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Out on a Limb

New Jersey recently established the Territorial Rating Equalization Exchange, also known as TREE. Could it be the answer to affordable auto insurance in the Garden State?

by Robert Aldorisio

▶ **The Background:** New Jersey has struggled to make auto insurance affordable and available.

▶ **What Happened:** Lawmakers established the Territorial Rating Equalization Exchange to ensure that auto insurers write policies in high-cost areas.

▶ **Watch For:** New Jersey to finish developing TREE.

New Jersey has wrestled with the high cost of automobile insurance for more than 30 years. Still, the true cost of insuring vehicles remains extremely high in the most congested areas, where losses tend to be higher and more frequent. These costs are beyond the means of many drivers, and until recently, this business environment has driven many insurers out of the Garden State's market.

New Jersey considered auto insurance a public policy issue. Given that automobile insurance is mandatory in New Jersey, if an individual who needs a car to get to work cannot afford the insurance, then he or she has only two choices: Drive illegally without insurance or quit that job and find one closer to home that would not require driving. Either of these scenarios is considered unacceptable and the state has long sought to mitigate this problem.

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A Brief History

Legislators and regulators have tried various mechanisms over the years to hold down premium costs and increase availability in high-cost areas, including:

- Suppression of the overall statewide rate levels
- Artificial rate caps in certain territories
- Take-all-comers provisions

The Territorial Rating Equalization Exchange

TREE was established by the N.J. Legislature to ensure certain reforms—lifting the cap on rates in cities, requiring insurers to take all comers, creating new territories—would not lead to problems in the urban auto insurance market. Insurers that provide coverage in specific geographic areas would be compensated from a pool of money (territorial equalization charge) collected from all insurers writing auto insurance in the state.

A TREE Governing Committee has been appointed to:

- Determine ZIP codes where insurance companies would be eligible to receive an equalization reimbursement
- Calculate the territorial equalization charge that member companies would pay TREE
- Calculate the territorial equalization reimbursement for companies that write business in the designated ZIP codes

The following insurers are represented on the TREE Governing Committee:

Selective	New Jersey Manufacturers
Progressive	High Point
Travelers	Allstate
AIG	Skylands

Sources: State of New Jersey Department of Banking and Insurance; Insurance Information Institute

• Establishment of Urban Enterprise Zones

These steps, which tend to interfere with the free market for auto insurance, caused numerous problems for insurers. Until the past few years, insurers lost a lot of money in New Jersey. Many left the state, few if any entered, companies remaining did all they could to avoid writing underpriced risks in the high-cost areas, and insureds in lower-cost areas were forced to subsidize risks in the higher-cost areas.

Insurers have long argued that true rate competition would bring overall premium levels down (although it may not do much about the affordability problem in some areas), but the numerous financial and administrative burdens imposed by the New Jersey system made that practically impossible.

In the late 1990s, the state began changing the laws to start addressing some of the underlying costs of the system. While this was a step in the right direction, some of the other changes they made—such as a mandatory 15% rate reduction—were enough to drive more companies out of the state. When State Farm and AIG announced they would no longer write in the state, it was clear the system was at the brink of collapse.

This finally prompted New Jersey to create a more realistic and predictable rate-setting process. Not long after the 2003 reforms, profits improved. In the past few years, several new companies (including large insurers such as Geico and Progressive) began writing in the state. The increased competition has had a favorable impact on the average premium, which actually has decreased a bit in recent years.

Among the reforms that may go into effect in late 2008 or 2009 are requirements to:

- Completely redraw the territory map for the state
- Eliminate take-all-comers provisions
- Phase out artificial territorial rate caps over time

The insurance industry looks upon these reforms as good things, yet even with the significantly improved level of rate competition in the state, regulators and legislators remain concerned about affordability. They worry that once the dust settles on all of these reforms, there still could be areas within the state where the cost of insurance will still be unaffordable.

TREE in the Garden State

To address the affordability issue, New Jersey has established an entity named the Territorial Rating Equalization Exchange.

The TREE system would allow insurers to charge whatever premium they consider to be reasonable in each territory, subject both to prior approval and to competition. Once implemented, within certain designated TREE ZIP codes, insureds would be charged the insurer's filed rate minus a TREE subsidy, for which TREE would reimburse the insurer.

While the details of the TREE mechanics have not yet been worked out, the money to fund these subsidies likely would come from a specific TREE surcharge on every auto policy in the state, collected by insurers and passed along directly to TREE.

The advantages to this system compared to the old system of artificially suppressed rates include:

- Insurers would receive the full amount of their filed premiums
- Insureds would pay less than the filed premium
- The amount of the subsidy could be explicitly quantified

With this system in place, insurers would have little or no reason to avoid writing in high-cost areas. Together with the increased level of competition that now exists in the state, TREE should make insurance in the high-cost areas more available than ever before because it tackles the affordability issue that has ailed the state for so long.

Under TREE, the price to the insureds in these high-cost areas would be subsidized and therefore more affordable. While this may not provide an incentive to write in these areas, it at least would level the playing field.

Such a system appears to be unique in the insurance world. It is an interesting and innovative strategy to address affordability and availability issues without placing the entire burden on the insurers.

Insurers view this system as an improvement over the old system, but they do not consider it optimal—nor, indeed, even necessary. Insurers believe there are better ways to deal with affordability, including reforming the no-fault law to reduce costs, or increasing fraud prevention activities in high-cost areas.

They also argue that TREE should not be implemented until all reforms are in place and it becomes clear whether an affordability issue exists at all. If it does, insurers believe the state should handle the problem directly and take it entirely out of the hands of the insurers.

At this time, TREE is far from being implemented. While the commissioner has recently approved a plan of operation, few if any details of how it would work have been determined, and it will be some time—at least several months—before it could start to take shape. While TREE exists as an entity, it is possible that its provisions will never actually be implemented.

Still, New Jersey has shown a willingness to try something different and work with the insurance industry to address affordability without putting it entirely on companies' backs. For that, the state deserves credit. BR

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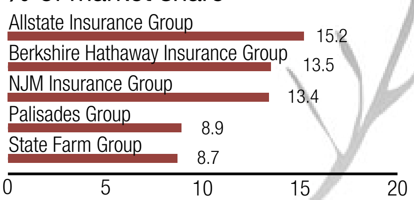
% of market share



Source: Best's State/Line Database