

INSURANCE  
DEPARTMENT OF BANKING AND INSURANCE  
OFFICE OF SOLVENCY REGULATION

Medical Malpractice Liability Insurance  
Corporate Governance

Proposed New Rules: N.J.A.C. 11:27-12

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

Authority: N.J.S.A. 17:1-8.1, 17:1-15e, 17:23-20 et seq. and 17:29AA-1 et seq.

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

Proposal Number: PRN 2008-53

Submit written comments by May 2, 2008 to:

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The agency proposal follows:

Summary

In the recent past, the medical malpractice liability insurance market has been strained in New Jersey, as well as throughout the nation. The issues of availability and affordability of medical malpractice liability insurance have been matters of concern. One consequence of availability and affordability problems with medical malpractice liability insurance is the potential negative impact on New Jersey residents' access to high-quality health care. To that end, the Legislature enacted the New Jersey Medical Care Access and Responsibility and Patients First Act, P.L. 2004, c. 17 (the Act), which provides various reforms to address the vital

interests to the State of ensuring that health care practitioners can continue to provide high-quality health care, and to ensure that such health care continues to be available to the residents of this State. In furtherance of these goals and of its oversight of medical malpractice liability insurers, the Department is proposing new rules to set forth minimum requirements for the independence of the boards of directors and committees of the boards of an insurer transacting medical malpractice insurance in this State. The proposed new rules also set forth requirements for one or more independent committees comprised solely of independent board members of an insurer transacting medical malpractice liability insurance in this State. The Department believes that board committees and boards of directors that are sufficiently independent will help ensure that appropriate business decisions are made, and that an insurer will operate in a sound manner. The requirements in the proposed new rules reflect those currently applicable to domestic insurers that are members of an insurance holding company system pursuant to N.J.S.A. 17:27A-4d(3) and (4) regarding the oversight of the insurer's financial condition and those requirements set forth in recently enacted amendments to the Annual Financial Reporting Model Rule adopted by the National Association of Insurance Commissioners (NAIC). Codifying these requirements for medical malpractice insurers will better ensure that these insurers operate in a financially sound manner. As a result, the potential negative impact upon the residents of this State from availability and affordability problems for medical malpractice liability insurance which can be exacerbated by volatility in rates, may be reduced. This, in turn, furthers the intent of the Act to help ensure that residents continue to have adequate access to high-quality health care in this State.

Proposed N.J.A.C. 11:27-12.1 sets forth the purpose and scope of the proposed new rules.

Proposed N.J.A.C. 11:27-12.2 sets forth the definitions of terms used throughout the subchapter.

Proposed N.J.A.C. 11:27-12.3 sets forth the requirements for independent directors. These requirements essentially reflect the existing requirements applicable to domestic insurers that are members of an insurance holding company system pursuant to N.J.S.A. 17:27A-4d(3) and (4).

Proposed N.J.A.C. 11:27-12.4 sets forth the requirements for the establishment of independent committees of the board of directors of a medical malpractice liability insurer. The proposed new rules set forth requirements for board committees, including the requirement that at least one board committee comprised solely of independent board members be established, which reflects the requirements in N.J.S.A. 17:27A-4d(3) and (4). In addition, the proposed new rule requires that an independent committee shall be established that shall be directly responsible for the appointment, compensation and oversight of the work of any accountant for the purpose of preparing the annual audited financial report required pursuant to N.J.A.C. 11:2-26. In addition, the proposed new rule provides that this independent committee shall require the accountant that performs for an insurer any audit required by N.J.A.C. 11:2-26 to timely report to that independent committee in accordance with specified requirements.

Proposed N.J.A.C. 11:12-27.5 sets forth the penalties for violations of this subchapter.

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 notice is not subject to the provisions of N.J.A.C. 1:30-3.1 and 3.2 governing rulemaking calendars.

### Social Impact

The proposed new rules establish minimum requirements for the independence of the boards of directors and board committees, including requirements for committees comprised solely of independent board members, of insurers transacting medical malpractice liability insurance in this State. The proposed new rules generally codify the existing requirements regarding independent boards of directors set forth in N.J.S.A. 17:27A-4d(3) and (4) applicable to domestic insurers that are members of an insurance holding company system, and the requirements established in recently adopted amendments to the NAIC Model Annual Financial Reporting Rule. The proposed new rules will enhance the level and quality of board oversight to reflect the current national standard of corporate governance best practices. This, in turn, should help ensure that medical malpractice liability insurers are operated in a sound and effective manner, thereby avoiding the potential that such an insurer will lapse into a hazardous financial condition. This, in turn, will help avoid attendant costs to practitioners, and ultimately residents of this State, related to the lack of availability and affordability of medical malpractice liability coverage, thereby furthering the goals of the Act.

### Economic Impact

Insurers transacting medical malpractice liability insurance in this State will be required to incur any costs associated with complying with the proposed new rules. These would include costs associated with appointing any additional independent directors to the board that may be needed to comply with the new rules and conducting meetings within the timeframes prescribed in the proposed new rules. Additional professional services may be required for some insurers to provide the information required to be supplied to the independent board member committee

referenced in proposed N.J.A.C. 11:27-12.4 to enable it to fulfill its responsibilities as set forth therein. These would include accounting and actuarial services.

