

the state of the market at that time are sufficiently improved, SFI may choose to remain in New Jersey. If at that time it chooses to complete winding down its business in New Jersey, then its exit would be conducted in an orderly manner according to the terms and conditions provided in this Order.

This Order helps ensure that SFI will have the resources to fulfill all of its obligations to its policyholders by strengthening its financial condition, and provides an opportunity for many of its policyholders and agents to continue their relationship in the future.

PROCEDURAL HISTORY AND BACKGROUND

SFI is an Illinois stock property and casualty insurer incorporated on January 18, 1991 under the laws of the State of Illinois. SFI received a certificate of authority from the Illinois Department of Insurance on March 9, 1991 and was admitted in New Jersey to write automobile insurance on April 2, 1992. SFI is not licensed to write insurance in any state other than Illinois and New Jersey. It has not written insurance in any state other than New Jersey and has no in-force business except New Jersey automobile insurance. SFI is wholly owned by State Farm Mutual Automobile Insurance Company (“State Farm Mutual”), a mutual property/casualty insurer domiciled in the State of Illinois. State Farm Mutual was admitted to transact the business of insurance in New Jersey on December 30, 1940 and withdrew from New Jersey pursuant to Order A92-165, dated April 8, 1992. SFI served as the replacement carrier in State Farm Mutual’s withdrawal regarding its automobile insurance business.

In addition, SFI has two other affiliates admitted to transact the business of property and casualty insurance in New Jersey, both of which are wholly-owned subsidiaries of State Farm Mutual: State Farm Fire and Casualty Company, an Illinois domestic stock property and casualty

insurer admitted on December 31, 1940; and State Farm General Insurance Company, an Illinois domestic stock property and casualty insurer, admitted on December 26, 1962.

SFI also has two affiliates admitted to transact the business of life insurance in New Jersey: State Farm Life Insurance Company, an Illinois domestic stock life insurer, admitted on April 13, 1955, which is wholly-owned by State Farm Mutual; and State Farm Annuity and Life Insurance Company, an Illinois domestic stock life insurer, admitted on December 31, 1982, which is wholly-owned by State Farm Life Insurance Company.

Since the time it was admitted, SFI's private passenger automobile insurance business has grown substantially from the 551,485 insured automobiles as of June 30, 1993 to 811,670 insured automobiles as of December 31, 2000.¹ As of December 31, 2001, SFI was the largest private passenger automobile insurer in the State with approximately 16 percent of the total market.

SFI has experienced a deterioration in its financial condition since 1998. As of December 31, 1998, the Company's surplus was approximately \$445 million, with net direct written premium of approximately \$885 million. In 1999 and 2000, SFI made increases of \$180 million for prior year loss and loss adjustment expense reserves and, as of December 31, 2000, SFI's surplus had dropped to \$283 million, with direct written premium of approximately \$846 million.

In October, 2000, SFI filed an application for a prior approval rate increase, as well as other changes to its rating system; and in December, 2000, SFI applied for relief from its obligation to provide coverage to all eligible persons pursuant to N.J.S.A. 17:33B-15 and N.J.A.C.11:2-35, as well as other relief. The Commissioner approved changes to SFI's tier rating system effective January 8, 2001, and granted relief from the Company's obligation to issue new coverage to eligible persons, accept assigned risks, and meet urban enterprise zone quotas by Order No. A01-120, issued April 6, 2001, and extended by Order No. A01-170. Nevertheless,

SFI's financial condition continued to deteriorate through 2001. The Company reported that surplus as of December 31, 2001 dropped another \$76 million to \$207 million, a decline of over 53% since 1998.

Changes in SFI's private passenger automobile insurance rates, as well as other rating system changes effective in January 2002, were approved in recognition of the financial condition of the company. On January 18, 2002, the Commissioner approved an expedited rate change for SFI's private passenger automobile insurance effective March 15, 2002 due to clearly demonstrated rate need.

Since the issuance of Order A01-120 that provided relief from writing new business, SFI's in-force private passenger automobile insurance exposures declined to 760,916 as of December 31, 2001, because of lapses and other voluntary terminations by SFI's policyholders, as well as by terminations otherwise permitted by New Jersey law.

