

NORTH CAROLINA DEPARTMENT OF INSURANCE  
RALEIGH, NORTH CAROLINA

IN THE MATTER OF THE FILING )  
DATED JANUARY 3, 2024, BY THE )  
NORTH CAROLINA RATE BUREAU )  
FOR REVISED HOMEOWNERS )  
INSURANCE RATES )  
BEFORE THE )  
COMMISSIONER OF )  
INSURANCE )  
DOCKET NO. 2157 )

**COPY**

BEFORE: AMY FUNDERBURK, HEARING OFFICER

TRANSCRIPT  
OF  
HEARING

VOLUME I - P. M. SESSION

Raleigh, North Carolina  
Thursday, October 7, 2024  
1:30 p.m.

A P P E A R A N C E S

On behalf of the North Carolina Rate Bureau:

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Hearing in the matter of the filing dated January 3, 2024, by the North Carolina Rate Bureau for revised homeowners' insurance rates, at North Carolina Department of Insurance, 3200 Beechleaf Court, Raleigh, North Carolina, on the 7th day of October, 2024, at 1:30 p.m., before Wendy Sawyer, Court Reporter and Notary Public.

I N D E X   O F   E X A M I N A T I O N S

THE WITNESS: GEORGE ZANJANI	EXAMINATION
Continued Cross, by Mr. Friedman.....	85
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I N D E X   O F   E X H I B I T S

(No exhibits offered.)

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P R O C E E D I N G S

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HEARING OFFICER FUNDERBURK: Good afternoon. And I will -- does that sound a little better for those of us in the back? Okay. Great. Thank you. As I said when we started off, I've been accused several times of speaking too lowly, so hopefully that is a little better. I'll try to be more mindful of the microphone.

It is 1:30. We are back on the record, October 7th, 2024. When we recessed prior to lunch, Dr. Zanjani was on the stand, undergoing cross examination. Before we return to his testimony, counsel, is there anything we need to address housekeeping wise?

MR. FRIEDMAN: Not that I have, Your Honor.

MR. SPIVEY: Nothing here.

HEARING OFFICER FUNDERBURK: All right. Then Dr. Zanjani, I'll ask you to return to the witness stand, and I'll remind you that you continue to be under oath. Although, for purposes of -- well, Ms. Pearce, you swore in Dr. Zanjani.

Madam Court Reporter, do you have any concerns that he was sworn in prior to you coming

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i n?

THE COURT REPORTER: No.

HEARING OFFICER FUNDERBURK: Great.

All right.

Mr. Friedman, I'll ask that you  
proceed.

CONTINUED CROSS EXAMINATION

BY MR. FRIEDMAN:

Q. All right. Dr. Zanjani -- can everyone  
hear me, by the way? Because I know I had problems.  
Dr. Zanjani, if you could turn back to your resume,  
which is at RB-23.

A. I'm there.

Q. Okay. Between the University of Alabama  
and your time teaching at Georgia State University, I  
guess that's -- is that a combined about 10 years?

A. I started at Georgia State in 2008 and  
started at the University of Alabama in 2017.

Q. Okay. So about 18 years. I'm not great  
at math.

A. I'm not sure what you're trying to  
measure.

Q. How long you've been -- between the two of  
those, how long you've been teaching at American  
universities?

1 A. About 16 years.

2 Q. 16 years. Thank you. And over that time  
3 teaching at universities, have any of the college  
4 classes you've given concerned or addressed actuarial  
5 concepts?

6 A. Yes.

7 Q. Okay. Such as what?

8 A. So I teach -- I've taught a course on risk  
9 modeling, and I've taught an actuarial prep course, for  
10 the Exam P, which is Probability and Statistics. And I  
11 teach some actuarial concepts in Intro to Risk  
12 Management and Insurance and a course on proper  
13 property liability insurance.

14 Q. Are any of the students of those classes  
15 already actuaries?

16 A. No. I think some -- some of them may be  
17 taking exams.

18 Q. Okay. And are some of them, to your  
19 knowledge, planning to become actuaries?

20 A. Yes.

21 Q. On pages 1 through 3 of your resume, you  
22 cite a great number of publications you've been  
23 involved in or written yourself over the years. Do you  
24 see that?

25 A. I see.

1 Q. Did some of those publications address  
2 actuarial concepts?

3 A. I think some of those publications would  
4 be considered to be addressing actuarial concepts.  
5 Yes.

6 Q. Okay. And I guess, particularly, on page  
7 2, you list -- you list a -- let's see. About a little  
8 bit over halfway down, insurance risk, risk measures,  
9 and capital allocation navigating a Copernican shift.  
10 Do you see that?

11 A. I do.

12 Q. What's meant by capital allocation there?

13 A. Capital allocation concerns the amount of  
14 capital that is allocated to a risk within a -- an  
15 insurance portfolio or a financial institution  
16 portfolio generally.

17 Q. To your knowledge, have actuaries reviewed  
18 your publications?

19 A. I don't know for sure. You mean as -- as  
20 referees or as general interest readers?

21 Q. General interest readers.

22 A. I can't say for sure, but I wouldn't be  
23 surprised.

24 Q. For example -- okay. Scratch that.

25 Then if you could look at your professional

1        associations, which are on page 7.

2            A.     Yes.

3            Q.     Does the American Risk and Insurance  
4        Association involve actuarial methods?

5            A.     I wouldn't call that an actuarial  
6        association. There are people in that association who  
7        are actuaries. There might be some actuarial research  
8        that has presented at those associations' meetings.

9            Q.     And were there actuaries on the board of  
10       the ARIA when you were on the board?

11          A.     Hard for me to recall the composition of  
12       the board. I think I may have overlapped with Richard  
13       Derrig, who was an actuary. I don't remember offhand  
14       if there were other actuaries on the board.

15          Q.     Now, with regard to this filing in  
16       particular, and I'm not asking about the substance of  
17       any communications, but did you communicate with the  
18       three actuaries who filed pre-filed testimonies  
19       alongside yours?

20          A.     So I think I said earlier that I  
21       communicated with Paul Anderson, and I believe that was  
22       in error. The actuary, if he is an actuary, that I  
23       communicated with was Ericksen, actually indirectly.  
24       Ericksen and Conover. I think Conover sent me data  
25       from Verisk, that was necessary for the work I was



1       doi ng.  And I think Ericksen was cc'd, but that's my  
2       recol lecti on.

3               Q.     And is Conover with ISO?

4               A.     I believe he's with Verisk.  Yeah.

5               Q.     Verisk.  Okay.  And Verisk owns ISO, does  
6       it not?

7               A.     I believe so.  Yeah.

8               Q.     Okay.  And do you know that they do  
9       business under the same name simply nowadays, Verisk?

10              A.     Yeah.  It -- I'm not trying to draw a  
11      distinct -- distinction between Verisk and ISO.  The --  
12      the emails say Verisk on them.

13              Q.     All right.  So we have testified about --  
14      you've testified about ASOP 30, and that is included at  
15      Exhibit -- sir, do you have a copy of DOI's exhibit  
16      book?  The DOI's Exhibit Book 3.

17                      MS. WHARRY:  Your Honor, may I approach  
18      the witness?

19                      HEARING OFFICER FUNDERBURK:  Yes.  And  
20      counsel, have you provided -- have you provided  
21      that to opposing counsel as well as a copy for the  
22      bench?

