

INSURANCE
DEPARTMENT OF BANKING AND INSURANCE
OFFICE OF SOLVENCY REGULATION

Increase in Capital and Surplus Requirements for Insurers and Health Maintenance
Organizations
Company Action Level Event

Adopted Amendment: N.J.A.C. 11:2-39.4

Proposed: July 21, 2008 at 40 N.J.R. 4287(b)

Adopted: December 11, 2008 by Steven M. Goldman, Commissioner, Department of
Banking and Insurance

Filed: December 15, 2008 as R. 2009 d.28, without change.

Authority: N.J.S.A. 17:1-8.1, 17:1-15e, 17:17-6 et seq. and 17:50-1 et seq.

Effective Date: January 20, 2009.

Expiration Date: September 21, 2010.

Summary of Public Comment and Agency Response:

The Department of Banking and Insurance (Department) timely received a written comment from Reciprocal Management Corp. (Attorney-In-Fact for Citizens United Reciprocal Exchange and New Jersey Physicians United Reciprocal Exchange).

COMMENT: The commenter, while it acknowledged that the Department was adopting the amendment to conform with the existing trend test as set forth in the Model Risk Based Capital (RBC) Act adopted by the National Association of Insurance Commissioners (NAIC), believed that the amendment does not take into account the steady surplus infusion that a reciprocal or any other similarly situated insurer receives. The commenter stated that under the power of attorney its subscribers are required to execute, each subscriber agrees to pay, in addition to premium, a percentage of premium as a surplus contribution for the benefit and protection of all subscribers,

which is the fundamental structure of a reciprocal. The commenter stated that surplus contributions are not included as part of stated net income in an insurer's annual statement, but rather as a separate line item directly increasing the insurer's surplus value. The commenter stated that, under the proposed trend test calculation, the surplus contributions are not accounted for. The commenter stated that the NAIC trend test calculation uses a combined ratio threshold of 120 percent. Accordingly, the commenter believed that investment and other income are considered when evaluating whether the condition of a property/casualty insurer is at a "Company Action Level event" under the RBC instructions, but surplus contributions are not included in the calculation of the combined ratio. The commenter maintained that, for entities similar to those represented by the commenter, which receive an infusion of surplus, the trend test calculation does not present a clear and accurate picture of their financial condition. The commenter believed that the Department should give consideration to those insurers that receive this constant infusion of surplus outside of their net income. The commenter believed that failure to do so would penalize entities represented by the commenter and companies that operate in a similar manner, compared to those companies that do not have surplus infusions to assist in defraying the impact of the 120 percent combined ratio. The commenter thus requested that the Department modify the NAIC trend test calculation to allow such insurers to include the surplus contribution as income in the trend test calculation when determining the appropriate RBC action level.

RESPONSE: Upon review, the Department has determined not to change this provision. The trend test calculation is the national standard adopted by the NAIC with respect to property/casualty insurers. The Department also notes that combined ratio does not include

investment and other income, as the commenter asserted. The combined ratio equals: losses incurred and loss adjustment expenses incurred divided by premiums earned, plus underwriting expenses incurred divided by net premiums written. The surplus contribution referenced by the commenter is not a component of calculating the combined ratio. Further, the Department does not believe that surplus contributions should be included in the NAIC trend test as they are not treated as premium and do not enter the calculation of the combined ratio. The combined ratio is based on premiums earned and premiums written, neither of which include contributions. Moreover, companies do not pay premium tax on these amounts, which the Department believes further indicates that surplus contributions should not be considered premium for purposes of the trend test. In addition, contributions can be returned to subscribers at a future point in time.

Moreover, the Department notes that reciprocal insurance exchanges are subject to the same minimum capital and surplus standards as are domestic insurers pursuant to N.J.S.A. 17:50-5.

Further, the commenter identifies no undue burden that would result from the application of the rule. The purpose of the trend test is not to enable the Department to take action against an insurer, but to require that an insurer be aware of its financial situation and begin to develop a plan to address the current situation. The Department believes that any prudent company would take such action in any case.

Federal Standards Statement

A Federal standards analysis is not required because the adopted amendment is not

subject to any Federal requirements of standards.

Full text of the adoption follows:

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