

ATTORNEY GENERAL

February 10, 1978

JAMES J. SHEERAN, *Commissioner*
Department of Insurance
201 East State Street
Trenton, New Jersey 08625

FORMAL OPINION NO. 1—1978

Dear Commissioner Sheeran:

You have asked for advice concerning the requirements of the insurance rating laws when a company proposes to adopt a rating system approved for a rating organization of which it was not previously a member, whose loss and expense experience would have been included in the organization's rate filing. For the following reasons, it is our opinion that the Commissioner of Insurance has the authority to make a separate determination as to whether the use or adoption of a rating organization's rating system will result in appropriate rates for an insurer in light of its own particular loss and expense experience and data.

You have advised us that Allstate Insurance Company and several other companies that traditionally have made independent rate filings for private passenger automobile insurance have sought to adopt the rate increase you recently approved for the Insurance Services Office ("ISO"). ISO is a rating organization authorized to make uniform rate filings on behalf of approximately 230 companies that write automobile coverage in New Jersey. Allstate and other independents had individual filings pending contemporaneously with that made by ISO. A separate hearing was held on each rate application and an individual report and recommendations was submitted to you following each hearing. The Hearing Officer has recommended an average overall rate increase for Allstate of approximately seven percent. Although you ultimately approved an increase for ISO averaging about fourteen percent, the Hearing Officer's recommendation on that application was even higher than the amount actually approved for ISO. Following the ISO approval, you were advised by Allstate¹ that it was withdrawing its independent application and would adopt the new ISO rates. We understand that in the past the Department has permitted independent companies to adopt ISO rates after an increase without the formality of full membership in instances where their experience had been filed with ISO but they had not previously authorized ISO to file for rates on their behalf. Similar so-called "Me Too" filings have been allowed to other companies that had not filed their experience with ISO but which had insufficient volume, in any event, to support an independent rate filing. No large independent filer like Allstate, however, has ever previously sought or obtained Department approval to adopt an ISO rate increase upon withdrawal of a separate, pending application.

New Jersey has opted for the prior approval system of establishing

1. For convenience, we will limit the factual discussion to the Allstate situation, but the legal principles would apply to any company that uses or proposes to adopt the system approved for a rating organization where such use would permit rates that were clearly excessive or inadequate for the individual company.

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insurance rates, as set forth in N.J.S.A. 17:29A-1 *et seq.* For all kinds of insurance not expressly exempted from the application of the Act, an insurance company may not charge premiums in New Jersey except in accordance with a rating system on file with and approved by the Commissioner. N.J.S.A. 17:29A-15 and 25. An insurance company may develop and file its rating system independently or as a member of a licensed rating organization, which may do so on behalf of all of its member companies. N.J.S.A. 17:29A-2, 4, 6 and 14. Moreover, rating organizations generally must be open to membership by any insurance company. *See* N.J.S.A. 17:29A-3. Rating organizations like ISO provide an economical method for insurance companies with relatively small shares of the market to pool their resources in gathering the complex data needed to support a rate filing. Membership in a rating organization is beneficial to such companies because the cost to each of them of developing independent rate filing data would be excessive. Moreover, ISO and other rating organizations provide the Department of Insurance with a workable method for determining proper rate levels for many small companies in the aggregate; most of these companies are too small to have sufficient loss experience data for the level of actuarial "credibility" necessary for proper rate determinations. For correlative reasons, the larger companies have traditionally made independent rate filings in New Jersey. Each of them writes a percentage of the total market representing a large enough sample for the development of credible loss data, and is able to bear the expense of developing independent statistics in support of an individual rate. Although it would be unusual, it is clear that nothing in the rating laws would prevent Allstate from becoming a member of ISO, which could then file a rating system on behalf of Allstate along with all other member companies.

The question of whether Allstate may simply abandon a pending, independent rate filing and adopt a recent ISO rate increase, however, requires a more comprehensive analysis of the rating laws. The statutory guideline and mandate with respect to the determination of proper rates are that rates shall be approved only if they are neither unreasonably high or excessive nor inadequate for the safeness and soundness of the insurer and they must not be unfairly discriminatory as between similar risks. N.J.S.A. 17:29A-4, 7, 10, 11 and 14. In applying those criteria, the Commissioner is specifically required to consider the following:

the factors applied by insurers and rating organizations generally in determining the bases for rates; the financial condition of the insurer; the method of operation of such insurer; the loss experience of the insurer, past and prospective, including where pertinent, the conflagration and catastrophe hazards, if any, both within and without this State; to all factors reasonably related to the kind of insurance involved; to a reasonable profit for the insurer, and, in the case of participating insurers, to policyholders' dividends. . . . [N.J.S.A. 17:29A-11.]

