ANALYSIS OF THE NEW JERSEY

FISCAL YEAR 2001 - 2002 BUDGET

DEPARTMENT OF BANKING AND INSURANCE

PREPARED BY

OFFICE OF LEGISLATIVE SERVICES

NEW JERSEY LEGISLATURE

APRIL 2001

NEW JERSEY STATE LEGISLATURE

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DEPARTMENT OF BANKING AND INSURANCE

Budget Pages....... C-16, C-29, C-31, D-29 to D-35

Fiscal Summary ($000)

	Expended FY 2000	Adjusted. Appropriation FY 2001	Recommended FY 2002	Percent Change 2001-02
State Budgeted	$59,516	$63,256	$63,313	0.1%
Federal Funds	0	0	0	—
Other	28,269	37,630	37,630	0.0%
Grand Total	$87,785	$100,886	$100,943	0.1%

Personnel Summary - Positions By Funding Source

	Actual FY 2000	Revised FY 2001	Funded FY 2002	Percent Change 2001-02
State	467	493	544	10.3%
Federal	0	0	0	—
Other	5	5	5	0.0%
Total Positions	472	498	549	10.2%

FY 2000 (as of December) and revised FY 2001 (as of September) personnel data reflect actual payroll counts. FY 2002 data reflect the number of positions funded.

Introduction

The Department of Banking and Insurance is primarily responsible for the State's regulation and monitoring of the banking and insurance industries. The Division of Banking is charged with the chartering, licensing and supervision of banks, savings and loans, and a wide range of other financial institutions and firms responsible for consumer finance in this State. The Division of Insurance monitors and examines the policies, practices and financial condition of insurance companies, including the financial condition of health maintenance organizations, and licenses and regulates insurance producers. The division also monitors the business activities of real estate brokers and agents. The two divisions were formerly distinct departments, and were consolidated into the current Department of Banking and Insurance in FY 1997. The department is fully funded by the industries it regulates.

Key Points

- The department's recommended FY 2002 General Fund appropriation is $63.3 million, representing an increase of 0.1 percent or $57,000 over the FY 2001 adjusted appropriation. This increase reflects additional State support/funding for actuarial services, supervision and examination of financial institutions and financial examinations of health maintenance organizations (HMO's).

- For banking related functions, the Governor's FY 2002 budget recommends an overall decrease of $240,000 due to a loss of banking revenues and the transfer of staff from the Division of Banking to the Division of Insurance. Of the $240,000, $140,000 represents the transfer of two employees from the Division of Banking to the Division of Insurance and $100,000 represents the administrative savings associated with the Summit/Fleet merger.

- For insurance related functions, the Governor's FY 2002 budget includes an increase of $297,000 to enhance Insurance operations. These enhancements include $39,000 for a new position within the Division of Actuarial Services to accommodate the increased workload of the Health Bureau. The remaining $258,000 appropriation represents funding for five additional positions for the Financial Examinations of State Chartered Banks and Insurance Companies, intended to eliminate the dependence on outside consultants and reduce the costs assumed by the insurance companies.

- A continued Special Purpose appropriation of $600,000 for the Actuarial Services Unit, within the Division of Insurance, is recommended to support the revision of the current territorial rating plan, a part of the division's automobile insurance reform initiatives. The Automobile Insurance Territorial Rating Plan Advisory Commission, established within the division, is responsible for redrawing the 50-year-old territorial rating plan used to set automobile insurance premiums throughout the State.

- While appropriations for Insurance Fraud Prevention and Insurance Fraud Prosecution remain within the department, the fraud prevention investigator functions were shifted to the Department of Law and Public Safety in FY 1999 in an effort to provide more effective prosecution of insurance fraud related cases. These appropriations remain within the department's budget display because they are still funded through insurance industry assessments. However, all but $2.2 million of the $28.2 million appropriated for this purpose will be expended by the Department of Law and Public Safety. The $2.2 million will be utilized to fund the Anti-Fraud Compliance Unit within the Department of Banking and Insurance.

- The recommended appropriation from "all other" funds is $37.6 million, the same level as in FY 2001. Of that total, $34.6 million represents assessments imposed to cover shared program losses related to the New Jersey Individual Health Coverage Program, P.L. 1992, c.161 (C.17B:27A-2 et seq.). Budget language authorizes this program to operate from receipts.

- Proposed budget language (page F-8) recommends a shift of $10 million from the Stock Workers' Compensation Security Fund to the General Fund as State revenue. The fund (page H-40) is funded exclusively by assessments levied again stock insurance carriers writing workers' compensation insurance. Payments from the fund are made to persons entitled to receive workers' compensation when a stock carrier is determined to be insolvent.

Key Points (Cont'd)

Background Papers:

- ! Automobile Insurance Urban Enterprise Zone Program p. 17
- ! State and Federal Efforts to Address Abusive or Predatory Lending Practices p. 20

Program Description and Overview

The primary responsibilities of the Department of Banking and Insurance are the regulation and monitoring of the banking and insurance industries. The Division of Banking charters, licenses and supervises banks, savings and loans, and a wide range of other financial institutions and firms responsible for consumer finance in the State. The Division of Insurance monitors and examines policies, practices and the financial condition of insurance companies. The Division of Insurance also monitors the business activities of real estate brokers and agents. Previously two separate departments, the former Department of Banking and Department of Insurance were merged by P.L.1996, c.45 (C.17:1-13 et seq.) to form the current Department of Banking and Insurance. The department is fully funded by the industries it regulates.

Division of Banking

The Division of Banking is responsible for chartering, licensing and supervising commercial and savings banks, savings and loan associations, limited trust companies and credit unions. The division is also responsible for licensing, examining and supervising a number of other financial service entities, including, but not limited to: licensed lenders (mortgage bankers and brokers, mortgage solicitors, consumer lenders, secondary mortgage lenders and sales finance companies); money transmitters and foreign money transmitters; insurance premium finance companies, pawnbrokers and check cashers.

The division consists of two offices, the Office of Depositories and the Office of Consumer Finance. The Office of Depositories conducts examinations of State-chartered banking and savings and loan institutions, and takes enforcement action if it discovers any violations of banking statutes or regulations. It also processes and reviews applications by depository institutions for new charters, branches, relocations, plans of acquisition, mergers, bulk sales, stock conversions and auxiliary offices. The Office of Consumer Finance examines, and when appropriate, takes enforcement actions against, the other entities regulated by the division and also investigates complaints filed by consumers.

In its oversight functions, the division works closely with the Federal Deposit Insurance Corporation (the FDIC insures the deposits of all chartered institutions); the Board of Governors of the Federal Reserve System, which oversees State-chartered banks that are members of the Federal Reserve System; and the federal Office of Thrift Supervision (OTS), which oversees savings and loan associations. The division and the Federal Reserve examine State-chartered commercial banks on an alternating basis. The division shares information with the OTS to decide whether State examinations of certain State-chartered savings and loan associations are necessary.

