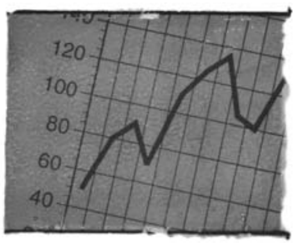

ANALYSIS OF THE NEW JERSEY BUDGET

DEPARTMENT OF BANKING AND INSURANCE

FISCAL YEAR 2006 - 2007

PREPARED BY OFFICE OF LEGISLATIVE SERVICES
NEW JERSEY LEGISLATURE • APRIL 2006

NEW JERSEY STATE LEGISLATURE

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This report was prepared by the Commerce, Labor and Industry Section of the Office of Legislative Services under the direction of the Legislative Budget and Finance Officer. The primary author was Sonya S. Davis. Richard T. Corbett was the primary author of the background paper entitled “Insurance Credit Scores as a Factor in Automobile Insurance Rates.”

Questions or comments may be directed to the OLS Commerce, Labor and Industry Section (Tel. 609-984-0445) or the Legislative Budget and Finance Office (Tel. 609-292-8030).

DEPARTMENT OF BANKING AND INSURANCE

Budget Pages....... C-11; C-18; D-23 to D-29; H-20; H-37

Fiscal Summary ($000)

	Expended FY 2005	Adjusted. Appropriation FY 2006	Recommended FY 2007	Percent Change 2006-07
State Budgeted	$64,386	$68,033	$67,965	(.1%)
Federal Funds	0	0	0	—
Other	432	896	896	—
Grand Total	$64,818	$68,929	$68,861	(.1%)

Personnel Summary - Positions By Funding Source

	Actual FY 2005	Revised FY 2006	Funded FY 2007	Percent Change 2006-07
State	4	3	4	33.3%
Federal	0	0	0	—
Other	495	498	501	.6%
Total Positions	499	501	505	.8%

FY 2005 (as of December) and revised FY 2006 (as of September) personnel data reflect actual payroll counts. FY 2007 data reflect the number of positions funded.

Key Points

- The department's recommended FY 2007 General Fund appropriation is $68.86 million, which represents a decrease of 0.1 percent, or $68,000 below, the FY 2006 adjusted appropriation.

- The department is recommended to receive an additional $1.8 million for the transfer of managed care regulatory responsibilities from the Department of Health and Senior Services. This increase is offset by decreases totaling $1.86 million in salary and other operating costs for attrition, elimination of funding for vacant positions, and reduced administrative overhead.

- The proposed FY 2007 budget anticipates revenues for the department of $121.9 million, an increase of $21.8 million, or 21.8 percent, over the current year's estimate of $100.1 million. This increase reflects the department's intention to impose by

Key Points (Cont'd)

regulation a $25 fee for appointments, terminations, and renewals of insurance producers pursuant to P.L. 2001, c.210. The fee increase for insurers is estimated to generate $18.3 million in additional revenue. $1.8 million of the $21.8 million revenue increase is predicated on the assumed passage of legislation that will impose fees on licensed lenders, pawn brokers, solicitors, and other money handlers.

- The Workers' Compensation Security Fund (WCSF), established pursuant to P.L. 2004, c.179, provides payment for individuals entitled to receive workers' compensation benefits when a stock or mutual workers' compensation insurer is determined insolvent. The WCSF is funded through assessments levied against stock insurance carriers writing workers' compensation business in the State. The WCSF year end FY 2006 balance is estimated to be $3.7 million., reflecting expenditures of $40 million. The FY 2007 budget (p.H-37) estimates the WCSF balance to be depleted by the end of FY 2007.

- The "Automobile Insurance Cost Reduction Act" (AICRA), P.L.1998, c.21 established the Office of Insurance Claims Ombudsman, which is charged with the responsibility to: investigate consumer complaints regarding automobile insurance policies and the payment 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. In FY 2004, the Office of the Insurance Ombudsman was re-organized by the department. The Governor's Budget shifts the $711,000 appropriation to the department's Consumer Protection Services and Solvency Regulation.