Nevertheless, SFI's financial condition continued to deteriorate in that its net written premium to surplus ratio currently is 4.0 to 1.0; and it continues to exceed other benchmarks for measuring financial condition, as established by the New Jersey and Illinois Departments reflecting guidelines established by the National Association of Insurance Commissioners, including Risk Based Capital standards under N.J.A.C. 11:2-39.

On June 13, 2001, SFI filed a plan with the Department to cease all automobile insurance operations in New Jersey, pursuant to N.J.S.A.17:33B-30 and N.J.A.C.11:2-29, as well as supplemental materials filed on August 13, 2001 (hereinafter, collectively the "Filing"). In the Filing, SFI requested a waiver from any requirement that its property and casualty insurance affiliates surrender their New Jersey licenses, and a waiver of the requirement for certain special deposits as set forth in N.J.A.C. 11:2-29.3(b)5. The Department requested additional information

from SFI regarding the Filing, and the Company responded to all such requests. The Filing was deemed complete as of January 18, 2002.

In the Filing, SFI projected that, assuming no changes in its rate structure, its surplus would decline to \$122 million by year-end 2002, resulting in a premium-to-surplus ratio of 6.9 to 1. SFI further projected that absent immediate action, its surplus would further decline to \$29 million by year-end 2003, which would subject it to mandatory rehabilitation by its Illinois regulator under Risk Based Capital Mandatory Control Level rules.

Because of its financial condition and the harm that would result to its policyholders and the New Jersey automobile insurance market as a whole if the Company became insolvent, SFI proposed the following timetable in its Filing for non-renewal of its policies: non-renewal of policies would commence on January 1, 2003, and would continue on a rolling basis as each policy reached its first expiration date in 2003. Because approximately 98 percent of SFI's policies are six-month policies, the proposed plan would have resulted in the termination of nearly all policies by June 30, 2003.

SFI also stated in the Filing that it has been seeking, and will continue to seek, to place its business with a replacement carrier or carriers. Further, SFI stated in the Filing that it will continue to serve existing policies during the non-renewal period, and will continue claims and other related operations into the future as necessary to resolve open claims. The Filing also included transitional provisions to address any resulting dislocations for agents and employees.

Although the financial projections provided by SFI in its filing were understandable at the time, more recent analysis in light of changing circumstances and Department actions, indicates that the financial decline of the Company has moderated: its surplus declined \$4.2 million in the first quarter of 2002 compared to \$17.6 million in the first quarter of 2001. Although stabilization

has not yet been achieved, SFI's current condition provides an opportunity for terms and conditions that better protect SFI policyholders, agents, employees and the market than the hasty exit plan originally proposed by the Company.

DECISION

The State Farm organization, either through SFI or affiliated companies, has been an integral part of the insurance market in New Jersey for over 60 years. The loss of a major insurer such as SFI would create significant disruption to the market and have an adverse impact on all consumers. Not only is SFI a major insurer, it is a significant employer of New Jersey citizens and substantially contributes to the economy of the State and to the community in general. The State Farm organization employs about 2,500 New Jersey citizens who work at 43 offices throughout the State. Additionally, it markets its products through 187 New Jersey agents, who themselves employ another 672 people in their offices. Its employees and agency workforce have ties to their communities that make them an important part of the economic and social fabric of New Jersey. Notwithstanding its importance and contributions, the needs or concerns of any single insurer cannot determine the course of the Department's obligation to regulate the market in the interest of New Jersey's citizens.

SFI's Filing is complete and the Company has provided the Department with all information necessary to issue this Order. Accordingly, the Commissioner is obligated by statute and regulation to approve a plan subject to the terms and conditions she deems appropriate. The terms and conditions of this Order are directed at protecting the interests of New Jersey consumers and preserving the stability of the New Jersey auto insurance market. If the provisions of this

Order provide a sound basis for SFI to reconsider its decision, then the State of New Jersey will be well served.