23                      MR. FRIEDMAN:  Book 3?  Um-hum.

24                      MS. WHARRY:  Book 3 to the witness?

25                      HEARING OFFICER FUNDERBURK:  Yes.

1 Please approach. Thank you.

2 BY MR. FRIEDMAN:

3 Q. All right. Mr. Zanjani, I'm going to be  
4 refer -- first of all, if you go to page 50, which is  
5 in the lower right hand corner of that exhibit, you'll  
6 see Actuarial Standard Practice 30. The numbers are in  
7 the lower right hand.

8 A. I'm sorry. Are we in Book 3?

9 Q. Book 3 should be Exhibit No. 12.

10 A. Yes.

11 Q. All right. So I'm going to be referring  
12 to both of that and to specific pages in your  
13 testimony, if you need to have the testimony also  
14 handy.

15 So you testified that you, as I understood it --  
16 and please correct me if I'm wrong -- that you felt  
17 informed by certain provisions or tried to align your  
18 testimony with certain provisions of ASOP 30 and didn't  
19 try to align it with other provisions. Is that fair?

20 A. I don't remember exactly what I said, but  
21 I prepared my testimony after reviewing the guidelines  
22 in ASOP 30. So I'm aware of what ASOP 30 says about  
23 certain aspects that -- that affect my testimony and  
24 analysis.

25 Q. Okay. So did you take into account all of

1 ASOP 30 when you prepared your testimony or only  
2 certain subsections?

3 A. I don't remember which subsection. So in  
4 in particular, I'm not sure if this is the same  
5 document I reviewed, but the section on the one I  
6 recall looking at ASOP 1. Okay. It should be right  
7 here, 30.

8 Q. So wait a second. Now we're turning to  
9 ASOP 1?

10 A. No. I was on ASOP 1.

11 Q. Oh, okay.

12 A. I -- I was confused. So I'm now on ASOP  
13 30. So the -- I may not have, you know, reviewed the  
14 section on, say, disclosures very carefully.

15 Q. Okay. Is that the only provision you  
16 didn't review very carefully? And if you need some  
17 time to go through the provisions --

18 A. Well, again, this was not an actuarial  
19 report, and I did not feel bound by ASOP 30. However,  
20 as someone preparing provisions on profit and  
21 contingencies, the guidance about how those should be  
22 prepared and particularly the relationship to cost of  
23 capital, those are the guidelines in ASOP 30 that I  
24 especially was paying attention to.

25 Q. Okay. So other than the responsibility

1 to, I believe you said, the provision that you didn't  
2 review in detail was -- could you tell me which  
3 subsection you didn't reveal in detail -- review in  
4 detail?

5 A. I don't -- if we're asking -- if you're  
6 asking me about which sections I reviewed before  
7 preparing my testimony, I don't remember which -- which  
8 sections I -- I reviewed particularly.

9 Q. Okay.

10 A. I have reviewed the standard before, and  
11 I'm familiar with the provisions that I mentioned.

12 Q. All right. In your testimony at page 4,  
13 bleeding over into 5, that last -- the answer at the  
14 bottom of 4, you state that your understanding of North  
15 Carolina law is that insurance rates are set -- are to  
16 be set such that those rates are expected to provide a  
17 return to insurers that is equal to the returns of  
18 industries of comparable risk and that in calculating  
19 that expected return, the investment income on capital  
20 surplus is to be -- capital and surplus -- is to be  
21 excluded from consideration. Do you see that  
22 statement?

23 A. I do.

24 Q. What's the extent of your understanding of  
25 North Carolina law on the particular exclusion of

1 capital and surplus?

2 A. Well, as stated in the testimony, my  
3 understanding is that it is to be excluded from  
4 consideration in the rate. And so my -- but more  
5 specifically, the -- my understanding is from the  
6 statute, which -- and also from conversations with  
7 counsel explaining to me the --

8 Q. Okay. So other than conversations with  
9 counsel and the statute, have you reviewed any North  
10 Carolina law, including prior Commissioners' orders or  
11 appeal decisions from the Courts of Appeals?

12 A. So I have reviewed various decisions and  
13 various orders and do not consider myself a lawyer. So  
14 many of them seem to conflict to me or at the time I  
15 reviewed them. So, mainly, my -- my understanding  
16 of -- of all of that legal history is guided by my read  
17 of the statute and the conversations with counsel.

18 Q. I understand that you're not a lawyer.  
19 But on pages 45 and then also at the bottom of page 3,  
20 you do specifically state your understanding of North  
21 Carolina law. Correct?

22 A. Right.

23 Q. And going then to ASOP 30, 4.1. That's  
24 under section 4, page 54 of that collection of ASOPs.  
25 Are you there?

1 A. Yes.

2 Q. Did you review that section, specifically  
3 4.1?

4 A. I did not review or I do not recall  
5 reviewing that section.

6 Q. Okay. Did you develop a rate in  
7 accordance with what you understood to be North  
8 Carolina law?

9 A. I did.

10 Q. Okay.

11 A. And also in my testimony, there is a  
12 calculation under the alternative that would have been  
13 done had North Carolina law not been in place.

14 Q. And that particular calculation is one  
15 that does take into account the interest earned on  
16 capital and surplus?

17 A. That's correct.

18 Q. All right. Is it your general  
19 understanding that when we refer to total profit for an  
20 insurance company, there are technically two parts of  
21 that? Namely, the first part would be total profit  
22 being what the company earns on insurance operations.  
23 And the second part instead, additionally, including  
24 underwriting profit and investment income from  
25 premiums? Is that fair?

1 A. Could you repeat that, please?

2 Q. Sure. And I'm reading from a particular  
3 case. If you'd like me to hand up the -- the copy of  
4 the case to you, that might make it easier, but I'm not  
5 suggesting you had to have read the case. I don't know  
6 if you have. Would that make it easier?

7 A. Well, are you asking me what I understand  
8 the sources of insurance company income to be, or are  
9 you asking me what the case says the -- the -- the  
10 sources are?

11 Q. The former.

12 A. Okay. So --

13 Q. With regard to total profits. Excuse me.

14 A. Okay. Could you repeat the question,  
15 please?

16 Q. Sure. Is one part of total profit what  
17 the insurance company earns on insurance operations?

18 A. So I think you could do a lot of  
19 decompositions of the accounting profit of insurance  
20 companies. And the accounting profit has various  
21 components. It includes the underwriting profit,  
22 investment income earned on premiums and -- or premiums  
23 and lost reserves and so forth as well as investment  
24 income earned on capital and surplus.

25 Q. Okay. And so that would include what they

1       earn on insurance operations?

2               A.       The accounting profits of insurance  
3       companies include various components. The investment  
4       income on capital and surplus would not be included in  
5       insurance operations except indirectly through the  
6       determination of premiums if you were determining  
7       something like operating returns.

8               Q.       So I'm a little bit confused. Do you --  
9       are you saying that insurance operations themselves  
10       necessarily contain some of -- some consideration of  
11       capital and surplus if they're addressing premiums?

12              A.       The premiums set by actuaries consider,  
13       you know, in -- in all states but North Carolina, I  
14       should -- should qualify -- the premiums set by  
15       actuaries generally in other jurisdictions include  
16       consideration of investment income on capital and  
17       surplus.

18              So if you were calculating an operating return,  
19       you would be using premiums that include consideration  
20       of capital and surplus.

21              Q.       Thank you for clarifying that. But in  
22       North Carolina, is it your understanding that in  
23       calculating a total return, you cannot include  
24       consideration of capital and surplus?

25              A.       That is my understanding.



1 Q. Outside of North Carolina, when you're  
2 calculating total profit, the -- another part of it, in  
3 addition to insurance operations, is profits earned by  
4 investing capital and surplus funds or investments from  
5 those?

