NEW YORK STATE
INSURANCE DEPARTMENT

FIRST AMENDMENT TO REGULATION NO. 105
(11 NYCRR 166)

PART 166
TREATMENT OF EXCESS PROFITS IN MOTOR VEHICLE INSURANCE

SUBPART 166-1
GENERAL RULES

SUBPART 166-2
DISCUSSION OF GENERAL RULES

I, Gregory V. Serio, Superintendent of Insurance of the State of New York, pursuant to the authority granted by Sections 201, 301, 2323, and 2329 of the Insurance Law, do hereby promulgate the following First Amendment to Subparts 166-1 and 166-2 of Part 166 of Title 11 of the Official Compilation of Codes, Rules and Regulations of the State of New York (Regulation No. 105), to take effect upon publication in the State Register, to read as follows:

(Matter in brackets is deleted; new matter is underlined)

The statutory authority references for Part 166 are repealed and a new statutory authority is added to read as follows:

Insurance Law Sections 201, 301, 2323, and 2329

Section 166-1.0(a) of Subpart 166-1 is amended to read as follows:

(a) Section [677(5)] <u>2329</u> of the New York State Insurance Law, as amended by [chapter 501 of the Laws of 1974, chapter 9 of the Laws of 1977, chapter 498 of the Laws of 1979 and chapter 527 of the Laws of 1982] <u>Part I of chapter 105 of the Laws of 2002</u>, requires insurers to return to consumers any "excess profits" on automobile insurance written in New York State for the [10-year] period from January 1, 1974 through [December 31, 1983] <u>August 2, 2002</u>.

Section 166-1.4(b) of Subpart 166-1 is amended to read as follows:

(b) Section [178(3)] <u>2323</u> of the Insurance Law states that rates of return on net worth, assets and premiums earned shall be calculated. Section [677(5)] <u>2329</u> requires that an excess profit be defined in terms of return on [new] <u>net</u> worth.

Subdivisions (b) and (f) of Section 166-2.0 of Subpart 166-2 are amended to read as follows:

(b) No responsible regulator can ignore these events. The insurance business is affected with the public interest and must inform the public of what is happening to its funds. The department does not expect that implementation of section 677(5) (now section 2329) of the Insurance Law will end debate on the subject. This regulation presents a reasonably simple, practical, and conceptually defensible approach to the determination of excess profits which takes into account the interests of all concerned--consumers, insurers, regulators and investors.

(f) The department recognizes that carrying out the mandate of section 677(5) (now section 2329) is a unique and difficult task. The department's consultant, Professor C. Arthur Williams, who is also editor of the *Journal of Risks and Insurance*, prepared a report [2] entitled "Determining Excess Profit Refunds on New York State Automobile Insurance 1974-1982" (hereinafter cited as *Williams*). His final report reflects consideration of the comments and suggestions of consumers, specialists in insurance accounting, and others who presented their views at these hearings. Professor Williams' report represents a major advance in the measurement of insurer profitability. His approach, which uses all-industry data averaged over time, produces results which have few of the distortions present in earlier measures.

Subdivision (e) of Section 166-2.1 of Subpart 166-2 is amended to read as follows:

(e) Use of the discounted cash flow method has also been suggested to estimate a reasonable rate of return. It is extremely difficult to obtain representative data for this analysis; data submitted by the Consumer Protection Board in support of this approach (which has been used in public utility regulation) were based on nine stock insurers, two of which do not write automobile business in New York. The method analyzes insurers' dividend patterns and retained earnings countrywide for all lines in order to estimate a reasonable rate of return. No reflection of the underwriting results of New York's automobile business is included. This deficiency appears to invalidate the approach, since one intent of the statute is to provide a safeguard in the event that unusual occurrences, such as a no-fault law or other legislative enactment, would produce windfall profits in New York. The department notes that much of the difficulty of implementing section 677(5) (now section 2329) arises from the requirement that a "by line, by state" analysis be made, although many of the components are, by their nature, companywide quantities. Additionally, there is no methodology for selecting an excess profit above the reasonable point, as the law requires. While there is much to admire in the work of public utility regulators, their approach is not generally applicable to the task before the department, largely because of the differing competitive nature of the industries.

Subdivision (a) of Section 166-2.5 of Subpart 166-2 is amended to read as follows:

(a) Section 677(5) (now section 2329) of the Insurance Law specifies that an excess profit shall be "so far above a reasonable profit as to amount to an excess profit". It is exceedingly difficult to quantify this concept. The department has followed the general approach of its consultant's statistical analysis and, largely on a judgment basis, has modified the excess profit threshold of 22.4 percent that was recommended by Professor Williams.

Subdivision (c) of Section 166-2.6 of Subpart 166-2 is amended to read as follows:

(c) Investment income and capital gains are now the major contributors to overall insurer profitability. Section 677(5)(now section 2329) of the Insurance Law permits the use of uniform assumptions when reasonable, and the department concurs with Professor Williams' use of industrywide all-lines investment results in profitability measurement. It is not the intention of the statute to reward or punish individual insurers for their differences in investment strategy, financial structure or good fortune.[7] Likewise, industrywide premium-to-surplus ratios and taxes are used. New York's industrywide automobile underwriting results are included in Professor Williams' formula, since individual-insurer results are excessively volatile and would produce rates of return which would not be credible.