While the primary functions of the Division of Banking have not changed significantly in recent years, its responsibilities and workload have changed as a consequence of an increase in the number of new bank charters, the need to examine financial institutions, additional categories of licensure, and changes in State and federal laws and regulations.

The passage of the various federal laws in the 1990's significantly increased the division's workload, as well as its staff training requirements. More recently, the passage of the Gramm-Leach-Bliley Act of 1999, which repealed the last vestiges of the Glass Steagall Act of 1933 (repeals the restrictions placed on cross-industry affiliations) and authorized the creation of a new entity, the financial holding company, authorized to engage in: underwriting and selling insurance and securities; confirms state regulations of insurance while prohibiting states from discriminating against persons affiliated with a bank; permits national banks to engage in new financial activities through financial subsidiaries; initiates processes for creating uniform nationwide licensing of insurance agents and brokers; permits national bank subsidiaries and affiliates to sell all types of

Program Description and Overview (Cont'd)

insurance, including title insurance; preempts state laws that interfere with affiliations between banks and insurance companies; and requires every financial institution to disclose its policy regarding the sharing of "non-pubic personal information" with affiliates and with third parties and requires that consumers be given an opportunity to "opt out" of sharing their non-public personal information with nonaffiliated third parties.

Other recent changes in State law include: the Trust Modernization Act; the Licensed Lenders Clean-up Act; amendment to the New Jersey Credit Union Act; the New Jersey Money Transmitters Act; major changes requiring depository institutions to offer basic low-cost checking accounts; allowing for State-chartered mutual savings banks; and permitting State-chartered capital stock savings and loan associations to convert their charters to State-chartered capital stock savings banks.

Also included within the division is the Pinelands Development Credit Bank, which is empowered to purchase and sell development rights in the Pinelands region. The intent of the program is to simplify both the preservation of resources of the Pinelands area and the accommodation of regional growth influences in an orderly fashion.

Division of Insurance

The Division of Insurance monitors and examines the policies, practices and financial condition of insurance companies, including the financial condition of health maintenance organizations, and licenses and regulates insurance producers. According to the department, the division has direct regulatory responsibility over approximately 108 domestic insurance companies, 100,026 licensed producers and 1,146 public adjusters. In addition, the division works in conjunction with the Department of Law and Public Safety to enforce insurance fraud laws, administers the Unsatisfied Claim and Judgement Fund, regulates the training and licensing of real estate agents and brokers and investigates consumer inquiries or complaints regarding these industries.

Over the past several years, the division has expanded and revised its responsibilities as a result of statutory changes and as a result of major events and changes within the insurance industry. For example, the Division of Insurance engaged in significant efforts during fiscal year 2001 to protect consumers of certain health maintenance organizations facing serious financial difficulties. To avoid future HMO insolvencies, legislation was enacted to provide for the licensure of "organized delivery systems" (ODS) that assume financial risk, and for the certification of those ODSs that do not assume financial risk. Pursuant to P.L. 1999, c. 409, the department is authorized to review financial risk sharing between and among HMO's and subcontractors. In addition, managed care regulations, together with new laws promoting expedited billing and payment processes, will increase the department's ability to monitor New Jersey's managed care industry and provide a stronger financial safety net for health care consumers and providers.

The "Automobile Insurance Cost Reduction Act of 1998," P.L. 1998, c.21 (AICRA) provided for an overall 15 percent reduction in automobile insurance rates. Several cost-saving modifications were added to the existing system, including: the creation of a basic automobile insurance policy (implementation of the basic policy encourages motorists who otherwise would be uninsured to obtain required insurance coverage), in addition to the standard automobile insurance policy; the adoption of medical protocols that reduce overuse and fraud in the treatment of injuries from automobile accidents, while ensuring that doctors provide necessary treatment to those who are truly injured. The law also established the Office of Insurance Claims Ombudsman, charged with the responsibility to: investigate consumer complaints regarding insurance policies and the payment

Program Description and Overview (Cont'd)

of claims; monitor the implementation of various insurance regulations; respond to consumer inquiries about policy provisions and coverage availability; and publish and distribute buyers' guides and comparative rates. Pursuant to AICRA, the fraud investigative functions of the former Division of Insurance Fraud Prevention were transferred to the newly created **Office of the Insurance Fraud Prosecutor**, housed within the Department of Law and Public Safety. At the same time, the **Anti-Fraud Compliance Unit** was established within the Department of Banking and Insurance. The Anti-Fraud Compliance Unit is charged with three primary functions: insurance industry compliance, collection of penalties and fines, and industry education. AICRA also established the **Automobile Insurance Territorial Rating Plan Advisory Commission** which is responsible for the revision of the current territorial rating plan, another aspect of automobile insurance reform. State law places a cap on the automobile insurance premiums that can be charged in certain areas of the State which are inadequate to cover the losses that are generated there and shifts those costs to other New Jersey drivers to subsidize the rates. The law therefore mandates the commission to review and revise these geographic territories for the first time in over 50 years.

As a result of the increase in competition within the automobile insurance industry, the department developed the "**Consumer Handbook on Tier Rating**," to educate consumers to "shop" comparatively for automobile insurance. This handbook provides concise, comparative information about New Jersey's automobile insurers, including a wide range of prices available for automobile insurance policies. According to the department, consumer "shopping" increased by 20 percent since the implementation of tier rating.

The Recommended FY 2002 Budget

The department's recommended FY 2002 budget of $63.3 million in Direct State Services funding and $37.6 million from all other funds, is an increase of $57,000 or .1 percent over the current fiscal year. The bulk of the $37.6 million in all other funds in the department's budget represents insurance industry assessments imposed to cover shared program losses related to the New Jersey Individual Health Coverage Program, P.L.1992, c.161 (C.17B:27A-2 et seq.). Budget language authorizes this program to operate from receipts.

The funding increase of $57,000 is the net result of a decrease of $240,000 for banking related functions and an increase of $297,000 for insurance related functions.