6 A. Well, those profits are also earned in  
7 North Carolina.

8 Q. Yes. But they're --

9 A. They're -- they're -- the consideration of  
10 those profits -- not profits, investment income -- the  
11 consideration of that investment income in the  
12 calculation of the accounting return is, as I  
13 understand it, prohibited by North Carolina law.

14 Q. So outside of North Carolina, when you are  
15 calculating total profit, you would be considering  
16 profits earned by capital and surplus funds, and inside  
17 North Carolina, you would not?

18 A. My understanding of the statute relates,  
19 and the law in North Carolina relates to the  
20 calculation of rates. I believe the calculation of  
21 profit -- I'm not sure what -- how it's calculated or  
22 if there's some other statute relating to the  
23 calculation of profit in North Carolina. But  
24 generally, insurance companies would consider that in  
25 calculating their accounting profits.

1           So if you picked up a statutory statement and  
2           derived a bottom line profit from that, it would  
3           include investment income on capital and surplus.

4           Q.     I should clarify, then, that I am talking  
5           about profits in the sense that they're used for  
6           calculating rates.

7           A.     So could you repeat the question, please?

8           Q.     That may prove a chore for me. But the --  
9           so outside -- let's use the term total return instead.  
10          Outside North Carolina, as part of calculating a total  
11          return for the purposes of rate making, you would  
12          consider the earnings on investments of capital and  
13          surplus?

14          A.     Typically, a -- an approach outside of  
15          North Carolina would consider the investment income on  
16          capital and surplus.

17          Q.     So using the term "total return", as it's  
18          calculated outside of North Carolina, would you agree  
19          that a total return simply can't be the basis for a  
20          North Carolina profit provision?

21          A.     A total return, meaning an accounting  
22          profit, should exclude investment income on capital and  
23          surplus. So in my testimony, I distinguished between a  
24          statutory return that excludes investment income on  
25          capital and surplus and a total return that includes

1 investment income on capital and surplus. But just to  
2 be clear, we're talking about accounting returns when  
3 we talk about returns.

4 Q. Okay. Whether accounting or statutory,  
5 has it been your experience that outside North  
6 Carolina, a total return includes consideration of  
7 investment income from capital and surplus?

8 A. So, again, I think a company calculating a  
9 total return, in general, would include investment  
10 income on capital and surplus, whether they were in  
11 North Carolina or not.

12 In a rate making exercise, they would be  
13 excluding investment income from the accounting return  
14 in North Carolina. And outside North Carolina, they  
15 would be including investment income on capital and  
16 surplus.

17 Q. Thank you. Would you agree that a cost of  
18 capital analysis includes consideration of investment  
19 income on capital and surplus?

20 A. No.

21 Q. How not?

22 A. A cost of capital analysis concerns the  
23 return that investors require on the underlying  
24 investments in the insurance industry and industries of  
25 comparable risk.

1           So the investor is not looking at the accounting  
2 returns and does not care about the composition of  
3 income. The investor ultimately is focused on capital  
4 appreciation of the investment, capital appreciation  
5 and -- and dividends. So it's -- it's the notion of  
6 the return in the case of a cost of capital analysis is  
7 the return to the investor on the investment.

8           Q.     Is that in keeping with your statement  
9 this morning that the source of the cost of capital  
10 calculation is irrelevant?

11          A.     To the investor in an insurance company  
12 security or -- yeah. Yes. That's -- that's correct.

13          Q.     What about to North Carolina law? Do you  
14 know if that's relevant to North Carolina law?

15          A.     My understanding of North Carolina law is  
16 that rates are to be set without consideration of  
17 investment income on capital and surplus in determining  
18 the accounting return and that insurance companies are  
19 entitled to a fair and reasonable return or a fair and  
20 reasonable margin for profit.

21                The fair and reasonable margin for profit, I  
22 interpret as corresponding to generating the accounting  
23 return that would deliver the cost of capital that  
24 investors demand.

25          Q.     In the court cases that you reviewed, do

1 you recall it mattering to the courts that, in fact,  
2 the sources of the cost of capital are relevant to the  
3 prohibition on consideration of capital and surplus?

4 A. I couldn't possibly list to you all of  
5 the, yeah, references that I found in the court  
6 opinions and -- and orders and so forth. However,  
7 the -- the statement that you made, could -- could you  
8 repeat it, please?

9 Q. Sure.

10 A. The composition of?

11 Q. You've stated that to an investor, the  
12 source of what you used to rely -- to arrive at a cost  
13 of capital isn't relevant from his perspective. Do you  
14 know if it's relevant to North Carolina courts, the  
15 source of what you use to calculate the cost of  
16 capital?

17 A. Well, the cost of capital, again, is a  
18 market concept referring to the returns that investors  
19 demand on their investments, okay, and that consists of  
20 capital appreciation and dividends. Okay?

21 So the sources you're talking about are an  
22 accounting concept. And my understanding of the law is  
23 that the investment income of on capital and surplus is  
24 explicitly to be excluded from those accounting  
25 returns.

1           So as -- but, again, my understanding is just  
2 based on reading the statute and the interpretation I  
3 gave you as well as discussions with counsel.

4           Q.     When you speak of sources, does that  
5 include the methods for calculating the cost of capital  
6 or just the data that's loaded into the method or  
7 considered in the method?

8           A.     Could you repeat the question, please?

9           Q.     Okay. So I've been referring to sources  
10 for cost of capital mostly because that was a term you  
11 used this morning. But my question now is, when you  
12 refer to sources, does that include the method or  
13 various methods you may use to -- you may utilize to  
14 try to estimate the cost of capital?

15          A.     Well, I don't understand the question in  
16 the sense that the sources that we discussed consist of  
17 underwriting profit, investment returns on policyholder  
18 supplied funds, investment returns on capital and  
19 surplus.

20          So those -- those are the sources we're -- we're  
21 talking about. And then there are methods to determine  
22 the cost of capital. So I'm -- I'm not sure what the  
23 connection you're drawing is.

24          Q.     Okay. So the methods -- is it fair to say  
25 that the methods may consider the sources, but the

1 sources aren't necessarily the methods?

2 A. Well, the methods are aimed at determining  
3 the return that investors require, which consists of --  
4 well, it depends on the method. It may -- it might be  
5 easier if we talk about specific methods, but many of  
6 them are risk -- premium-based methods that look at the  
7 correlation between returns on stocks and the overall  
8 market. So those are entirely focused on capital  
9 appreciation and dividends.

10 Q. Okay. And I will absolutely get to the  
11 particular methods that you mentioned in your report  
12 that you used to calculate the cost of capital. And  
13 would you agree cost of capital is a synonym for cost  
14 of equity?

15 A. No.

16 Q. Okay. What's the difference?

17 A. Well, people -- sorry. I don't mean to be  
18 difficult.

19 Q. No. Not at all. You're -- you're a Ph.D.  
20 You get to be.

21 A. So those -- those terms are sometimes used  
22 interchangeably. But just to be clear, cost of capital  
23 can sometimes refer to a -- a weighted average cost of  
24 capital that also considers the cost of debt that's  
25 been issued, or it may just refer to a cost of equity.

1 But it -- it might be helped helpful to be precise.

2 Q. You know whether the courts or the Rate  
3 Bureau itself has characterized the two as synonymous  
4 before?

5 A. I think a previous witness may have used  
6 the cost of equity approach, and I don't know  
7 whether -- I don't know whether he characterized the --  
8 the terms as being synonymous or not, or I don't  
9 remember. Though again, some -- some people do use  
10 that terminology. I just -- I just don't.

11 Q. I understand that, and I appreciate there  
12 are nuances and that people certainly misuse legal  
13 terminology a lot, including lawyers.