Background Paper:

Fiscal and Personnel Summary

AGENCY FUNDING BY SOURCE OF FUNDS ($000)

	Expended FY 2005	Adj. Approp. FY 2006	Recom. FY 2007	Percent Change 2005-07	Percent Change 2006-07
General Fund					
Direct State Services	$64,386	$68,033	$67,965	5.6%	(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	**$64,386**	**$68,033**	**$67,965**	**5.6%**	**(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	**$64,386**	**$68,033**	**$67,965**	**5.6%**	**(0.1%)**
Federal Funds	$0	$0	$0	0.0%	0.0%
Other Funds	$432	$896	$896	107.4%	0.0%
Grand Total	**$64,818**	**$68,929**	**$68,861**	**6.2%**	**(0.1%)**

PERSONNEL SUMMARY - POSITIONS BY FUNDING SOURCE

	Actual FY 2005	Revised FY 2006	Funded FY 2007	Percent Change 2005-07	Percent Change 2006-07
State	4	3	4	0.0%	33.3%
Federal	0	0	0	0.0%	0.0%
All Other	495	498	501	1.2%	0.6%
Total Positions	**$ 499**	**$ 501**	**$ 505**	**1.2%**	**0.8%**

FY 2005 (as of December) and revised FY 2006 (as of September) personnel data reflect actual payroll counts. FY 2007 data reflect the number of positions funded.

AFFIRMATIVE ACTION DATA

Total Minority Percent	30.0%	31.6%	33.2%	—	—

Significant Changes/New Programs ($000)

Budget Item	Adj. Approp. FY 2006	Recomm. FY 2007	Dollar Change	Percent Change	Budget Page

ECONOMIC REGULATION

ANTICIPATED REVENUE

Budget Item	Adj. Approp. FY 2006	Recomm. FY 2007	Dollar Change	Percent Change	Budget Page
Total Anticipated Revenue	**$100,141**	**$121,940**	**$21,799**	**21.8%**	**C-11**

According to the Office of Management and Budget (OMB), the increase in anticipated revenue is primarily due to a $25 fee for appointments, terminations, and renewals of insurance producers, to be imposed by regulation, pursuant to P.L.2001, c.210. This fee increase is estimated to generate $18.3 million in additional revenue. $1.8 million of the $21.8 million revenue increase is predicated on the assumed passage of legislation that will impose fees paid by licensed lenders, pawn brokers, solicitors, and other money handlers.

DIRECT STATE SERVICES

Budget Item	Adj. Approp. FY 2006	Recomm. FY 2007	Dollar Change	Percent Change	Budget Page
Total	**$68,033**	**$67,965**	**($ 68)**	**(.1%)**	**D-28**
Consumer Protection Services and Solvency Regulation	**$17,234**	**$17,880**	**$ 646**	**3.7%**	**D-27**
Actuarial Services	**$6,194**	**$6,344**	**$ 150**	**2.4%**	**D-27**
Regulation of the Real Estate Industry	**$3,151**	**$3,009**	**($ 142)**	**(4.5%)**	**D-27**
Public Affairs, Legislative and Regulatory Services	**$2,012**	**$1,971**	**($ 41)**	**(2.0%)**	**D-27**
Insurance Fraud Prevention	**$31,976**	**$31,747**	**($ 229)**	**(.7%)**	**D-27**
Supervision and Examination of Financial Institutions	**$3,547**	**$3,404**	**($ 143)**	**(4.0%)**	**D-27**
Administration and Support Services	**$3,919**	**$3,610**	**($ 309)**	**(7.9%)**	**D-28**

Significant Changes/New Programs ($000) (Cont'd)

The FY 2007 recommended budget anticipates a total decrease in Direct State Services funding of $68,000 or 0.1 percent below the FY 2006 adjusted appropriation. All decreases and increases represented above in Direct State Services are in the salaries and wages and services other than personal accounts. These decreases occur in all program classes, and result from attrition, elimination of funding for vacant positions, and reduced administrative overhead.

The increases for Consumer Protection Services and Solvency Regulation and related costs are the result of the transfer of $1.8 million for Office of Managed Care positions from the Department of Health and Senior Services to the Department of Banking and Insurance pursuant to Reorganization Plan No. 005-2005. A total of 21 positions were transferred to the department. However, for FY 2007, 18 positions will be funded. Three positions are estimated to be lost due to attrition. The transfer of $1.8 million for managed care is offset by department–wide decreases totaling $1.86 million.