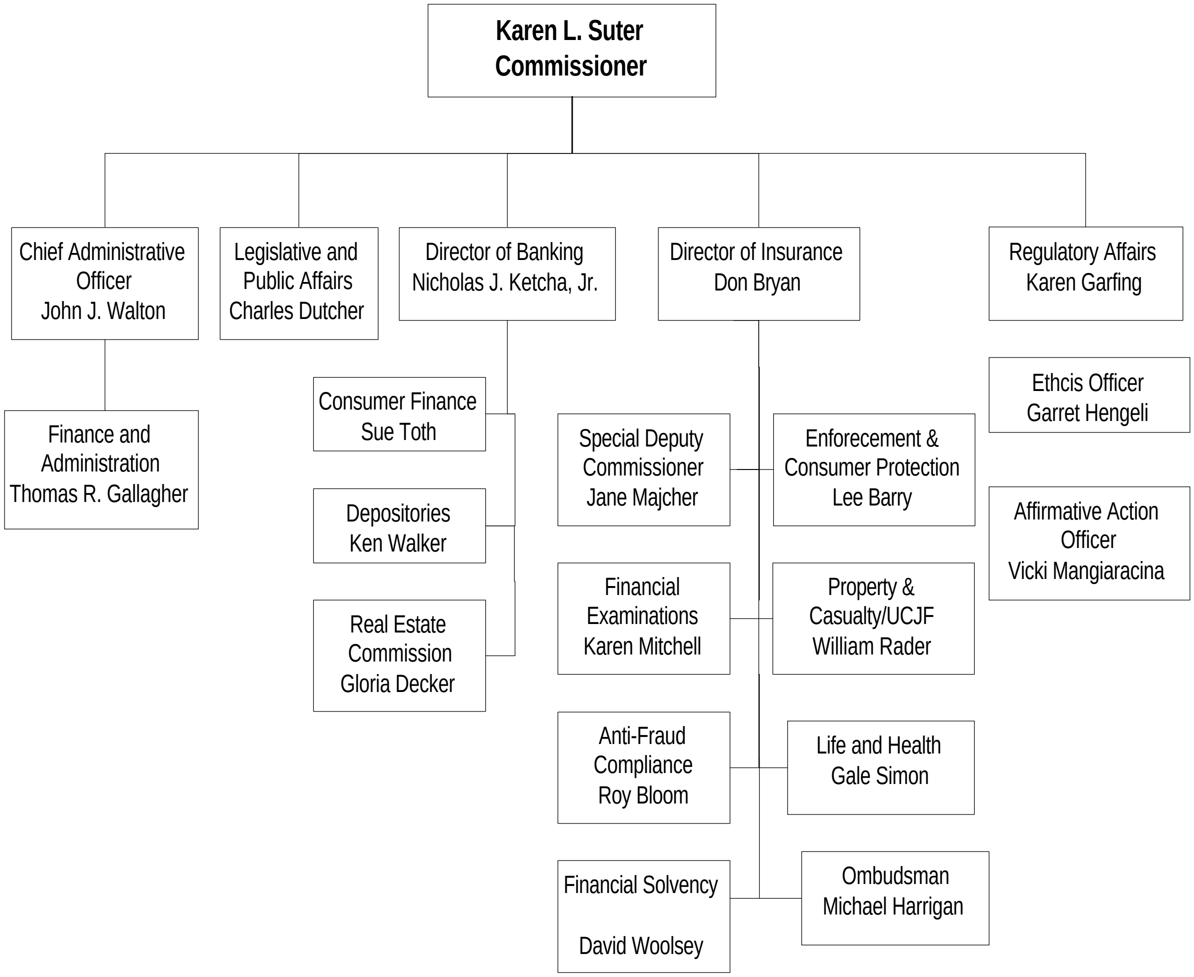
A continued Special Purpose appropriation of $600,000 for the Actuarial Services Unit, within the Division of Insurance, is recommended to support the revision of the current territorial rating plan, a part of the division's automobile insurance reform initiatives. The Automobile Insurance Territorial Rating Plan Advisory Commission, established within the division, is responsible for redrawing the 50-year-old territorial rating plan used to set automobile insurance premiums throughout the State.

The regulated industries fully fund the department. The proposed FY 2002 budget anticipates revenues for the department of $81.6 million, a decrease of $154,000 or .19 percent, over the current year's estimate of $81.7 million. These revenues include an estimated $15.6 million in revenues from the "Special Purpose Assessment" in FY 2002. Pursuant to P.L. 1995, c.156 (C.17:1C-19 et seq.), the Special Purpose Assessment consolidates certain insurance industry fees and charges to streamline the department's billing and collection process and to permit the department to charge insurers for all direct and indirect costs to the department.

Program Description and Overview (Cont'd)

Although appropriations for Insurance Fraud Prevention and Insurance Fraud Prosecution remain within the department's display in the Governor's proposed budget, these functions were transferred to the Office of the Insurance Fraud Prosecutor in the Department of Law and Public Safety. The appropriations remain within the department's display since the industry funds them through insurance assessments. The Department of Law and Public Safety will expend all but $2.2 million of the $28.2 million appropriated for this purpose. The Division of Insurance will utilize the remaining $2.2 million to fund the Anti-Fraud Compliance Unit within the Department of Banking and Insurance.

Organization Chart



Fiscal and Personnel Summary

AGENCY FUNDING BY SOURCE OF FUNDS ($000)

	Expended FY 2000	Adj. Approp. FY 2001	Recom. FY 2002	Percent Change 2000-02	Percent Change 2001-02
General Fund					
Direct State Services	$59,516	$63,256	$63,313	6.4%	0.1%
Grants-In-Aid	0	0	0	0.0%	0.0%
State Aid	0	0	0	0.0%	0.0%
Capital Construction	0	0	0	0.0%	0.0%
Debt Service	0	0	0	0.0%	0.0%
Sub-Total	$59,516	$63,256	$63,313	6.4%	0.1%
Property Tax Relief Fund					
Direct State Services	$0	$0	$0	0.0%	0.0%
Grants-In-Aid	0	0	0	0.0%	0.0%
State Aid	0	0	0	0.0%	0.0%
Sub-Total	$0	$0	$0	0.0%	0.0%
Casino Revenue Fund	$0	$0	$0	0.0%	0.0%
Casino Control Fund	$0	$0	$0	0.0%	0.0%
State Total	$59,516	$63,256	$63,313	6.4%	0.1%
Federal Funds	$0	$0	$0	0.0%	0.0%
Other Funds	$28,269	$37,630	$37,630	33.1%	0.0%
Grand Total	$87,785	$100,886	$100,943	15.0%	0.1%

PERSONNEL SUMMARY - POSITIONS BY FUNDING SOURCE

	Actual FY 2000	Revised FY 2001	Funded FY 2002	Percent Change 2000-02	Percent Change 2001-02
State	467	493	544	16.5%	10.3%
Federal	0	0	0	0.0%	0.0%
All Other	5	5	5	0.0%	0.0%
Total Positions	472	498	549	16.3%	10.2%

FY 2000 (as of December) and revised FY 2001 (as of September) personnel data reflect actual payroll counts. FY 2002 data reflect the number of positions funded.