14 A. Well, I'm not -- I'm not saying that he  
15 was misusing it either, if -- if -- if he was. I'm --  
16 I'm -- I'm just saying that, to me, cost of capital  
17 means a certain thing.

18 Q. So at least Mr. Anderson relied on your  
19 report for his report. Do you recall that we went over  
20 his testimony?

21 A. I recall both in Mr. -- I think it was  
22 Ericksen's and Mr. Anderson's aligned reference.

23 Q. I think I found the specific word  
24 "relied" --

25 A. Oh, relied.



1 Q. -- in Mr. Anderson's testimony.

2 A. Okay. I -- I -- I don't recall, but I --  
3 I recall reading some sentence from his testimony.

4 Q. Okay. Since he has to comply with the  
5 actuary -- the ASOPs for his report, in writing your  
6 report, did you feel any responsibility for better  
7 educating or fully educating yourself on the case law  
8 and past Commissioners' orders regarding what  
9 constitutes consideration of the cost of capital?

10 A. In my report, I fully disclosed the nature  
11 of my understanding of -- of North Carolina law. And  
12 so I think I made that clear in my report to anyone who  
13 is using it.

14 Q. Okay. But you've testified you don't  
15 recall details from the court opinions you've read.

16 A. I certainly do not recall all the details  
17 from the court opinions I've read. I found them very  
18 confusing, in general, and conflicting in -- in many  
19 cases. So my -- the reliance for my understanding is  
20 primarily from my reading of the statute and my  
21 discussions with counsel.

22 Q. In drafting your report, given that Mr.  
23 Anderson relied on it for his actuarial opinion, did  
24 you feel any responsibility to discuss those specific  
25 attempts at calculating profit without regard to

1 capital and surplus that had been rejected by the  
2 courts? So --

3 A. I'm sorry. I don't understand your  
4 question.

5 Q. For your report, did you, for the purposes  
6 of a person like Mr. Anderson, who reviewed your report  
7 and then relied on it, did you feel any responsibility  
8 to give examples of the sort of calculations that in  
9 North Carolina that the courts had rejected as not as  
10 act- -- being improper because they included the cost  
11 of capital?

12 A. Again, my understanding of North Carolina  
13 law, as disclosed in my testimony and I think we've  
14 covered, is such that is -- is as I laid out, and my  
15 understanding is that the calculations I did were in  
16 compliance with North Carolina law as on the basis of  
17 that understanding and my discussions with counsel. So  
18 I did not feel any responsibility that you mentioned.

19 Q. Okay. Switching gears a bit. As I  
20 understand from your resume, you began working on North  
21 Carolina Rate Bureau filings in 2019? That would be, I  
22 believe -- let's see. So, I'm looking at pages 4  
23 through 5.

24 A. I'm there.

25 Q. And I think the first time I see you

1 mentioned as a witness for the Rate Bureau is in 2019?

2 A. Yes. So I'm -- I'm not sure if that was  
3 if the work for that started in 2018, but I believe it  
4 was for a 2019 filing.

5 Q. And have any of the cases in which you  
6 filed or in which you submitted pre-filed testimony  
7 gone to a hearing?

8 A. Not in North Carolina.

9 Q. Okay. I should clarify that. In your  
10 resume, you state that you've also provided expert  
11 witness testimony in Massachusetts, Florida, and  
12 Virginia. Is that correct?

13 A. That's correct.

14 Q. Okay. And was that oral or was that all  
15 in writing?

16 A. Florida concerned oral testimony as well  
17 as written testimony, and Massachusetts concerned  
18 written testimony until this current year when -- when  
19 it also involved a hearing.

20 Q. Now, is it your understanding that prior  
21 to you becoming an expert witness for the Rate Bureau,  
22 the Rate Bureau had employed another couple of  
23 economists, Doctors Appel and Dr. Vander Weide in  
24 calculating the profit provision for the Bureau?

25 A. My understanding is that the Bureau

1 employed Dr. Appel and Dr. Vander Weide.

2 Q. And I believe Dr. Appel is in the room.

3 A. Dr. Appel is in the room. Yes.

4 Q. Okay. Did you ever talk with them about  
5 the work that they had performed on the past North  
6 Carolina cases?

7 A. I never talked with Dr. Vander Weide. I  
8 did talk with Dr. Appel.

9 Q. Okay. Did you talk with Dr. Appel about  
10 his work on the 2014 homeowners' hearing?

11 A. I don't recall specific conversations, but  
12 I think probably. Yes.

13 Q. Did you talk with him about, whether in  
14 that hearing or prior hearings, attempts that he had  
15 made to arrive at a profit provision that were  
16 nonetheless rejected?

17 A. So I don't recall the conversation with  
18 Dr. Appel about that particular topic. No.

19 Q. Was it your understanding that some of his  
20 attempts at calculating the profit provision had been  
21 rejected by the courts?

22 A. It is my understanding that the courts  
23 rejected certain aspects of the Bureau's filing in  
24 2014. I don't know -- I don't recall exactly which one  
25 of those or what aspects were rejected by the court in

1 2014.

2 Q. Are you familiar with the fact that the  
3 courts also rejected the Rate Bureau's calculations in  
4 a personal auto filing in 2001? The filing was in  
5 2001. I think the decision was in 2003.

6 A. Okay. And this -- this is -- I'm having a  
7 hard time keeping the years straight.

8 Q. Sure.

9 A. There -- I thought there was a Supreme  
10 Court case around that time that -- that, in rough  
11 terms, sided with the Bureau's position in the '96  
12 filing.

13 Q. That's right.

14 A. Okay.

15 Q. And then there was --

16 A. That's -- that's not what you're talking  
17 about.

18 Q. No, sir. There was a --

19 A. That's not the 2001 case?

20 Q. No.

21 A. Okay.

22 Q. The 2001 case was a separate auto filing  
23 from the 1996 case --

24 A. Okay.

25 Q. -- and it went on appeal. I believe the

1 appeal was decided in 2003.

2 A. Um-hum.

3 Q. Do you -- are you familiar with the fact  
4 that that -- the court in that rejected Dr. Appel's  
5 method of calculating the cost of capital or  
6 calculating the profit provision?

7 A. So I'm not familiar with specific cases  
8 because for -- as I mentioned before, they are  
9 conflicting or give conflicting information, at -- at  
10 least as far as I can tell from what the -- the -- the  
11 courts determined or Commissioners ordered in the past.

12 Q. So were you familiar that his -- Dr.  
13 Appel's method had been rejected prior to the 2014  
14 homeowners' filing at least once before?

15 A. So when you say the method was rejected,  
16 that's what I'm having a hard time understanding. Was  
17 it the --

18 Q. The way that he --

19 A. -- entire -- was it the entirety of every  
20 single page in the pro forma, the way he calculated  
21 investment returns on the asset portfolio, the way he  
22 calculated leverage. I mean, there -- there are so  
23 many things that go into determining what the  
24 accounting return associated with an underwriting  
25 profit provision is.

1           So when -- when you say the -- the court  
2 rejected it, I don't know what part of the calculation  
3 you're referring to.

4           Q.     That the court rejected his entire method  
5 for calculating the profit provision.

6           A.     Okay. I was not aware that the court said  
7 that you can't use the method.

8           Q.     Were you aware that the court in 20- -- in  
9 the 2014 homeowners' case rejected the method that Mr.  
10 -- Dr. Appel used?

11          A.     So, again, my understanding of North  
12 Carolina law and the extent to which this complies,  
13 what I've done complies with North Carolina law, it's  
14 based on my reading of the statute and conversations of  
15 counsel who -- with counsel -- who digested the various  
16 opinions for me.