Language Provisions

2006 Appropriations Handbook	2007 Budget Recommendations
p. B-13	p. D-29
In addition to the hereinabove, such other sums as the Director of the Division of Budget and Accounting shall determine, are appropriated from the assessments of the insurance industry pursuant to P.L. 1995, c.156 (C.17:1C-19 et seq.).	In addition to the **amounts appropriated** hereinabove, such other sums as the Director of the Division of Budget and Accounting shall determine, are appropriated from the assessments of the insurance industry pursuant to P.L. 1995, c.156 (C.17:1C-19 et seq.) **and from the assessments of the banking and consumer finance industries pursuant to P.L. 2005, c.199 (C.16:1C-33 et seq.) for the purpose of implementing the requirements of those statutes.**

Explanation

This new language is a result of passage of P.L.2005, c.199 which provides a dedicated funding mechanism for the Division of Banking, commencing in FY 2007, in the form of industry-wide assessments for costs of certain special functions undertaken by the division.

Discussion Points

1. In June, 2004, the "New Jersey Medical Care Access and Responsibility and Patients First Act" P.L. 2004, c.17, was enacted. That act provides for a comprehensive set of reforms affecting the State's tort liability system, health care system and medical malpractice liability insurance carriers. The goal of these reforms is to ensure that health care services continue to be available and accessible to residents of the State.

The act established the Medical Malpractice Liability Insurance Premium Assistance Fund (MMLIPA), the purpose of which is to provide medical malpractice liability insurance premium relief for certain health care providers in the State who have experienced or are experiencing a liability insurance premium increase. Eligibility for the relief is determined by the amount of the premium, which is established by the Commissioner of Banking and Insurance by regulation.

The MMLIPA fund is comprised of revenue from $3 annual surcharges paid on or by employees who are subject to the "unemployment compensation law" and $75 annual surcharges paid on the professional licenses of physicians, podiatrists, dentists, chiropractors, and attorneys, unless exempted under the law.

The act further provides that the fund, which will expire in July, 2007, be administered by the Department of Banking and Insurance. The act provides that in each of the three years of its operation, the MMLIPA fund shall distribute a total of $26.1 million annually, allocated as follows: $17 million for premium relief to eligible health care providers who have experienced or are experiencing a premium increase; $6.9 million for the Health Care Subsidy Fund; $1 million for a student loan expense reimbursement program for obstetricians/gynecologists who agree to practice in medically underserved areas of the State for a minimum of four years; and $1.2 million for the NJ FamilyCare program to enroll new mothers with income up to 100% of the federal poverty level whose postpartum eligibility for Medicaid has expired.

Pursuant to the department's Order #A05-122, issued on June 29, 2005, eligible specialties for 2004 premium relief subsidies included obstetrics/gynecology, neurosurgery, and diagnostic radiology. According to the Governor's Budget, the department distributed over $13 million to over 1,200 physicians in high-risk specialties. The revenue to the MMLIPA fund totaled $21.3 million in FY 2005. The Governor's Budget Recommendation estimates that the fund's resources will total $37.7 million in FY 2006 and $22.3 million in FY 2007.

- ***Question:*** **Please indicate the amount of projected revenue generated from the respective surcharges, by category, for FY 2006.**

  What is the average amount of premium relief subsidy per physician and the number of covered physicians by physician specialty? Does the department have any plans to study: (1) the effect of the premium relief subsidy on the retention of key medical specialties in the State; (2) whether additional specialties should be eligible for the subsidy; or (3) the state of the medical malpractice insurance market?

2. On June 30, 2005, Governor Richard Codey filed Reorganization Plan No. 005-2005 transferring the Office of Managed Care from the Department of Health and Senior Services to the Department of Banking and Insurance. According to the Governor's FY 2007 Budget, 21

Discussion Points (Cont'd)

managed care staff were transferred as a result of the reorganization resulting in an increase of $1.8 million in staffing costs.

- *Question:* **Please indicate if administrative efficiencies and cost savings have been achieved by the transfer of Office of Managed Care to the department. Will the department seek any further changes to streamline the regulation of health insurance?**

3. The Workers' Compensation Security Fund (WCSF), established pursuant to P.L. 2004, c.179, provides payment for individuals entitled to receive workers' compensation benefits when a stock or mutual workers' compensation insurer is determined insolvent. The WCSF is funded through assessments levied against stock insurance carriers writing workers' compensation business in the State. The WCSF year end FY 2006 balance is estimated to be $3.7 million., reflecting expenditures of $40 million. The FY 2007 budget (p.H-37) estimates the WCSF balance to be depleted by the end of FY 2007.