AFFIRMATIVE ACTION DATA

Total Minority Percent	27.6%	26.1%	23.7%	----	----

Significant Changes/New Programs ($000)

Budget Item	Adj. Approp. FY 2001	Recomm. FY 2002	Dollar Change	Percent Change	Budget Page

ECONOMIC REGULATION

DIRECT STATE SERVICES

Budget Item	Adj. Approp. FY 2001	Recomm. FY 2002	Dollar Change	Percent Change	Budget Page
Salaries and Wages	$29,099	$29,156	$57	0.2%	D-34

This data displays the overall salary and wages account of the department. The salary and wage components are highlighted below.

Budget Item	Adj. Approp. FY 2001	Recomm. FY 2002	Dollar Change	Percent Change	Budget Page
Salaries and Wages: Licensing and Regulatory Affairs (100)	$2,422	$2,322	($100)	(4.1)%	D-34
Salaries and Wages: Licensing and Regulatory Affairs (101)	$8,609	$8,867	$258	3.0%	D-34

According to the Office of Management and Budget (OMB), the proposed increase of $258,000 for salaries and wages in the Financial Examinations Unit is offset by the decrease of $100,000 in the Division of Banking, representing administrative savings associated with the Summit/Fleet merger. The net effect is an additional $158,000 for five positions in the Financial Examinations Unit, intended to partially eliminate the dependence on outside consultants and reduce the costs assumed by the insurance companies.

Budget Item	Adj. Approp. FY 2001	Recomm. FY 2002	Dollar Change	Percent Change	Budget Page
Salaries and Wages: Actuarial Services	$4,189	$4,228	$39	0.9%	D-34

According to the Office of Management and Budget (OMB), the proposed increase of $39,000 is for a new position within the Division of Actuarial Services to accommodate the increased workload of the Health Bureau.

Budget Item	Adj. Approp. FY 2001	Recomm. FY 2002	Dollar Change	Percent Change	Budget Page
Salaries and Wages: Administration and Support Services	$730	$590	($140)	(19.2)%	D-34

According to the Office of Management and Budget (OMB),the proposed decrease of $140,000 represents the transfer of two employees from the Division of Banking to the Division of Insurance. According to the department, the Division of Insurance intends to utilize current vacancies within the division to fill these two positions.

Language Provisions

2001 Appropriations Handbook	2002 Budget Recommendations
	D-35
No comparable language.	Proceeds from the sale of credits by Pinelands Development Credit Bank pursuant to N.J.S.A.13:18A-34 et seq. shall be appropriated to the Pinelands Development Credit Bank for the same purposes.

Explanation

The Pinelands Development Credit Bank, establish pursuant to P.L.1985, c.310, is empowered to purchase and sell Pinelands development credits in accordance with the Comprehensive Management Plan in the Pinelands region. The intent of the program is to simplify both the preservation of resources of the Pinelands area and the accommodation of regional growth influences in an orderly fashion.

According to the Office of Management and Budget, the purpose of this language is to provide for the appropriation of proceeds from the sale of credits by the Pinelands Development Credit Bank. According to the department, there was no prior revenue source available for proceeds from the sale of credits by the Pinelands Development Credit Bank; therefore, this language allows the department to establish a revenue source account.

Discussion Points

1. The Governor's proposed budget recommends funding a total of 549 positions for the Department of Banking and Insurance. This proposal includes a net increase of 4 additional staff to support insurance actuarial services and examinations of financial institutions. Since the department currently has about 500 (State funded) filled full-time positions, the proposed FY 2002 budget would effectively provide funding for about 50 State funded, but currently vacant positions.

! *Question:* Please provide a detailed summary of how many new employees the department expects to hire, as well as where these employees will be allocated within the department and when it expects to fill these positions. Please specify what types of positions are needed throughout the department, such as actuaries, fraud investigators, real estate investigators and clerical staff.

How many positions does the recommended budget of the department support within other departments? For example, how many positions in the Department of Personnel under "Shared Service," or in the Department of Health and Senior Services under the "CHIME" program are recommended to be funded through the Department of Banking and Insurance?

2a. The Governor's budget proposal for FY 2002 continues a $600,000 appropriation for the Actuarial Services Unit within the Division of Insurance. The appropriation is recommended to support the revision of the current automobile insurance rating territorial plan, as a component of the division's automobile insurance reform initiatives, pursuant to the "Automobile Insurance Cost Reduction Act," P.L.1998, c.121, (AICRA).

The recommended funding is allocated for the hiring of actuarial consultants needed to review rate filings that will result from territorial redrawing. Historically, the Division of Insurance has experienced difficulty in hiring and retaining actuaries.

! *Question:* How many actuaries does the division currently have on staff? Please break down by unit. Please detail the division's efforts in hiring actuaries during FY 2001.

Since the level of actuarial salaries has contributed to the division's difficulty in hiring actuaries in the past, would the division recommend that the $600,000 appropriation be utilized to increase the level of staff actuarial salaries rather than for the hiring of consultants?

2b. In FY 2001, the budget allocated $165,000 to the Actuarial Services Unit for the hiring of four additional staff, two analysts and two interns.

! *Question:* Have the four staff been hired?

2c. In its response to last year's discussion points, the division indicated that in FY 2000 the department spent close to $325,000 for consulting actuaries.

! *Question:* What are the division's anticipated expenses for actuarial consultants in FY 2001? How many actuarial consultants does the division intend to utilize in FY 2002? Does the division anticipate this trend in using outside consultants to continue?

Discussion Points (Cont'd)

2d. As indicated by the department in response to one of last year's discussion points, consulting actuaries have been used primarily by the department in connection with insurer rate filing matters, to review the filing and testify at hearings, if required.

! *Question:* Please indicate the number of insurer rate filings currently pending? Please break down by type of property/casualty insurance (for example, home owners, automobile insurance, etc.). Is the $600,000 appropriation sufficient to adequately review those filings and accomplish the other responsibilities of the division?

3. The Automobile Insurance Territorial Rating Plan Advisory Commission, established by the "Automobile Insurance Cost Reduction Act" (AICRA), is responsible for redrawing the 50-year-old territorial rating plan used in determining automobile insurance premiums throughout the State.

! *Question:* Have the rules to establish standards for automobile insurance rating territories been completed? If not, what is the anticipated time frame for the Commission to complete its revision of the rating territories?

Does the department have sufficient actuarial and other staff to adequately review the territorial rating plans filed by insurers that choose to develop their own plan rather than use the plan developed by the Commission?

4. During FY 2000, new regulations provided for increased financial oversight of the managed health care industry by the department. Beginning in FY 2000, managed care entities were required to demonstrate their compliance with the regulations by submitting additional financial and other documents to the department for its review. As a result of its enhanced regulatory role, the department indicates that the workload in the Health Bureau has increased 10% due to the number of reviews of managed care contract forms. Therefore, the FY 2002 budget includes $39,000 for a new position within the Division of Actuarial Services to accommodate this increased workload.