17          So I -- I don't what the -- those particular  
18 decisions said, I couldn't begin to interpret  
19 particular decisions.

20          Q.     Did you review any prior written  
21 testimonies of Dr. Appel or Dr. Vander Weide?

22          A.     Yes, I did.

23          Q.     Okay. Did you use any of the formulas  
24 they created in your current pre filed testimony for  
25 the homeowners' filing this year?

1           A.     My -- so Dr. Vander Weide, let's start  
2 with him, I believe used a risk premium method, and he  
3 may have used a discounted cash flow method as well.  
4 My own calculations were done using risk premium  
5 methods that were not exactly the same as Dr. Vander  
6 Weide's.

7           And then I consulted various third-party sources  
8 for methods, some of which are similar to what Dr.  
9 Vander Weide was using.

10           In the case of Dr. Appel, the approach is very  
11 similar in many respects to what -- what he did in  
12 previous filings but -- but different on certain  
13 counts. And the formulas and calculations, I did  
14 independently. In some cases, they are the same as  
15 the -- the formulas that he was using.

16           Q.     Okay. And in what respects are your  
17 calculations different? I believe you just said your  
18 calculations, in some respects, were different from Dr.  
19 Appel's. In what respects were they?

20           A.     So various respects. So in certain cases,  
21 I used different source material for returns on  
22 invested assets. So, we -- we may have had access to  
23 different data sources, so there -- there were some  
24 changes there.

25           I believe I expanded the -- or the expansion of



1 the categories of investments that were considered  
2 in -- in the rate making approach. I expanded that to  
3 include other long term invested assets.

4 I believe he was calculating leverage on the  
5 basis of a -- the weighted average of the top 30  
6 writers, whereas I was using the -- I used the entire  
7 market.

8 I made various -- oh, I'm basing leverage based  
9 on direct premiums rather than net premiums is -- is  
10 another difference.

11 I make adjustments for reinsurance in the  
12 policyholders' supplied funds calculation as well as in  
13 the adjustment for returns on agents' balances. Like,  
14 I think those are the -- the major ones I can think of.

15 Q. Quick question on agent balances since  
16 we're there, but what's your understanding, at least in  
17 North Carolina, of how long agents hold on to premiums  
18 before they're remitted to the insurance companies?

19 A. I don't have an understanding. So that  
20 particular assumption is based on, I believe, overall  
21 data for the -- actually, I'd -- I'd have to check the  
22 testimony, but I've never done an independent review of  
23 how long agents hold -- hold balances. So I'm relying  
24 on the data for that that was supplied by Verisk.

25 Q. Okay. Is it your understanding, just

1 generally, that insurance companies often sweep the --  
2 an agent's premium account on a monthly basis?

3 A. I don't have an understanding of what  
4 typical practice is regarding to sweeping accounts. So  
5 my understanding, to the extent that there is an  
6 understanding, is limited to what I see in statutory  
7 data, which is basically what ISO has provided, so  
8 agents' balances in the -- in the statutory statements.

9 Q. Okay. But you are familiar that things  
10 like monthly sweeps of premium accounts happen?

11 A. I don't know how prevalent that is.

12 Q. But you've heard of it.

13 A. Yes, I've heard of it.

14 HEARING OFFICER FUNDERBURK: And I'll -  
15 - I'll just briefly ask the witness. You've been  
16 on the stand about an hour. Are you okay to keep  
17 proceeding, or do you need a few minutes?

18 THE WITNESS: Pardon me?

19 HEARING OFFICER FUNDERBURK: Do you  
20 need a few minutes' break, or are you okay to keep  
21 proceeding? I'm just mindful. You've been  
22 testifying about an hour.

23 THE WITNESS: I can go.

24 HEARING OFFICER FUNDERBURK: Okay.

25 BY MR. FRIEDMAN:

1 Q. Now, you've emphasized before that it was  
2 the subcommittee that adopted the recommended rate  
3 based on your work product. Is that correct? The  
4 recommended rate in the filing.

5 A. The subcommittee, with respect to my  
6 participation, the subcommittee made a selection of an  
7 underwriting profit factor. And I believe, as was  
8 mentioned in the opening statements maybe -- or maybe  
9 by Ms. Billiouris, the subcommittee made a number of  
10 other selections as well.

11 Q. Did you actually present that data in  
12 person to the subcommittee?

13 A. I -- what I presented to the subcommittee  
14 was presented in this particular case over Zoom, I  
15 believe.

16 Q. Okay. And in your presentation, did you  
17 make a recommendation as to the acceptable ranges of  
18 underwriting profit or a range of acceptable  
19 underwriting profit percentages?

20 A. I presented, in general, two pieces of  
21 information. One was these costs of capital estimates  
22 for the needed market return and an array of showing  
23 the underwriting -- matching different levels of  
24 underwriting profit provisions to different accounting  
25 returns. I did not make a recommendation.

1 Q. So turning back to your actual report,  
2 which is -- let's see. In the main -- in the filing  
3 binder at Exhibit RB-22?

4 A. I'm there.

5 Q. Okay. At the bottom of page 3, you  
6 provide numbers for both the statutory return and a  
7 total return. Do you see that?

8 A. I do.

9 Q. Okay. And that calculation of the total  
10 return would include consideration of investment in --  
11 or let's better say, would include consideration of the  
12 cost of capital.

13 A. No. The total return includes  
14 consideration of investment income on capital and  
15 surplus, while the statutory return does not and was,  
16 as discussed in the testimony, prevented -- or  
17 presented for informational purposes.

18 Q. Turning to page 4. That last paragraph  
19 before Roman Numeral II, you did compare the cost of  
20 equity -- strike that. Strike that. I'm turning to a  
21 different page.

22 MR. FRIEDMAN: Can I have a second,  
23 Your Honor, just to --

24 BY MR. FRIEDMAN:

25 Q. On page 3 of your report, do you see where

1 you discuss how you generated your estimates using a  
2 single factor risk premium approach?

3 A. I do.

4 Q. All right. And within your risk premium  
5 approach, you determined the cost of equity according  
6 to three different measures. Correct?

7 A. So --

8 Q. I'm looking at the -- looks like the  
9 second full answer on page 3.

10 A. Um-hum.

11 Q. Where you say -- you point out and the  
12 cost of equity was determined --

13 A. Right.

14 Q. -- by the historical -- okay.

15 A. Yeah.

16 Q. We're at the same place.

17 A. So -- so I didn't use three methods.

18 Those are three components.

19 Q. Sure.

20 A. To calculating the cost of equity.

21 Q. And the historical excess return of the  
22 overall stock market over bonds. The excess return of  
23 the overall stock market would include industry returns  
24 for companies that -- well, would include returns based  
25 on investment income from capital and surplus.

1 Correct?

2 A. The returns on the stock market concern  
3 returns on the equities, so price changes and  
4 dividends.

5 Q. Okay. And then the equity includes  
6 capital and surplus. Is that fair?

7 A. Well, no. The capital and surplus  
8 concerns accounting return. So investment income on  
9 capital and surplus can be used outside of North  
10 Carolina in rate making cases, at least in rate making  
11 cases to determine the accounting profit.

12 The returns we're talking about here aren't  
13 anything related to underlying sources of income.  
14 They're returns based on how much the security price  
15 changed over time.

16 Q. Is it fair to say that the historical  
17 excess return of the overall stock market did include  
18 the cost of equity?