The Department, however, believes that these costs should not impose an undue burden on insurers. As noted in the proposal Summary above, the proposed requirements reflect standards regarding the independence of the board of directors currently applicable to domestic insurers that are members of an insurance holding company system. Further, the proposed requirements for the committee of independent board members reflect the requirements in the recently adopted amendments to the NAIC Model Annual Financial Reporting Rule, and, therefore, reflect the national standard and best practices related to this area. In addition, the Department believes that any additional costs are outweighed by the potential benefits to be gained by helping to ensure that medical malpractice liability insurers are operated in a financially sound manner, so as to avoid the issues, including volatility in rates, which have in the past caused problems related to the availability and affordability of medical malpractice liability insurance. Minimizing the potential for availability and affordability problems ultimately benefits the residents of this State by helping to ensure that they continue to have adequate access to high-quality health care in this State, and further implements the goals of the Act.

#### Federal Standards Statement

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

### Jobs Impact

The Department does not anticipate that any jobs should be generated or lost as a result of the proposed new rules.

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

### Agriculture Industry Impact

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

### Regulatory Flexibility Analysis

The proposed new rules will apply to small businesses, as that term is defined in the Regulatory Flexibility Act, N.J.S.A. 52:14B-16 et seq. To the extent that the proposed new rules apply to small businesses, they will apply to insurers transacting medical malpractice liability insurance in this State. As noted in the Economic Impact above, the proposed new rules will require insurers to incur any costs related to complying with the proposed new rules, including costs associated with appointing additional directors, if needed, and conducting meetings within the timeframes prescribed. As was also noted above, additional professional services may be required, such as accounting and actuarial services, to provide the independent board member committee with the required information as set forth in these proposed new rules.

The proposed new rules provide no differentiation in compliance requirements (described in the Summary above) based on business size. As noted above, the purpose of the proposed new rules is to codify the national standards regarding corporate governance and best practices,

so as to better ensure that medical malpractice liability insurers are operated in an appropriate manner, and avoid issues, including volatility of rates, that have, in the past, contributed to problems of availability and affordability of medical malpractice liability insurance. By avoiding these potential problems, practitioners will be in a position to continue to provide high-quality health care to the residents of this State. These goals do not vary based on business size.

#### Smart Growth Impact

The proposed new rules will not have an impact on the achievement of smart growth or the implementation of the State Development and Redevelopment Plan.

Full text of the proposed new rules follows:

## SUBCHAPTER 12. CORPORATE GOVERNANCE

### 11:27-12.1 Purpose and scope

(a) The purpose of this subchapter is to set forth minimum requirements for the independence of the board of directors and the committees of the board of directors of an insurer transacting medical malpractice liability insurance in this State.

(b) This subchapter shall apply to all insurers authorized or admitted to transact medical malpractice liability insurance in this State pursuant to N.J.S.A. 17:17-1 et seq. and 17:32-1 et seq., as applicable.

### 11:27-12.2 Definitions

The following words and terms, as used in this subchapter, shall have the following meaning, unless the context clearly indicates otherwise.

“Commissioner” means the Commissioner of the New Jersey Department of Banking and Insurance.

“Control,” “controlling” or “controlled by” are as defined in N.J.S.A. 17:27A-1c.

“Department” means the New Jersey Department of Banking and Insurance.

“Insurer” means an entity authorized pursuant to N.J.S.A. 17:17-1 et seq. or admitted pursuant to N.J.S.A. 17:32-1 et seq. to transact medical malpractice liability insurance in this State.

### 11:27-12.3 Board of directors

Not less than one-third of the directors of an insurer, and not less than one-third of the members of each committee of the board of directors of any insurer, shall be persons who are not officers or employees of that insurer or of any entity controlling, controlled by, or under common control with, that insurer and who are not beneficial owners of a controlling interest in the voting securities of that insurer or any such entity. At least one such person shall be included in any quorum for the transaction of business at any meeting of the board of directors or any committee thereof.

### 11:27-12.4 Independent board member committees

(a) The board of directors of an insurer shall establish one or more independent board member committees. Such committees shall be comprised of at least two members and shall be comprised solely of directors who are not officers or employees of the insurer or of any entity controlling, controlled by, or under common control with, the insurer and who are not beneficial owners of a controlling interest in the voting securities of the insurer or any such entity. Such committees shall meet not less than quarterly. Such committees shall be responsible for recommending the selection of independent certified public accountants and reviewing the insurer's financial condition, the scope and results of any independent audit or review, and any internal audit.

(b) Every insurer shall establish an independent board member committee which shall be directly responsible for the appointment, compensation and oversight of the work of any accountant (including resolution of disagreements between management and the accountant regarding financial reporting) for the purpose of preparing or issuing the audited financial report

or related work pursuant to N.J.A.C. 11:2-26. Each accountant shall report directly to the independent board member committee responsible for such oversight.

(c) The board committee referenced in (a) above shall require the accountant that performs for the insurer any audit required by N.J.A.C. 11:2-26 to timely report the results of the audit to the independent committee in accordance with the requirements of “SAS 61, Communication with Audit Committees,” or its replacement, including:

1. All significant accounting policies and material permitted practices;
2. All material alternative treatments of financial information within statutory accounting principles that have been discussed with management officials of the insurer, ramifications of the use of the alternative disclosures and treatments, and the treatment preferred by the accountant; and
3. Other material written communications between the accountant and the management of the insurer, such as any management letter or schedule of unadjusted differences.

#### 11:12-27.5 Penalties

Failure to comply with the provisions of this subchapter shall result in the imposition of penalties as authorized by law, including, but not limited to, the penalties authorized by N.J.S.A.

17:33-2.