! *Question:* How many reviews of managed care contract forms are currently pending? How many examinations were completed during FY 2001? How many examinations does the department anticipate for FY 2002? Please detail the procedure for reviewing such contract forms. Is one staff member enough to compensate for the Health Bureau's workload increase?

5. The Office of the Insurance Claims Ombudsman was established in 1998 by the "Automobile Insurance Cost Reduction Act" (AICRA) and charged with the responsibility to: investigate consumer complaints regarding insurance policies and the payment of claims; monitor the implementation of various insurance regulating laws; respond to consumer inquiries about policy provisions and coverage availability; and publish and disseminate buyers' guides and comparative rates.

The ombudsman must report annually to the Governor and the Legislature on significant insurance industry problems related to claims settlement practices and make recommendations for changes that will improve the State's ability to resolve claims and disputes.

! *Question:* Please detail how the $776,000 appropriation for the Ombudsman was allocated during FY 2001 and how the department anticipates the appropriation to be spent in FY 2002, including the number of staff. Please detail the Office's

Discussion Points (Cont'd)

accomplishments to date. Please provide the number of complaints and inquiries the Ombudsman's office has handled, including the disposition of those complaints.

6. The "New Jersey Insolvent Health Maintenance Organization Assistance Fund Act of 2000," P.L.2000, c.12, provides funds for health care providers with unpaid claims arising from the insolvencies of American Preferred Provider Plan (APPP) and HIP Health Plan of New Jersey (HIP-NJ). This act dedicates funds for the payment of allowed provider pre-rehabilitation claims only ($50 million from the tobacco settlement monies and $50 million from the health maintenance organizations doing business in New Jersey).

In addition, the act allows the commissioner to make an "interim distribution" from those funds while the claims of the providers are being reviewed for final payment. According to the Banking and Insurance Quarterly, Volume 1, No.1, Fall 2000 edition, $15.9 million (representing partial payments) has been paid to health care providers who are owed money as a result of the 1998 insolvencies of APPP and HIP-NJ. The department indicated that these monies are the first to have been disbursed under the authority of the act.

! *Question:* Please discuss the current status of the liquidation of both HIP and APPP, including the total number and amount of outstanding claims for both insolvent HMOs. How much money has been collected/received from the HMOs? Please indicate when these payments to providers were distributed. How long before the department anticipates another distribution? How much does the department anticipate to pay out in the next 2 years?

Please discuss the current status of all litigation filed by the department, with respect to the recovery of any assets of the two insolvent HMOs. What are the estimated costs, if any, associated with the litigation?

7. Prior to the merger of the Department of Banking and the Department of Insurance, the Department (now Division) of Banking published an annual report which contained comprehensive statistical information on financial institutions licensed by the State. Such information is no longer made available through the Department of Banking and Insurance's annual report.

! *Question:* Is the information provided elsewhere? If not, please provide the following information: the number of entities licensed under the Division of Banking, by type of license (and multiple authorities where appropriate) for the most recent year available and the same information for the one year period prior. For each license, please indicate the fee charged, the maximum fee currently permitted under the statute, and whether the license is annual or biennial.

8. As indicated in the FY 2002 budget request, the department currently relies on the use of consultants for routine regular condition financial examinations of financial institutions. The FY 2002 budget recommends $258,000 for five additional positions for the Financial Examinations of State Chartered Banks and Insurance Companies, in order to eliminate the dependence on outside consultants.

! *Question:* Please describe the duties performed by the department in connection with a routine regular condition financial examination. What are the anticipated specific duties and responsibilities, titles and salaries of the additional five new positions?

Discussion Points (Cont'd)

9a. New Jersey has seen a significant and continuous increase in the number of charters granted to new financial institutions in this State, including 27 new charters approved since 1994, with 3 additional applications approved, but the institutions have not yet opened and 2 applications currently pending.

! *Question:* Please provide a current breakdown of the total number of State charters, by type of financial institution (example: banks, savings banks, savings and loans). Please provide a breakdown of the number of new State charters, by type of financial institution, approved by the department in FY 2001. How many new charters does the department anticipate for FY 2002? Please specify by type of financial institution.

How has the number of new charters affected the workload of the Division of Banking?

How many financial institutions are State-chartered versus federally-chartered? Are there any financial institutions that are chartered by both the State and federal government? Please provide a list of those financial institutions, if any.

9b. According to the Banking and Insurance Quarterly, Volume 1, No. 1, Fall 2000 edition, the total number of State-chartered savings and loans declined from 15 to 12 between March 1999 and March 2000.

! *Question:* Please explain the reasons for the decline in the number of State-chartered savings and loans. Does the department anticipate this trend to continue? Does the department anticipate a decrease in the number of other State-chartered financial institutions? How has this decrease affected the department's workload?

9c. As with many industries, the banking industry has experienced a number of mergers and acquisitions. According to the Division of Banking, current through September, 2000, 7 bank mergers were accomplished in New Jersey in calendar year 2000, compared to 18 mergers in 1999, 12 in 1998, 8 in 1997, 18 in 1996, 11 in 1995, 10 each in 1994 and 1993, and 3 in 1992.

! *Question:* Please provide the number of mergers and acquisitions since September, 2000, by type of financial institution. With regard to the recent Summit/Fleet merger, does the department anticipate any similar mergers in FY 2002? How do such mergers and acquisitions, and the trend from State-charters to federal charters, affect the department's oversight responsibility?

10a. A provision of the "Financial Services Act of 1999," known as the Gramm-Leach-Bliley Act, authorizes the creation of the National Association of Registered Agents and Brokers (NARAB) to regulate insurance agents and brokers unless a majority of states enact uniform laws and regulations governing the licensure of insurance producers (agents and brokers), or a majority of states have entered reciprocal laws and regulations governing the licensure of nonresident producers, by November, 2002.

! *Question:* Does the department anticipate any necessary changes or modifications to the "New Jersey Insurance Producer Licensing Act," N.J.S.A.17:22-1 et seq. as a result of the enactment of this new federal law?

10b. Still other provisions of the federal act impose new regulations on both insurers and traditional financial institutions with respect to the privacy and use of non-public personal

Discussion Points (Cont'd)

information of consumers.

! *Question:* What role will the department have with respect to the issue of privacy of non public personal information of consumers of financial institutions and policyholders of insurers regulated by the State?

10c. According to the response to one of last year's discussion points, the department was looking at a possible alternative for the State charter system of financial institutions, as well as potential modifications of the powers granted to State-chartered financial institutions.