19 A. The cost of equity that I'm determining is  
20 based -- I'm -- I'm sorry. Could you repeat the  
21 question?

22 Q. Sure. Is it fair to say that when you  
23 reviewed the return of the overall stock market, part  
24 of that review would have included a review of the cost  
25 of equity?

1           A.     The purpose of reviewing the overall  
2     return on the stock market over whatever horizon we're  
3     considering is to determine the cost of equity.

4           Q.     Okay. And that overall stock market, the  
5     particular returns that you reviewed would include  
6     industry's income on capital and surplus investments?

7           A.     Could you repeat the question, please?

8           Q.     Sure. Tell you what, we'll move on.

9           Returning to Exhibit RB-24, where did you get  
10    this pro forma form in which you filled your own  
11    data -- into which you filled your own data and  
12    calculations?

13          A.     I created it.

14          Q.     Okay. Was it, in part, based on the form  
15    created by either Dr. Appel or Vander Weide?

16          A.     I'm not familiar with the form created by  
17    Dr. Vander Weide, but it is very closely related and  
18    follows Dr. Appel's analysis in terms of form.

19          Q.     So I'm looking I'm going to point you to  
20    an exhibit in Book 4.

21                   MS. WHARRY: Your Honor, may I approach  
22    the bench to give the witness and yourself the Book  
23    4?

24                   HEARING OFFICER FUNDERBURK: Yes. You  
25    may approach to obtain the -- the books.

1 MR. FRIEDMAN: All right. And -- Your  
2 Honor, I almost -- I or perhaps my colleague may  
3 have to point him to the specific item I'll be  
4 referring to in that book. Could I approach or  
5 could my colleague approach to point him to that  
6 and also point it out to opposing counsel and Your  
7 Honor because it's -- unfortunately, the book  
8 itself doesn't have tabs, and this is about two-  
9 thirds of the way back.

10 HEARING OFFICER FUNDERBURK: You -- you  
11 may approach your opposing counsel and the witness  
12 to identify the passage you're referring to.

13 (Off record discussion)

14 HEARING OFFICER FUNDERBURK: Mr.  
15 Friedman, could this be simplified using the  
16 projector?

17 MR. FRIEDMAN: It could be. The  
18 Clerk's more adept at using the projector than I  
19 am. Would -- would that suffice for you to put  
20 it on the projector?

21 THE WITNESS: I guess so.

22 MR. FRIEDMAN: There on the screen.

23 THE WITNESS: Oh, I got my own.

24 MR. FRIEDMAN: Yeah. Would it not show  
25 up on his screen?



1 HEARING OFFICER FUNDERBURK: We can --  
2 we can do that. We'll attempt to do that. Please  
3 have -- go ahead and have a seat.

4 MR. FRIEDMAN: Okay.

5 HEARING OFFICER FUNDERBURK: Mr.  
6 Spivey, I presume you don't have any objections to  
7 viewing it that way. But if you do, please let me  
8 know, and we'll find it in the book.

9 THE WITNESS: So are -- are we looking  
10 at Appel's testimony?

11 BY MR. FRIEDMAN:

12 Q. Yes. It is Appel's testimony, and it's  
13 his Exhibit RB-14.

14 A. Yeah. I -- I found it.

15 Q. Okay. Great. Then I guess we -- yeah.

16 MR. FRIEDMAN: Your Honor, I didn't  
17 show it to you. Would it be helpful for me to show  
18 you it in the book or on the screen?

19 (Off record discussion)

20 HEARING OFFICER FUNDERBURK: Or if it's  
21 easier, you can just find it in mine. Thank you.

22 MR. FRIEDMAN: Is that visible on  
23 everybody's screen?

24 THE WITNESS: I can see it.

25 MR. FRIEDMAN: We're not seeing it.

1 HEARING OFFICER FUNDERBURK: You're not  
2 seeing it? Okay.

3 MR. SPIVEY: Okay.

4 MR. FRIEDMAN: Your Honor, maybe it  
5 would be easier --

6 HEARING OFFICER FUNDERBURK: Got it?  
7 You've got it on your screen now?

8 MR. SPIVEY: I do. I do. Can we get  
9 it up here?

10 BY MR. FRIEDMAN:

11 Q. All right. So, Dr. Zanjani, do you see  
12 both your pro forma statutory rate of return form and  
13 the first -- and Dr. Appel's?

14 A. I do.

15 Q. Okay. So I am looking at the first page.  
16 I see that under premiums you took out from Dr. Appel's  
17 form a compensation for assessment risk. Is that  
18 correct?

19 A. I believe the compensation for assessment  
20 risk is in my form and not in Dr. Appel's form. Right?

21 Q. Yes. You added one, then, for  
22 compensation for assessment risk. Was that  
23 compensation for assessment risk based on Dr. Mao's  
24 calculations?

25 A. I'm not sure who calculated it, but it

1 was -- I took it as an input into my calculation.

2 Q. Who gave you the percentage?

3 A. I think it came through the Bureau. It  
4 may have been calculated by Dr. Mao or maybe Dr.  
5 Anderson.

6 Q. So other -- I see also that in that first  
7 big block, you have made acronyms of certain things  
8 that Dr. Appel spelled out like loss. You've put loss  
9 and LAE while he spelled out loss and loss adjustment  
10 expense.

11 Other than the compensation for assessment risk  
12 that you added there and your -- both in that first big  
13 block and then at the bottom of the assumptions and  
14 parameters is adjusting terms, not the numbers, but the  
15 categories on that first page, is this identical to Dr.  
16 Appel's?

17 A. So there in addition, there is an  
18 adjustment in the investment income on agent balances.  
19 Notice that there's an investment income on agent and  
20 reinsurance balances, which is different than -- than  
21 what you see in Dr. Appel's.

22 Now to be clear, when I constructed my own  
23 exhibits, I was following Dr. Appel's. So the first --  
24 first step in my construction, if it wasn't clear from  
25 my previous answer, was to reconstruct what he had done

1 and then to, you know, make -- make modifications as I  
2 saw to be necessary.

3 Q. Okay. Turning to the second page. Well,  
4 let me ask you this. If the Court were to go  
5 through --

6 HEARING OFFICER FUNDERBURK: Counsel,  
7 is there a separate page you'd like to show? Keep  
8 in mind, I don't -- you have my exhibit book --

9 MS. WHARRY: Your Honor --

10 HEARING OFFICER FUNDERBURK: -- so I do  
11 need to get it back or see it on the screen.

12 MS. WHARRY: Your Honor, may I switch  
13 to projecting from my computer instead of the  
14 projector. And then that way I can --

15 HEARING OFFICER FUNDERBURK: And  
16 that -- that way you can you can share the  
17 documents and counsel will be able to reference  
18 those same documents in your -- in your book.  
19 Please do so.

20 MS. WHARRY: It's ready to -- and Your  
21 Honor, I can bring it back to you.

22 HEARING OFFICER FUNDERBURK: Um-hum.  
23 If you could leave it open to that page, that would  
24 be great. Thank you.

25 BY MR. FRIEDMAN:

1 Q. Hopefully, the following question will not  
2 require any further review of the specifics of certain  
3 pages. Dr. Zanjani, is it fair to say that if the  
4 court reviews your RB-24 and compares it with the RB-14  
5 of Dr. Appel in 2014, you'll see the differences  
6 between them or the Court would?

7 A. You're asking me if we were to review Dr.  
8 Appel's pro forma and testimony and my testimony that  
9 we would observe differences.

10 Q. And you'd observe all the differences at  
11 least in that pro forma. I'm --

12 A. Yes.

13 Q. Thank you. That's -- trying to shortcut  
14 it. Thank you. That helps. All right. So moving on  
15 from the pro forma.