The non-renewal of nearly 800,000 insured vehicles over a one-year period, as originally proposed by SFI, would significantly disrupt the New Jersey private passenger automobile insurance market. For this reason alone, SFI's Filing cannot be approved as filed. Beyond the direct disruption and dislocation to a significant number of policyholders, the absorption of such a large number of automobile insurance policies over such a short period of time would adversely affect the New Jersey automobile insurance market, and other insurers' ability to adequately service their existing business as well as the increase in business resulting from the influx of such a large number of additional insureds. This could result in even further market disruption and dislocation. More importantly, it is consistent with the obligations of the Commissioner to the citizens of New Jersey to address the underlying cause of the Company's financial circumstances and the basis for its application before simply approving its exit from the market.

The regulation of auto insurance has been problematic for many years in New Jersey. It presents challenges to consumers, regulators, and insurers alike. Many of the problems facing the market are incidental to characteristics of the State, such as dense population, traffic congestion, and high cost of living. Others are more enigmatic and may be the unintended result of the confluence of various regulatory initiatives and market conditions. The insurance marketplace is dynamic and its regulation must be reviewed and renewed on a continual basis. Many of the existing regulations, while important and necessary when created, may or may not continue to serve a significant purpose as the market and the needs of consumers change. Because of these realities, the Commissioner has undertaken a comprehensive review of the auto insurance system.

On March 11, 2002, the Commissioner formed an Automobile Insurance Working Group to examine New Jersey's auto insurance system and propose improvements. The Working Group includes consumer advocates, medical providers, attorneys, and insurance industry representatives. The Commissioner charged the group with developing ideas that, if implemented, would attract new insurance companies to New Jersey and improve the auto insurance system for citizens. The Commissioner's goal is to develop a healthy and competitive market that will not be disturbed by the decisions of a single insurer.

An analysis of what brought SFI to its present circumstances, and the business decisions it has made in response, underscores the need to re-examine our regulatory system and identify what might be required to develop a market that better serves the interests of consumers. First, SFI's fundamental financial problem is that, at present, it has insufficient capital/surplus to properly support the auto insurance business it writes. Ironically, during the years 1997 and 1998, SFI returned to policyholders almost \$70 million computed pursuant to our excess profits law. Reserve adjustments required in 1999 and 2000 demonstrated there were no "excess profits" during those years, and the capital needed to support the Company's business was unnecessarily depleted. Secondly, when SFI sought to address the financial problems it was facing, the regulatory system hampered its ability to respond prudently, as it might do elsewhere. Its growth continued unabated at twice the rate of the overall market because of its obligation to provide coverage to all eligible persons that applied, and relief was denied and delayed until its financial condition became unstable. Finally, a decision on SFI's request for rate relief took more than a year to be issued, while the Company's financial condition deteriorated further.

Regardless of the events that led to the Filing, the Commissioner's present obligations to the citizens of New Jersey require her to address the terms and conditions of SFI's withdrawal in a

manner that serves the interests of consumers, policyholders, claimants and SFI. To the extent that future regulatory changes facilitate a healthy SFI, the withdrawal must be pursued in a manner that gives those changes an opportunity to work and protects the consumers from unnecessary disruption. For these reasons, the Commissioner is approving this Market Stabilization Order to provide needed stabilization of SFI, while also assuring that SFI fairly considers the impact of any regulatory changes on the Company and its decision to withdraw from the market.

In developing this Order, the Commissioner has worked cooperatively with the Illinois Department of Insurance to take such action as is necessary to stabilize the financial condition of SFI. Given that the Illinois Department is the primary regulator of SFI for purposes of solvency, it is necessary that both Departments develop comprehensive solutions to the matters before them. Similarly, the New Jersey Department is the primary regulator of SFI for purposes of its service to policyholders generally, and with regard to its planned withdrawal in particular. The Illinois and New Jersey Departments have consulted extensively in order to develop a plan that harmonizes the obligations of each, while protecting the interests of policyholders, agents, and employees. The Commissioner gratefully acknowledges the efforts of Illinois Director Nathaniel Shapo and his staff in developing the plan embodied in this Order.

As noted above, SFI has grown significantly in recent years, growth that was too rapid for the Company's resources. Although the Department's grant of relief to SFI from its statutory obligation to accept all eligible persons helped reverse that growth, the Company continues to insure too many vehicles for the surplus available. It is therefore necessary to further reduce the Company's book of business. Toward that end, Phase I of this Market Stabilization Order recognizes the Corrective Order issued by the Illinois Department of Insurance, which directs the Company to nonrenew a limited number of policies in order to bring the number of vehicles

insured in line with the Company's surplus. These nonrenewals will take place at a measured rate over the course of approximately the next two years. This will provide the affected policyholders with adequate opportunity to obtain alternate coverage, while also allowing the market to safely absorb these policies.

