodily injury package was reduced effective January 1, 1973 by 33% , and these rates remain in effect.

INA filed a revision in 1972 that became effective on August 1st which reduced the overall cost of the liability package by 2.7%, which included a 10% reduction for bodily injury rates. The company, of course, also put through the no-fault reduction of 15% for bodily injury liability and elimination for the charge for medical payments coverage averaging 10% effective January 1, 1973. The current revision approved for INA consists of a 14% increase for bodily injury and a 20% for property damage, averaging 15% for the liability package. Consequently, the revised bodily injury component of the INA rates is still lower than the comparable provision in the rates effective

July 1, 1972, the date to which the no-fault mandated rate reduction refers.

From the above it is evident that the revisions at hand did not in any way nullify or weaken the expectations as to the cost of insurance under no-fault. The estimated 15% savings are retained throughout.

What the cost of insurance for bodily injury liability above the tort exemption limit and the cost of the personal injury protection coverage actually is will not be known until sufficient experience is available. The first year's experience under no-fault is just becoming available now. It will be carefully analyzed and appropriate public announcements on this matter will be made.

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