16 HEARING OFFICER FUNDERBURK: Counsel, I  
17 just want to clarify. I have the list of Rate  
18 Bureau exhibits that includes an RB-14 reinsurance  
19 program summary. The document that you've shown  
20 also has Exhibit RB-14, page 1 at the top.

21 MR. FRIEDMAN: Yes. That was what I  
22 was referring to.

23 HEARING OFFICER FUNDERBURK: Okay. So  
24 it is the same document?

25 MR. SPIVEY: No, Your Honor.

1 MR. FRIEDMAN: No. It's not. He's  
2 testified that he updated and changed, added some  
3 provisions and added some acronyms to the RB-14  
4 from 2014. And I'm -- was trying to shortcut all  
5 of this and simply say, can we all determine the  
6 differences by comparing those two?

7 HEARING OFFICER FUNDERBURK: Okay. I  
8 just wanted to clarify that they are, indeed,  
9 separate documents. You have your own RB-14. This  
10 just happens to have an annotation RB-14 at the top  
11 of it, but it is not your RB-14 for the 2024 case.

12 MR. SPIVEY: Correct, Your Honor.

13 HEARING OFFICER FUNDERBURK: Okay.  
14 Thank you for clarifying.

15 BY MR. FRIEDMAN:

16 Q. Hopefully, that should take us out of the  
17 2014 rate filing, Your Honor. So I'm clearing that off  
18 my desk.

19 MR. FRIEDMAN: Oh, could you take 2014  
20 off of the screen, Madam Court Reporter? So all  
21 right. So that's been removed from the screen?  
22 Thank you.

23 BY MR. FRIEDMAN:

24 Q. Does your cost of capital calculation  
25 include unrealized capital gains?

1 A. We're now not talking about RB-24 anymore?

2 Q. No. No. I'm talking very generally  
3 about --

4 A. Cost of capital? Okay.

5 Q. Yes.

6 A. So the cost of capital calculations,  
7 again, involve -- depends on the method -- but are  
8 aimed at understanding the return demanded by investors  
9 on an insurance company investment.

10 So unrealized capital gains, again, are an  
11 accounting concept and would concern how you calculate  
12 profit for an accounting profit for an insurance  
13 company, whether you include them or exclude them.  
14 Unrealized capital gains are not a -- a concept that's  
15 important for the cost of capital as I'm estimating it.

16 Q. So my question is whether what, for  
17 accounting purposes, is characterized as capital gains,  
18 somewhere in your method of calculating cost of capital  
19 is that number considered?

20 A. Well, to reiterate and maybe reformulate,  
21 when I calculate a cost of equity using the risk  
22 premium methods, for example, I am calculating  
23 correlation with market returns, so correlation of  
24 security market returns.

25 When calculating well, I don't do a DCF

1 calculation, but when Kroll calculates it, it's based  
2 on a discounted present value of dividends. So there  
3 is no unrealized gain that's entering into that  
4 calculation. I -- I don't understand.

5 Q. The present value of -- of dividends does  
6 not itself constitute unrealized capital gains?

7 A. No. So the -- the return that we're  
8 getting from these methods is what an investor is  
9 saying, what do I need from this investment over the  
10 next, you know, whatever horizon we're talking about?  
11 Say it's a one-year investment. So whether that return  
12 ends up in a realized -- being realized or unrealized  
13 isn't entering into the calculus.

14 Q. I'm sorry. I -- I do have to ask this.  
15 Let's just say that in an accounting statement, there  
16 is a number for what for accounting purposes is  
17 described as unrealized capital gains. Does that  
18 number or is that number show up or is that number in  
19 some way subsumed within your calculation of the cost  
20 of equity?

21 A. So unrealized capital gains, if we were  
22 going to consider it -- and it is not considered in our  
23 accounting profit calculations -- would appear  
24 somewhere in these exhibits alongside -- so if you'll  
25 turn to Exhibit RB-24, page 13, there's a calculation



1 of realized capital gains.

2 So unrealized capital gains are not reflected in  
3 the calculation of the accounting return. The only  
4 thing that we're calculating or reflecting in the  
5 accounting return is the realized capital gains.

6 Neither of these is considered in the cost of  
7 equity calculation, which again is we're looking at in  
8 the case of the risk premium methods, the correlation  
9 of security returns with the overall market and in  
10 general attempting to determine the return that an  
11 investor demands for investing in an insurance company.

12 Q. So I'm going to switch gears here and turn  
13 to the Department's -- the Book 3, and in particular  
14 Exhibit 1 in Book 3. Take your time, please.

15 A. Oh, no.

16 Q. Take your time, please.

17 A. No, I -- I just demolished Book 3, I'm  
18 afraid.

19 MS. WHARRY: Your Honor, may I  
20 approach? I can give him Book 3 from the clerk  
21 temporarily while I put that back together?

22 HEARING OFFICER FUNDERBURK: I think  
23 that might make it a little easier for you. Would  
24 you prefer to do that? We can -- we can get you a  
25 different copy so you don't have to --

1 THE WITNESS: Are we talking about  
2 Schwartz?

3 MR. FRIEDMAN: Yes.

4 THE WITNESS: Okay. I think I have in  
5 here, why don't we see how it goes?

6 MR. FRIEDMAN: Your Honor, would now be  
7 a good time perhaps for a short break?

8 HEARING OFFICER FUNDERBURK: We can do  
9 that, but we'll keep it as a very short break  
10 because we do plan on recessing at 4 p.m. We'll  
11 take a ten-minute recess. At ten minutes, I expect  
12 everyone at 10 after 3:00 to be in their seats  
13 ready to proceed. We're in recess. Thank you.  
14 (Recess taken from 3:00 p.m. to 3:11 p.m.)

15 HEARING OFFICER FUNDERBURK: Madam  
16 Court Reporter, Madam Clerk, we are back on the  
17 record. It is 3:11 p.m., and we are ready to  
18 resume hearing.

19 And at the time we took recess, Mr.  
20 Friedman, you were cross examining the witness.  
21 Are you ready to resume?

22 MR. FRIEDMAN: I am, Your Honor.

23 HEARING OFFICER FUNDERBURK: Please go  
24 ahead.

25 BY MR. FRIEDMAN:

1 Q. Mr. Zanjani, I hate to be skipping around  
2 so much with this, but if we could turn back to your  
3 testimony, and in particular, page 10 of your  
4 testimony.

5 MR. SPIVEY: So Mr. Friedman, you're  
6 now in RB-22?

7 MR. FRIEDMAN: Yes. I'm back in RB-22.  
8 In this case, I have put aside the 2014 filing  
9 entirely.

10 THE WITNESS: I'm there.

11 BY MR. FRIEDMAN:

12 Q. All right. Great. Where you refer under  
13 the cost of capital that you considered for publicly  
14 traded companies, you refer to the CAPM. Do you see  
15 that?

16 A. I do.

17 Q. And what's that stand for?

18 A. Capital Asset Pricing Model.

19 HEARING OFFICER FUNDERBURK: Just one  
20 moment, please. We need to turn your microphone  
21 back on.

22 I'm sorry, Mr. Friedman. If you could  
23 begin again.

24 MR. FRIEDMAN: Sure. Begin again from

25 --

1 HEARING OFFICER FUNDERBURK: For  
2 anything that the witness needs to have on the  
3 record.

4 BY MR. FRIEDMAN:

5 Q. Okay. So, as I understand it, you just  
6 testified, Dr. Zanjani, that your reference on page 10  
7 to CAPM refers to the Capital Asset Pricing Model.