It is projected that at the end of Phase I, SFI's financial condition will largely stabilize, although it will not have fully recovered. During Phase II, through the end of 2005, existing business will be renewed with the exception of nonrenewals that occur in the ordinary course of business. For the period of Phase II, it is expected that the downsizing of SFI will coincide with the stabilization of the market in general, having absorbed the nonrenewal of a portion of SFI's business. Further, by that time regulatory reforms developed from the suggestions of the Working Group, as well as other regulatory changes, will have become operational with an opportunity to assess their effectiveness.

Following this Market Stabilization period, Phase III will provide a basis for SFI to remain in New Jersey or to wind down its business in an orderly manner over two to three years, according to the terms and conditions set forth herein. If the Company's financial condition recovers as expected, SFI shall reconsider whether to complete its withdrawal based on its analysis of the circumstances at the time. The Commissioner may also provide SFI's management and Board of Directors with the Department's analysis of the market and the prospects for the Company should it choose to remain in New Jersey. In the event that SFI ultimately elects to complete its withdrawal, it will continue to seek a replacement carrier or carriers for an additional year in order to promote a smoother transition for its policyholders before proceeding to wind down its business over two years.

SFI has been seeking a replacement carrier or carriers to take some or all of its business since the filing of its plan. The potential for locating a suitable replacement carrier will be substantially enhanced by improving SFI's financial condition and restoring its book of business to profitability. If it decides to complete its withdrawal, SFI must release those agents who elect to continue as automobile insurance producers from the exclusivity portion of their agency contracts, allowing them to enter into relationships with other insurers to continue to service their auto insurance business.

In consideration of the foregoing, the SFI Filing is subject to the terms and conditions set forth in the Order below.

ORDER

THEREFORE, pursuant to N.J.S.A. 17:1-15, 17:33B-30, and 39:6A-1, et seq, and N.J.A.C.11:2-29; and upon consideration of the Filing,

IT IS on this 25th day of June 2002 ORDERED that:

PHASE I FINANCIAL STABILIZATION

1. In order to address SFI's financial instability, a Corrective Order was issued by the Director of the Illinois Department of Insurance. Under the Illinois Corrective Order, SFI shall nonrenew a limited portion of its existing New Jersey voluntary private passenger automobile insurance business, beginning with policies scheduled for renewal on and after July 1, 2002, or as soon thereafter as practical, in the following manner:

A. SFI shall identify a pool of policies, as of May 31, 2002, first written by a State Farm company since January 1, 1996, and exclusive of policies with a multi-line rate. The size of the pool is estimated to include policies insuring in excess of 200,000

automobiles. Consistent with the Illinois Corrective Order (attached), SFI shall nonrenew policies insuring approximately 96,000 vehicles from this pool. These policies shall be nonrenewed effective from the earliest time in 2002 when nonrenewals can reasonably begin for a period of 24 months at a reasonably constant rate that approximates 4,000 vehicles per month.

B. The nonrenewals authorized in the preceding subparagraph shall be in addition to any nonrenewals, cancellations or lapses in coverage that occur in the ordinary course of business, transfers of policies to a replacement carrier or carriers, or are otherwise authorized by this Order, by law, or by order of the Illinois Department.

C. SFI shall provide notice, in a form approved by the Department, as soon as practical and prior to the first nonrenewal notices being sent out under this provision to the policyholders identified pursuant to Paragraph 1A above, that they may be nonrenewed as their policies come up for renewal pursuant to this Order. Because nonrenewals under this Paragraph are at the direction of the regulator, the notice provisions of N.J.A.C. 11:2-29.5(a)1i are inapplicable.

D. Throughout the periods covered by this Order, SFI shall continue to provide a monthly report of in-force private passenger automobile insurance business, as provided by Order No. A01-120.

E. Nothing in this order shall be deemed to preclude the New Jersey Department or the Illinois Department of Insurance, separately or in cooperation, from ordering additional nonrenewals in the event it is determined necessary to maintain the financial soundness of SFI.