In order to assure proper rate determinations, statistical information concerning the loss and expense experience of all insurers must be reported and filed with the Commissioner. N.J.S.A. 17:29A-5. Insurers are

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prohibited from giving false or misleading information to a rating organization or to the Commissioner that would affect the proper determination of rates. N.J.S.A. 17:29A-16. The public importance of determining proper rates and charging premiums only in accordance with an approved rating system is underscored by the fact that any violation of the act is a ground for the assessment of penalties of up to \$500 for each violation. N.J.S.A. 17:29A-22 and 23. The statutory provisions requiring the filing of accurate loss and expense data by insurers and rate approval by the Commissioner based upon factors that vary among companies, such as financial condition, method of operation and loss experience, make the underlying purpose of the legislation clear. The factors to be considered in a rate determination for an independent filer or for a rating organization ordinarily should be based upon the particular loss and expense data of the company or companies that will use the rate ultimately approved. Thus, for example, a company cannot be a member of more than one rating organization, hoping to use whichever rating system would provide the higher rate, as approved. See N.J.S.A. 17:29A-2. And, upon the application of a member, the Commissioner must make a separate determination of whether to allow it to deviate from the rating system approved for its organization. N.J.S.A. 17:29A-10.

The Act does not provide any express guidance as to whether the Commissioner has the authority to make a separate determination bearing on the reasonableness of the rates of a particular member or subscriber to a rating organization. N.J.S.A. 17:29A-10 by its terms refers only to the deviation of a member company from the approved system of a rating organization made on its own application. N.J.S.A. 17:29A-7, however, permits the Commissioner to order an alteration of a previously approved rating system on his own initiative whenever he finds that it results in inadequate or excessive rates. In this case, it is our opinion that in view of the underlying statutory purpose, N.J.S.A. 17:29A-7 would apply even though the Allstate and ISO applications were for alterations of previously filed rating systems (i.e. rate increases) rather than for initial rating systems.

In *Insurance Company of North America v. Howell*, 80 N.J. Super. 236 (App. Div. 1963), the court held that a provision which stated that if the Commissioner failed to approve or disapprove a rating system within 90 days after it was filed, the system would be deemed approved by him, applies only to an original rate filing and not to filings for alterations of existing rating systems. The INA decision does not require, however, that once a rate system has been amended by an approved alteration filed pursuant to N.J.S.A. 17:29A-14, the Commissioner no longer has any power to consider whether the modified rating system produces appropriate rates for an insurer or a rating organization.² The insurance

2. Although the question was not decided, the court suggested in the INA case that the Commissioner, in the exercise of the broad powers conferred upon him, might inferentially at any time, direct a change in a previously approved alteration of a rating system in light of insurance experience, even though no express language to that effect appears in Section 14. See *Insurance Company of North America v. Howell*, *supra* at 251-52.

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rating laws should not be interpreted to undermine the intended legislative purpose of insuring that rates are reasonable and adequate. Consequently, it is clear that an application for an increase or other alteration in a rating system does not extinguish the Commissioner's on-going power to determine that rates provided on behalf of an insurer are adequate for the safeness and soundness of the insurer and not unreasonable or excessive with respect to insureds. To construe the insurance rating laws in any other manner would be to reach an inconsistent result and undermine the salutary legislative purpose underlying the enactment of the insurance rating laws. *See State v. Bander*, 56 N.J. 196 (1970); *Marranca v. Harbo*, 41 N.J. 569 (1964).

In light of these underlying principles, it is our judgment that under N.J.S.A. 17:29A-7 the Commissioner has the authority to make a separate determination as to whether the ISO rating system as applied to the expense and loss experience of a particular insurer will produce rates that are not unreasonably high or excessive and are adequate for the safeness and soundness of the insurer. As to ISO members and subscribers, this authority should be exercised only in unusual circumstances where it is reasonably clear that a rating organization's rating system would not provide appropriate rates for an individual insurer consistent with the legislative scheme. On the other hand, it would not ordinarily be appropriate for non-rating organization members or subscribers to use rating organization rates. This would be particularly true in the Allstate situation where the report and recommendations of a hearing officer who considered the evidence adduced to support the application concluded that, in light of its experience, Allstate was entitled to a percentage increase substantially lower than that which was separately approved for ISO. But even as to non-rating organization members or subscribers there may be individual circumstances in which an insurer's experience is so limited in nature that the rating organization system may be deemed to be appropriate. All of these determinations in individual cases are committed to the sound discretion of the Commissioner of Insurance in carrying out his regulatory responsibilities under the insurance laws.

You are therefore advised that whenever a company uses or proposes to adopt a rating system approved for a rating organization, the Commissioner of Insurance has the authority to make a determination as to whether the rating system applied to the insurer will provide rates that are not unreasonably high or excessive and are adequate for the safeness and soundness of the insurer consistent with the provisions of the insurance rating laws.³

Very truly yours,
JOHN J. DEGNAN
Attorney General

By: THEODORE A. WINARD
Assistant Attorney General

3. It is suggested that the Department of Insurance should give consideration to the adoption of regulations or guidelines dealing with the circumstances under which an independent evaluation may be made to determine the appropriateness of a rating system approved for a rating organization to the insurer which uses or proposes to adopt such a rating system.