- *Question:* **Please provide an explanation for the level of spending anticipated for FY 2006 and an analysis of expected WCSF revenue and expenditures for FY 2007. Please include the amount estimated to be paid from the WCSF for claims in FY 2006 and FY 2007, the number of insolvent companies with outstanding claims, and the value of these claims. Given the $0 estimated fund balance for year end FY 2007, are current assessment levels sufficient to cover future possible insolvencies and resultant claims?**

4. Pursuant to P.L.2005, c.375, enacted on January 12, 2006, and effective May 12, 2006, certain health insurers are required to extend health insurance coverage to certain dependents up to 30 years of age. According to the department's bulletin No.06-06 the department is in the process of developing rules for implementing this new law. Carriers must develop rates for coverage for qualified eligible dependents prior to the effective date of May 12, 2006.

- *Question:* **Has the department experienced any problems in implementing the act? If so, how does the department plan to remedy the problems?**

5. The "Automobile Insurance Cost Reduction Act" (AICRA), P.L.1998, c.21 established the Office of Insurance Claims Ombudsman, which is charged with the responsibility to: investigate consumer complaints regarding automobile insurance policies and the payment 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. In FY 2004, the Office of the Insurance Ombudsman was re-organized by the department. The Governor's Budget shifts the $711,000 appropriation to the department's Consumer Protection Services and Solvency Regulation.

- *Question:* **Please detail how the $711,000 appropriation for the Ombudsman was allocated during FY 2006 and how the department anticipates the Ombudsman reallocation to the Consumer Protection Services and Solvency to be spent in FY 2007, including the number of staff. Please detail the Office's accomplishments to date. Please provide the number of complaints and inquiries the Ombudsman's office has handled, including the disposition of those complaints.**

Discussion Points (Cont'd)

6. P.L. 2005, c.195, enacted in August 2005, strengthens the enforcement powers of the Division of Banking over State-chartered banks, savings banks, and savings and loan associations. The new law provides the department with expanded regulatory authority which corresponds more closely to its federal counterparts.

- *Question:* **Please detail the department's progress in supervising financial institutions and protecting consumers as a result of the broader enforcement authority provided by P.L. 2005, c.195.**

7. Under P.L.1999, c.154, an advisory board comprised of representatives from the department and the Department of Health and Senior Services, health insurance carriers, health care providers, higher education, business, organized labor, and health care consumers, was established to ensure that the State was compliant with federal privacy laws concerning medical information and its electronic transmission. The advisory board, which is now based in the department and referred to as the HINT/HIPAA Task Force, has received nation-wide acclaim for effectively ensuring that the State was compliant with federal law. Under the authority of P.L.1999, c.154 and P.L.2005, c.352, the task force launched the "Electronic Health Records Health Policy Initiative" to develop policies and the infrastructure to implement the use of electronic health records in the private and public sectors of the State.

With the ultimate goal of having a fully digitized or "paperless" health care system, electronic health records hold the promise of reducing the rate of medical errors, eliminating unnecessary testing, and streamlining administration, all of which could lower the cost of health care.

- *Question:* **What is the progress to date of the task force? How many staff members are assigned to the task force? What kind of financial investment is needed from the State in order to support a paperless infrastructure? Assuming the goal of a paperless health care system is met, please estimate the cost savings to the State of a paperless system. Specifically, where would these cost savings be achieved?**

8. The FY 2007 Budget anticipates about $122 million in revenue from departmental assessments, fees, billings and other charges, an increase of approximately $22 million over revised FY 2006 estimates. The Budget recommends approximately $68 million for the department's operations, or about 56 percent of department revenues.

- *Question:* **Please explain why the department's revenues exceed appropriations by this extent. How frequently does the department examine its assessments and schedules for other fees and charges? What factors, other than the costs of executing departmental regulatory and oversight duties, are considered in establishing assessments, fees and other charges?**

Background Paper: Insurance Scoring: Credit Scores as a Factor in Automobile Insurance Rates

Introduction

Insurance scoring is a method of using certain aspects of consumer credit history to determine rates for automobile and homeowners insurance policies. This report will focus on the use of insurance scoring by private passenger automobile insurers in the State and the consumer protections that apply to this practice.

Insurance scores are calculated for insurers by outside vendors, using information from credit reports supplied by credit reporting bureaus. Some insurers use insurance scoring to rate their automobile insurance policies because they believe that an insurance score is one factor in predicting the likelihood that an insured will file insurance claims. Nationwide, some form of insurance scoring is permitted in over 40 states. According to one industry survey, 92 of the 100 largest auto insurers nationwide used some form of insurance scoring in 2001. In New Jersey, the Department of Banking and Insurance has only recently allowed private passenger automobile insurers to use insurance scoring, and only with certain consumer protections in place.