PHASE II MARKET STABILIZATION

2. During the period following Phase I above through December 31, 2005, SFI shall continue to renew its existing business, except for such nonrenewals that may occur in the ordinary course of business as authorized by law, unless it is determined by the New Jersey Department or the Illinois Department of Insurance, separately or in cooperation, that further financial stabilization efforts are required.

PHASE III MARKET REENTRY ASSESSMENT

3. If, based on the regularly filed 2005 Third Quarter Statement of SFI, the Company meets each of the Financial Benchmarks set forth below, then the following provisions shall apply:

A. At either a regularly scheduled or special meeting of the Board of Directors of SFI prior to December 31, 2005, SFI shall reconsider whether to complete winding down its New Jersey auto insurance business, considering all information it considers relevant. In addition, SFI shall permit the Department to appear before the management and Board of Directors and present such information as the Department deems appropriate for consideration by the Company.

B. On or before December 31, 2005 SFI shall notify the Department of its decision.

C. In the event SFI elects not to proceed to wind down its business in New Jersey, and so notifies the Department, then Paragraphs 3E and 4 of this Order shall be null and void.

D. In the event that SFI elects to complete its withdrawal, then SFI shall continue to seek a replacement carrier or carriers through December 31, 2006.

E. In the event that SFI elects to complete its withdrawal, it may begin to nonrenew remaining policies at a reasonably constant rate effective over the two year period beginning January 1, 2007 that will result in the termination of all policies by December 31, 2008.

F. For the purpose of the Market Reentry Assessment, SFI's financial condition shall be measured by the following Financial Benchmarks:

- i. Combined ratio of 102% or lower;
- ii. Statutory surplus of \$375 million or greater; and
- iii. Net Written premium to surplus ratio of 2.5 to 1 or lower, calculated by dividing net written premiums for the previous 12 months by surplus reported in the most recent statement.

All data used for determining the forgoing values will be taken directly from the information included in the Annual or Quarterly statements as filed by SFI with the Illinois Department of Insurance. In the event SFI is directed by the Illinois Department of Insurance to modify or amend its Annual or Quarterly statements, the values will be based on such modified or amended data.

4. If, based on the regularly filed 2005 Third Quarter Statement of SFI, the Company does not meet all of the Financial Benchmarks, SFI may begin nonrenewing all remaining policies at a reasonably constant rate that will result in the termination of all policies by December 31, 2007.

5. Regardless of whether any of the provisions of Paragraphs 3 or 4 have been met, SFI may notify the Department at any time prior to December 31, 2005 that it elects not to

complete its withdrawal from New Jersey, in which case, Paragraphs 3 and 4 of this Order shall be null and void.

6. In the event that SFI proceeds to nonrenew policyholders under Paragraphs 3E or 4, it shall provide notice to its policyholders pursuant to law, except that the present requirement of notice under N.J.A.C. 11:2-29.5(a)1i is waived as unnecessary and would interfere with the schedule for nonrenewals in Paragraphs 3E and 4.

7. Nothing in this Order shall prohibit SFI from responding appropriately to individual requests of its agents to retire, relocate, transfer or otherwise terminate or modify their business arrangements with SFI with or without the incentives outlined in the SFI's Filing, or prohibit SFI from managing its business efficiently in response to the reduced number of insured vehicles. SFI may extend or otherwise modify the terms under which its agents may elect the career choices set forth in the Filing, to the extent that SFI deems it appropriate under the terms of this Order.

8. The Commissioner hereby defers until on or before February 1, 2006, decisions upon the following, including appropriate terms and conditions:

A. SFI's request for a waiver from any requirement that its property and casualty affiliates surrender their licenses to do business in New Jersey; and

B. SFI's request for waiver of special deposits specified in N.J.A.C. 11:2-29.3(b)(5). Should the Commissioner determine that special deposits are required, she shall confer with the Illinois Department before specifying an amount of SFI's surplus to be deposited, in order to assure that SFI will not be subject to delinquency proceedings in Illinois.