! *Question:* Please describe these alternatives and modifications, and the current status of these alternatives and modifications?

11. The National Association of Insurance Commissioners (NAIC) is an organization of insurance regulators from the 50 states, the District of Columbia and the four U.S. territories. The NAIC provides a forum for the development of uniform policy and support to the insurance commissioners. To be accredited by the NAIC, a state must have laws, regulations, practices and procedures similar to those deemed by regulators as necessary for effective solvency regulation. Under the NAIC program, each state is evaluated for compliance with those standards.

In the March 2001 edition of Governing magazine, the article, "The Riskiest Business," discusses various problems with state regulation of the insurance industry nationwide. According to the article, for the past year, state insurance commissioners have been working through the NAIC to modernize state systems, and in particular to allay the industry's discontent with the states' lack of uniformity on regulatory approaches.

Included in the article is a map of the United States that rates each state's level of compliance with the NAIC criteria for its "Uniform Regulations Through Technology" program, 2000. According to the map, New Jersey scored only 50 to 74 percent compliant with NAIC's criteria for the program.

! *Question:* Please provide a list of NAIC state standards. Please describe the NAIC's "Uniform Regulations Through Technology" program and the program's criteria for compliance. Since NAIC recently accredited the Department of Banking and Insurance, please indicate how New Jersey performed in other NAIC standards.

Background Paper: Automobile Insurance Urban Enterprise Zone Program

Purpose To encourage greater availability of automobile insurance in certain urban areas of this State.
Action Set the goal for all qualified insurers to achieve the same marketshare in the UEZs as they have in the remainder of the State.
Results Greater choice of automobile insurance alternatives for citizens living in UEZs. From 1997 to 1999, the number of insured vehicles in the UEZs increased 12 percent, compared to a 5 percent growth rate for the non-UEZ market.

P.L. 1997, c.151 (C. 17:33B-64 et al) created the Automobile Insurance Urban Enterprise Zone Program (C.17:33C-1 et seq.). The purpose of the legislation was to encourage greater availability of automobile insurance in certain urban areas of this State. The Commissioner of Banking and Insurance was directed to establish the following:

- Geographic areas to be considered automobile insurance urban enterprise zones (UEZs);
- Incentives to encourage qualified insurers to write automobile insurance business in designated urban enterprise zones;
- Regulatory standards for qualified insurers;
- Regulatory requirements that should be satisfied if a qualified insurer limits the number of exposures written by a UEZ agent; and
- Regulatory requirements of qualified insurers engaged on a direct writing basis.

As a result, the New Jersey Department of Banking and Insurance adopted N.J.A.C. 11:3-46 et seq., first on May 9, 1998 and revised on July 19, 1999.

To determine UEZ areas, the commissioner first identified those areas of the State that are urban as defined by the State Planning Commission and Census data. Then the commissioner examined marketshare and certain rating territories. The cities and towns designated as Automobile Insurance Urban Enterprise Zones are as follows:

Atlantic City
Belleville
Camden
Clifton
East Orange
Elizabeth
Garfield
Gloucester
Guttenberg
Hawthorne
Irvington
Jersey City
Little Falls
Newark
New Brunswick
North Bergen
Orange City
Passaic
Paterson
Perth Amboy
Plainfield
Trenton
Union City
Wallington
Weehawken
West New York
West Paterson

Background Paper: Automobile Insurance Urban Enterprise Zone Program (Cont'd)

Since establishing the Automobile Insurance UEZ Program, the continued responsibilities of the Department of Banking and Insurance are as follows:

- Setting the annual goal in terms of exposures (cars) each insurer must have in force in the UEZs;
- Analyzing the quarterly reports of how many vehicles are insured in the UEZs to see if insurers have met their goals; and
- Activating the assignment process, which is run by the Personal Automobile Insurance Plan (PAIP), when a company does not reach its goal.

In order to become a qualified insurer, an automobile insurer must demonstrate to the commissioner that it will conduct business in UEZ areas. This can be accomplished by increasing access to automobile insurance for consumers in a UEZ, assisting UEZ agents, and adjusting business practices in UEZs. The goal of a qualified insurer is to achieve the same marketshare in the UEZs as they have in the remainder of the State. This share is determined every year in November by the commissioner.

Qualified insurers are advised to increase access to automobile insurance for consumers residing in a UEZ through the following measures:

- Appointing UEZ agents and using existing agents to carry out new market initiatives;
- Assisting newly appointed UEZ agents in developing appropriate business skills and providing them with necessary support services;
- Monitoring and evaluating the impact of efforts to expand services to UEZ regions; and
- Providing materials designed to assist consumers in understanding automobile insurance coverage.

Once an insurer provides the necessary information to the commissioner proving its commitment to the UEZ Program, it may become a qualified insurer. Only qualified insurers are eligible to participate in the UEZ program. According to the Department of Banking and Insurance, all active insurers have submitted plans to become qualified UEZ insurers.

If a qualified insurer fails to attain its marketshare goal in UEZs, that insurer will have to accept distributions from the voluntary rating tier in PAIP to meet its UEZ share. UEZ agents who have met their contractual exposure limit and certain other designated producers can submit eligible risks from UEZs to the voluntary rating tier for coverage. From this pool, exposures are distributed to qualified insurers that have not met their UEZ marketshare goal. These qualified insurers must use their voluntary market rates for voluntary rating tier exposures. Additionally, the qualified insurers must pay a commission to those UEZ agents and producers who submitted these risks to the voluntary rating tier. The voluntary rating tier cannot provide insurance coverage for more than five percent of the total number of private passenger automobile non-fleet exposures being written in the State.

Besides the penalties associated with not fulfilling their quotas by receiving assignments from the voluntary rating tier, rewards are available for qualified insurers who exceed their UEZ goals. For every three exposures that an insurer writes above its UEZ goal, it receives one assigned risk credit. There is no limit on how many credits a qualified insurer can receive. These credits can be used against the distribution of high risk exposures (drivers with 9 or more automobile insurance eligibility points) by PAIP.

Background Paper: Automobile Insurance Urban Enterprise Zone Program (Cont'd)

UEZ agents may be appointed by a qualified insurer to represent it in an automobile insurance urban enterprise zone. A UEZ agent must maintain a bona fide office within that automobile insurance urban enterprise zone. A qualified insurer may limit the number of exposures written by a UEZ agent in the UEZ agent contract. An eligible person applying for automobile insurance coverage after the limit is reached shall be advised by the UEZ agent that coverage may be available from another agent or from a direct writer. A UEZ agent is a producer who:

- is duly licensed with property/casualty authority for the three years immediately preceding the effective date of P.L.1997, c.151 (C.17:33B-64 et al);
- has no affiliation with a voluntary market insurer for the placement of automobile insurance;
- had an affiliation with a voluntary market insurer for the placement of automobile insurance that was terminated by the insurer in the last three years;
- demonstrates to PAIP that he is competent, efficient and effective in the solicitation, negotiation and effectuation of automobile insurance as evidenced by any history of disciplinary actions or complaints against the producer, and other relevant factors; and
- conducts his business in an office in an automobile insurance urban enterprise zone.