Background and Methodology

An insurance score (also known as a credit score) is a numeric rating, ranging generally from the lowest score of 150 to the highest score of 950, depending upon the system used by the company that provides the score. Insurers who use insurance scores view consumers with high scores as good risks and offer them the most favorable rates. Although insurance score methodologies vary, typically, a score above 720 is considered to be a good score; a score below 600 is considered to be a poor score.

An insurance score typically considers the following factors, as constructed from information from the consumer's credit report:

(1) payment history;
(2) length of credit history;
(3) new applications for credit;
(4) types of credit used; and
(5) amount of outstanding debt

Some insurers use insurance scoring to rate their automobile insurance policies because they believe that an insurance score is one factor in predicting the likelihood that an insured will file insurance claims. Based on their internal research and data provided by outside vendors, these insurers contend that there is a strong, statistical correlation between lower insurance scores and higher frequencies of filing automobile insurance claims. These insurers maintain that since credit scores are based on real data and statistics, they are more objective and reliable than other more subjective methods. Thus, they use insurance scores to more accurately price their policies, based on the likelihood of future claims, and accurate pricing benefits consumers generally. An insurance score is only one factor that some automobile insurers use to determine premiums; other factors include driving history, age, annual miles driven, and type of car.

Background Paper: Insurance Scoring: Credit Scores as a Factor in Automobile Insurance Rates (Cont'd)

Some consumer activists groups contend that a consumer's credit history should not be considered as a factor in setting automobile insurance rates and premiums because there is no causal relationship between credit history and driving ability. These groups claim that insurers simply allege a correlation, but do not fully explain how insurance scoring actually works, and do not publicly disclose the formulas used to calculate these scores. Further, consumer advocates contend that insurance scoring engenders an unintentional discrimination based on race, because minority policyholders have average insurance scores that are lower than non-minority policyholders.

Insurance Scoring in New Jersey

Generally, the federal "Fair Credit Reporting Act," 15 U.S.C. s.1681 et seq. provides a comprehensive framework for regulating credit reporting bureaus and their use of credit scores. The "New Jersey Fair Credit Reporting Act," P.L.1997, c.172 (C.56:11-28 et seq.), provides authority for credit reporting bureaus to provide credit history information for underwriting purposes, although that act does not specifically refer to or otherwise regulate the use of credit scores. See N.J.S.A. 56:11-31.

The Department of Banking and Insurance did not allow insurance scoring by insurers issuing policies in the State until 2003. According to the department's Bulletin No. 04-05, issued in April, 2004, in that year, the Department of Banking and Insurance permitted one company - Mercury Indemnity Company of America - to enter the State and use insurance scoring on a preliminary, trial basis.

After reviewing Mercury's experience of using insurance scoring in the State and the experiences of more than 40 states that already permit its use, the department allowed insurers to use insurance scoring as a factor in setting automobile insurance premiums - not to deny, cancel or non-renew a policy - only if the department approved the insurer's plan and the insurer maintains the consumer protections listed in the bulletin.

According to the department, to date, it has approved the use of some form of insurance scoring by 20 property/casualty insurers in New Jersey, provided that certain consumer protections are maintained. The department has indicated that the allowance of insurance scoring has created more options and provided more availability for New Jersey consumers through a more competitive marketplace.

As noted by Acting Commissioner Donald Bryan in his written testimony submitted at the FY2006 budget hearings, New Jersey allowed insurance scoring long after it had been allowed by many other states. As a result, New Jersey had the advantage of learning from the regulatory experiences of other states and developed a "best practices" approach reflected in the consumer protections listed in Bulletin No. 04-05.

Consumer Protections

The department's Bulletin No. 04-05 lists numerous consumer protections that insurers must maintain in their practices, if they use insurance scoring as one factor in determining rates. These requirements include, but are not limited to: disclosing to the department the statistical validation for its insurance scoring method; providing exceptions to rates for a consumer whose credit information has been directly influenced by certain extraordinary life

Background Paper: Insurance Scoring: Credit Scores as a Factor in Automobile Insurance Rates (Cont'd)

events; providing certain protections for people without credit history; and disclosing to consumers specific explanations for taking "adverse actions" based on negative information contained in a credit report. Further, insurance scoring may not be used in rating the special automobile insurance policy issued pursuant to N.J.S.A. 39:6A-3.3 (also known as a Dollar-A-Day policy) or the basic private passenger automobile insurance policy issued pursuant to N.J.S.A. 39:6A-3.2.

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Individuals wishing information and committee schedules on the FY 2007 budget are encouraged to contact:

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