9. If SFI nonrenews its remaining exposures pursuant Paragraphs 3E or 4, then the following terms and conditions shall apply:

A. No later than the date that the Company commences issuing nonrenewal notices pursuant to 9C below, SFI shall release those agents who elect to continue as automobile insurance producers in New Jersey from any exclusivity provision in their agency agreements that prohibit such agents from acting as an automobile insurance only broker for another insurer.

B. SFI's New Jersey certificate of authority shall be surrendered and SFI's authority to write business in New Jersey shall be terminated only when its New Jersey liabilities and potential liabilities have been fully satisfied and no longer exist.

C. SFI shall send to all policyholders subject to nonrenewal under Paragraph 3E or 4 of this Order, a notice of nonrenewal consistent with N.J.A.C. 11:3-8.3.

D. Each block of nonrenewals pursuant to Paragraph 3E or 4 shall, to the extent practical, consist of a representative cross-section of SFI's book of business. Nonrenewals shall be made randomly upon policy expiration date from the entire pool of remaining SFI automobile insurance policyholders, without regard to persistency, loss characteristics, or agent geographic location or loss experience, or other SFI affiliate policies.

E. Within 30 days of the expiration of its last automobile insurance policy under this approved plan, a senior officer of SFI shall submit a certification to the New Jersey Department of the date of expiration of the last automobile insurance policy. Upon receipt of said certification, the New Jersey Department will withdraw SFI's automobile insurance rating systems.

F. SFI shall refile for approval its proposed notices to its policyholders regarding the nonrenewals and its agents regarding termination to the extent that this Order or changed circumstances arising after entry of this Order necessitates changes in them.

10. Nothing in this Order shall prevent SFI from arranging for a replacement carrier or carriers, subject to the Department's approval, which would result in the nonrenewal and transfer of its business to a replacement carrier, nor shall it prevent the parent company, State Farm Mutual, from transferring its interests in SFI, subject to approval by the Department.

11. Nothing in this Order shall prohibit SFI from filing, from time to time, modifications to its rates, rules and forms in accordance with law. In order to ensure the financial integrity of SFI throughout the period covered by this Order, any requests for additional rating system changes shall be given prompt consideration with the New Jersey Department approving or disapproving promptly under the timeframes required by law, subject to the provisions of the Administrative Procedure Act, if a hearing is required. Further, in consideration of the interests of the Illinois Department, the New Jersey Department will provide the Illinois Department with notice regarding such rate relief requests and will consider any written submissions of the Illinois Department throughout any rate proceedings.

12. SFI shall semiannually notify the Department of the number of its active agents, which notice shall reflect the reasons for any changes. Nothing in this Order shall affect whatever rights SFI has to amend or replace its contracts with its agents or for SFI and its agents to agree to an amended or replacement agency contract. Nothing in this Order shall affect SFI's ability to terminate an agent or agents in the ordinary course of business.

13. Nothing in this Order is intended, or shall be construed, to supercede or interfere in any way with the obligation of SFI or its affiliates to comply with Orders issued by the Director of the Illinois Department.

14. The provisions of Order No. A01-120, as extended by Order No. A01-170, shall be continued throughout the periods covered by this Order, including the obligation of SFI to provide monthly reports concerning its finances and in-force business.

15. Nothing in this Order shall be construed to restrict or limit in any manner whatsoever the authority of the Illinois Department to take further actions authorized or required under its laws and regulations to protect the solvency of SFI and the interests of the Company's policyholders and creditors.

16. Nothing in this Order shall be construed to limit the authority of the New Jersey Department to request additional information as it may deem necessary either to monitor the financial and market condition of the Company or to make determinations regarding the waivers requested or the suitability of replacements carriers. Any such request for information related to updating or supplementing information contained in the Filing, or any future determinations provided or contemplated herein, including but not limited to those related to affiliate withdrawal, special deposits or replacement carriers, shall not alter this approval of the Filing as modified by the terms and conditions of this Order. To the extent the Filing contains any other matters that reflect dates or timeframes that are inconsistent with the terms and conditions set forth herein, SFI shall submit to the New Jersey Department appropriate revisions that modify any such matters so that they are made consistent with the terms and conditions of this Order.

17. This Order may only be enforced by the New Jersey Department and SFI

and no rights are conferred on any persons or entities other than the New Jersey Department and SFI.

/s/ Holly C. Bakke
Holly C. Bakke
Commissioner