A qualified insurer must give a UEZ agent at least 60 days' written notice of termination. A copy of the notice of termination shall also be sent to the commissioner. Qualified insurers have appointed 26 producer offices as UEZ agents since 1997. In addition, there are currently 183 Urban Zone Assigned Risk (UZAR) producers that do not represent an automobile insurer and work independently to provide insurance applications to PAIP.

In the two-year period from 1997 to 1999, the number of insured vehicles in the UEZs increased 12 percent, from 487,618 to 544,067. This is compared to a 5 percent growth rate for the non-UEZ market, from 3.9 million to 4.1 million insured vehicles. Some individual UEZs have seen much higher growth; for example, the number of insured vehicles in Newark has increased 28 percent. As of December 2000, the number of insured vehicles in UEZs surpassed 600,000.

Additionally, nine insurers fell short of their UEZ goals by nearly 30,000 vehicles in the year ending on September 30, 1998. By September 30, 1999, all but two insurers met their goals, and the shortfall of those two insurers was less than 1,200 vehicles.

Background Paper: State And Federal Efforts to Address Abusive or Predatory Lending Practices

Introduction

Predatory lending, which has become shorthand for describing a variety of lending practices that may be disadvantageous to borrowers, has received much media attention recently, heightening public awareness of this issue. Abusive or predatory lending - whether undertaken by creditors, mortgage brokers or home improvement contractors - may involve fraud or deception, manipulating borrowers through aggressive sales tactics or taking unfair advantage of a borrower's lack of understanding about loan terms. These practices occur most frequently in the subprime lending market and target lower-income and minority borrowers.

Currently, both federal and State law provide protections for consumers from predatory lending practices. However, as emphasized by both federal ands State regulators, enhanced consumer financial education is perhaps the most important tool in combating these practices. This paper highlights federal statutes and regulations designed to combat abusive and predatory lending practices and focuses on New Jersey's regulatory framework, which is more extensive than most other states. In addition, the paper identifies efforts by both the federal government and the Department of Banking and Insurance to promote increased consumer education as a means of preventing abusive or predatory practices and includes suggestions for future action by regulators.

The Subprime Lending Market

Subprime lending refers to financial institution programs that employ tailored marketing, underwriting standards and risk selection to make loans to borrowers who may not qualify for prime market loans. According to federal guidelines, the term subprime refers to the credit characteristics of individual borrowers who typically have weakened credit histories that include payment delinquencies and more severe problems such as charge-offs, judgments and bankruptcies. These borrowers may also display reduced repayment capacity as measured by credit scores, debt-to-income ratios or other criteria that may encompass borrowers with incomplete credit histories.

Federal statistics indicate that the expansion of the home mortgage market to a broader socioeconomic range of borrowers can be attributed to the development of the subprime mortgage market. The existence of the subprime market has given credit access to consumers who have difficulty in meeting the underwriting criteria of prime lenders because of their credit histories or other aspects of their profiles.

However, as recognized by the federal government, some forms of subprime lending may be abusive or predatory. Based upon recommendations of the HUD-Treasury National Predatory Lending Task Force, the *Expanded Guidance of Subprime Lending Programs* was jointly issued on January 31, 2001, by the Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation (FDIC) and Office of Thrift Supervision (OTS). It supports subprime lending that is appropriately underwritten, priced and administered with practices designed to responsibly service customers and enhance credit access for borrowers with special needs. At the same time it provides for the supervision of subprime lending activities and includes regulatory expectations for the review and treatment of certain potentially abusive or predatory lending practices.

Background Paper: State and Federal Efforts to Address Abusive or Predatory Lending Practices (Cont'd)

What is Predatory Lending?

According to federal and State financial regulators, the term predatory lending covers a potentially broad range of behavior and does not lend itself to a concise or comprehensive definition. However, based upon information gathered at hearings and seminars held at the State and federal levels of government, typically predatory lending involves at least one, and perhaps all three of the following elements:

- making unaffordable loans based on the assets of the borrower, rather than on the borrower's ability to repay an obligation (asset-based lending);
- inducing a borrower to refinance a loan repeatedly in order to charge high points and fees each time the loan is refinanced (loan flipping);
- engaging in fraud or deception to conceal the true nature of the loan obligation from an unsuspecting or unsophisticated borrower.

Some of these practices are clearly illegal and can be dealt with through effective enforcement of both federal and State law. However, other practices are more subtle, involving the misuse of practices that, when used for the borrower's benefit, can improve credit market efficiency.

For example, allowing for loan rates to rise above former usury law ceilings or **high-cost loans**, is generally desirable in that it matches relatively risky borrowers with appropriate lenders. At the same time, the payment implicit in very high interest rates can spell financial ruin for borrowers. In the majority of instances, **balloon payments** make it possible for young, first-time home buyers to purchase a home and match their mortgage payments with their rising income stream. On the other hand, balloon payments can ruin borrowers who do not have a rising income stream or who are unduly influenced by an immediate need for money. Again, most of the time, the ability to refinance mortgages permits borrowers to take advantage of lower mortgage rate, however, easy refinancing invites **loan flipping**, resulting in high loan fees and unnecessary credit costs. Often **credit life insurance** is desirable, but sometimes the insurance is unnecessary, and at times borrowers pay large up-front premiums as their loans are flipped. Generally **advertising** enhances information, but it can be deceptive. Most of the time, **disclosure** of mortgage terms is desirable, but sometimes disclosures are misleading, with key points hidden in the fine print.

Predatory lending entails either fraud or the misuse of these and other complex mortgage provisions that are generally desirable and advantageous to a borrower, but only when fully understood by the borrower.

Federal Efforts to Curtail Predatory Lending

The federal Home Ownership and Equity Protection Act (HOEPA) of 1994 amended and expanded certain provisions of the Truth in Lending Act (TILA). HOEPA bans certain practices with respect to high-cost mortgage loans made in the subprime market, namely: balloon payments in the first five years; prepayment penalties, and a pattern and practice of asset-based lending. Under HOEPA, lenders are required to provide a short disclosure to borrowers three days before a loan is closed and these loans are also subject to the normal three-day rescission period that pertains to other home equity loans.

The Federal Reserve Board is currently seeking to extend the coverage of HOEPA and its consumer protections through recently proposed revisions to its Regulation Z. Included in that

Background Paper: State and Federal Efforts to Address Abusive or Predatory Lending Practices (Cont'd)

proposal is the recommendation that a loan is subject to HOEPA protections if the annual percentage rate (APR) on a mortgage loan exceeds the Treasury rate on a bond of comparable maturity by more that eight percentage points, as opposed to the 10 percentage points in the current regulation. In addition, the proposal recommends that premiums on single-premium credit life insurance be included in the points and fees test, which serves to determine whether loans are subject to HOEPA protections.

The proposal also contains two provisions to reduce loan flipping. A creditor that holds a HOEPA loan would be prohibited from refinancing the original credit with another high-cost loan within 12 months of the origination and from refinancing certain zero-interest loans or other low-cost loans originated through mortgage assistance programs with higher-rate loans. Furthermore, the proposal attempts to stem the practice of making loans that are not based on the borrower's ability to repay an obligation (asset-based lending) by requiring lenders to document and verify a borrower's ability to repay HOEPA loans.

In addition to this proposal, the Federal Reserve Board has also recommended changes to its Regulation C, which implements the Home Mortgage Disclosure Act (HMDA). That law requires depository and certain for-profit non-depository institutions to collect, report and disclose data about applications for, origination of and purchases of home-mortgage and home-improvement loans. Denial rates can be inferred from this data. The three fundamental changes in this proposal would:

- increase the number of non-depository lenders required to submit data and extend HMDA coverage to very large nonbank (mortgage) lenders with relatively small percentages of mortgage loans in their portfolios;
- clarify and expand the types of reportable transactions to require the reporting of closed-end home improvement loans and open-end home equity lines of credit; and
- specify new loan elements to be included in the data, including the APR, whether the loan is subject to HOEPA and whether the loan involves a manufactured home.

Finally, as the Board of Governors of the Federal Reserve continues to emphasize, enhanced financial knowledge on the part of consumers with respect to their credit options and resources will be as effective a method to curtail predatory lending as any regulatory changes. The Federal Reserve System is currently engaged in numerous projects to promote community and consumer education and financial literacy. In the opinion of the Federal Reserve, a renewed focus on consumer education and financial literacy can provide the best defense against predatory lending.

Efforts of the Department of Banking and Insurance to Detect and Deter Abusive and Predatory Lending Practices

Predatory lending has received much media attention recently, heightening public awareness of this issue. It is important to note that unlike most other states, New Jersey has an extensive statutory and regulatory scheme in place designed to deter abusive and predatory lending practices. Of prime statutory importance is the New Jersey Licensed Lenders Act, P.L.1996, c.157 (C.17:11C-1 et seq.) which consolidated the provisions of three existing statutes regulating consumer lenders, secondary mortgage lenders and mortgage bankers and brokers. These types of lenders are active in the subprime lending market, and are subject to strict regulatory scrutiny by the Department of Banking and Insurance. The department conducts examinations of licensed lenders on a regular basis in order to review their lending practices.

Background Paper: State and Federal Efforts to Address Abusive or Predatory Lending Practices (Cont'd)

As part of its efforts to detect and deter predatory lending practices in this State, the department recently held a series of three public hearings on this issue. It was the department's intention to ascertain whether it had failed to detect predatory lending practices through its established examination process, even though examinations and filed complaints had not revealed a pervasive or sustained pattern. In response to testimony at those hearings concerning home repair contractors, the department formed a task force with the Division of Consumer Affairs in the Department of Law and Public Safety. The task force is currently investigating home repair contracting issues, including financing and the quality of repairs, for possible violations of New Jersey's consumer fraud laws. Such practices as false and misleading advertising, misrepresentation of financing terms and unacceptable or shoddy repair work are actionable offenses pursuant to the consumer fraud laws currently in place.

More recently, the Commissioner of Banking and Insurance outlined the department's consumer education efforts with respect to predatory lending practices at a public hearing held by the Senate Commerce Committee on February 8, 2001. As emphasized by both federal and State regulators, enhanced consumer financial education is perhaps the most important tool in combating abusive and predatory lending practices. As one of its initiatives, the department has produced a series of consumer pamphlets on a variety of lending-related topics, including obtaining a mortgage, protecting consumers from fraudulent financing schemes and scams along with detailed instructions on how to contact and file a complaint with the department.

For the past few years the department has focused on various efforts to increase consumer financial education and literacy, leading to the recent establishment of the full-time position of financial education officer. Under the direction of the financial education officer, the department has continued its initiative to promote financial education in the New Jersey school system. Working together with the Department of Education, the department has advocated having financial education adopted as part of the core curriculum and taught in classrooms throughout the State. As a component of this educational initiative, the department has forged a relationship with Rutgers University Cooperative Extension Service to develop teacher-training and classroom materials in the instruction of the fundamentals of financial education. It is the objective of both departments to encourage and facilitate the teaching of financial education. In addition, the department has also worked with several financial institutions to open bank branches in various schools to provide banking services to faculty and students, assist in training students for banking careers and provide hands-on financial education opportunities.

The department has also established the New Jersey Coalition for Financial Education, a group of governmental and private persons interested in the promotion of financial education for all consumers. Through the initiatives of the coalition and in cooperation with various financial institutions located in this State, departmental representatives regularly present financial education seminars to senior citizen groups at senior centers, senior residential communities and the 21 county offices on aging.

Suggestions for Future Action

As previously noted, the issue of abusive or predatory lending practices has received much recent attention from State and federal government regulators, consumer groups and the media. Although testimony has been offered during federal and State public hearings and forums investigating abusive lending practices, much of the information gathered has tended to be anecdotal in nature, with hard statistics and data largely unavailable. Moreover, certain restrictions on subprime lending that have been called for by certain organizations may have the undesirable

Background Paper: State and Federal Efforts to Address Abusive or Predatory Lending Practices (Cont'd)

result of further restricting lending to borrowers unable to access the prime lending markets because of certain credit characteristics.

In fashioning alternatives and developing constructive methods to curtail and eliminate abusive or predatory lending practices, State and federal regulators seek to balance the competing interests of creditors and borrowers. The federal government has proposed tightening certain existing lending regulations in order to curtail these practices. In addition, certain government agencies have stepped-up their consumer education and awareness efforts so that prospective borrowers are alerted to and can avoid these practices in the future.

In this State, the Department of Banking and Insurance has taken affirmative steps to determine the effectiveness of its regulatory efforts especially with respect to licensed lenders and subprime lending. In addition, the department is actively engaged in the education of consumers and potential borrowers of all backgrounds and ages on the subject of financial literacy. Eventually, through the efforts of both the federal and State governments in monitoring the subprime lending industry along with emphasizing consumer financial education and awareness, predatory and abusive practices should be significantly curtailed in the future.

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