8 A. Correct.

9 Q. And that's one of the models you used in  
10 determining your own cost of equity.

11 A. So the entries that are listed as capital  
12 asset pricing model are those by Kroll. So those  
13 estimates, I didn't actually independently generate,  
14 but --

15 Q. But you relied on those Kroll estimates of  
16 the CAPM for the purposes of determining your cost of  
17 equity.

18 A. Well, my cost of equities were estimated  
19 using the risk premium methods.

20 Q. And part of that --

21 A. So what I'm doing --

22 Q. Excuse me.

23 A. -- in this exhibit is gathering a variety  
24 of estimates of the cost of equity. So that's --  
25 that's one of the cost of equities in that table.

1 Q. Okay. And so you consider this as one of  
2 the estimates that ultimately contributed to your  
3 calculation of cost of equity?

4 A. Well, again, my calculation of the cost of  
5 equity was done independently. It -- the purpose of  
6 this table is to list a whole bunch of different  
7 estimates of the cost of equity for the reason that I  
8 believe it's a hard thing to pin down, and different  
9 methods produce different estimates. And if we're  
10 using a single estimate, we might get a very misleading  
11 picture.

12 So I like to appeal to something like the wisdom  
13 of crowds, not very literally. I'm not calculating an  
14 -- an average or something like that, but I'm trying to  
15 get a sense of where all the numbers are.

16 Q. Okay. Is it fair to say, then, you  
17 reviewed or compared the Kroll CAPM in the course of  
18 arriving at your cost of equity?

19 A. Again, my numbers were generated  
20 independently of Kroll --

21 Q. Understood.

22 A. -- so I did not --

23 Q. But you reviewed --

24 A. -- I did not consider it. I'm -- I'm  
25 listing it as an alternative estimate of the cost of

1 equity.

2 Q. Okay. Does the cop -- does a Capital  
3 Asset Pricing Model contemplate consideration of income  
4 on invested capital?

5 A. Can you repeat the question, please?

6 Q. Sure. Does a Capital Asset Pricing Model  
7 contemplate the consideration of income on invested  
8 capital?

9 A. The Capital Asset Pricing Model is a model  
10 that predicts the expected return demanded by investors  
11 in a security on the basis of the correlation of that  
12 security with the overall security market and a risk-  
13 free rate as well.

14 So the -- to elaborate, the expected return for  
15 a security is equal to the risk-free rate plus a beta,  
16 which measures that security's correlation with the  
17 overall stock market times a market risk premium.

18 Q. And part of that measure is the return on  
19 income from invested capital.

20 A. The measure, again, is a measure of  
21 expected return on a security, so the expected return  
22 that an investor in that security would demand to  
23 invest in that security.

24 Q. You used a DCF formula to determine your  
25 total return. Is that correct?

1           A.     So the total return we're referring to is  
2     the total return on page 1-A -- 1-A of Exhibit RB-24?

3           Q.     Or also referred to at page 3 of your  
4     narrative.

5           A.     So, no. The -- the total return referred  
6     to on page 3 in the narrative is -- is the same one  
7     that is on page 1-A of RB-24.

8           Q.     Okay.

9           A.     So that's an accounting return that has  
10    nothing to do with the DCF.

11          Q.     Okay. So you didn't use the DCF formula  
12    to determine what you've characterized here as the  
13    total return?

14          A.     Absolutely not.

15          Q.     I'm not asking whether you used them as a  
16    method in your calculation of the cost of equity, but  
17    just for other economists or perhaps for other  
18    actuaries, is the CAPM used as a method to calculate  
19    the cost of equity?

20          A.     The CAPM is probably the dominant method  
21    used in the financial community to calculate the cost  
22    of equity. There are other methods, so the DCF being  
23    one of them, and there are some others that are used,  
24    as well, such as the -- the Fama-French and some  
25    others.

1 Q. Okay. So the build-up method, is that  
2 another method of estimating the cost of equity, albei t  
3 not one that you say you used in your report?

4 A. Yes. It's a method that some use. I  
5 think that's less accepted than the others in the  
6 communi ty, but it is one that is appears and is  
7 produced by Kroll.

8 Q. And you just mentioned the Fama-French or  
9 Fama-French 5 factor. Is that another method that,  
10 other than yoursel f, others use to calculate the cost  
11 of equi ty?

12 A. Yes.

13 Q. And the implied premi um method as well?

14 A. So I don't think that is -- the implied  
15 premi um method woul d be wi del y recogni zed. That  
16 termi nology woul d be wi del y recogni zed to refer to a  
17 parti cul ar method.

18 That is -- the implied premi um method that I'm  
19 listing on my exhibi t is referring to a method being  
20 used by Aswath Damodaran, where he's basing the market  
21 risk premi um not on a hi storical average, whi ch is more  
22 typical in implementations of the CAPM, but on -- he's  
23 taking into account the current level of stock  
24 val uations and determi ning what he thi nks is a forward-  
25 looki ng market risk premi um.



1           So it's similar to a CAPM, but the  
2           implementation is different.

3           Q.     But is it a method used by others to  
4           calculate the cost of equity, whether it's similar to  
5           CAPM or not?

6           A.     Yes. It's used by, at least, by Aswath  
7           Damodaran, and he's a respected expert in that area.

8           Q.     And you refer to the Damodaran method in  
9           your report; do you not?

10          A.     I'd have to read it.

11          Q.     Let's see.

12          A.     So I -- I do have a section on that  
13          method. Yes.

14          Q.     Thank you. And does the risk premium over  
15          treasury bill method, is that also used by others, not  
16          you, to arrive at an estimate of the cost of equity?

17          A.     So we're referring to the -- it was used  
18          by me, I believe, right?

19          Q.     Okay.

20          A.     It's --

21          Q.     But you've explained that, as I understand  
22          it, your cost of equity calculation is a different  
23          concept than actually looking at the returns from  
24          investment on capital surplus. Is that a fair summary?

25          A.     Well, investment returns on capital

1 surplus, that's an accounting concept. The risk  
2 premium method is one of the methods used to determine  
3 the cost of equity. The risk premium method, one of  
4 the main reasons that I'm implementing those methods is  
5 that there is some question about whether a risk-free  
6 asset can be used in calculating the cost of equity in  
7 North Carolina.

8 So, I'm, again, I'm not a lawyer and don't claim  
9 to be able to parse the various legal decisions and  
10 orders over the years. But the -- for example, the  
11 risk premium over the AAA bond and the risk premium  
12 over the BAA bond is to be providing a method that is  
13 not -- that is not using a risk-free asset as a  
14 reference asset and is thus -- thus not subject to the  
15 criticism that it's based on a risk-free asset.

16 Q. Outside of North Carolina, do other  
17 economists or actuaries use a risk premium over  
18 treasury bill method to determine their cost of equity?

19 A. So that's a common method. Yes.

20 Q. So in determining what funds a North  
21 Carolina homeowner's carrier would have available to  
22 invest -- invest, first of all, you did determine that,  
23 did you not? I think we're mentioning particularly  
24 that you added prepaid expenses and agent balances in  
25 determining that.

1           A.     I subtracted those if we're talking about,  
2     page 7.

3           Q.     Um-hum.

4           A.     Is that what we're on, RB-24?

5           Q.     Yes. You subtracted them because they  
6     were unavailable to invest?

7           A.     Yeah. So the idea is that premium dollars  
8     are received. And one of the advantages or one of the  
9     sources of income that insurance companies receive  
10    concern investing those premium dollars, and that has  
11    to be accounted for in the -- in a profit calculation.

12                  However, some of those, some components of the  
13    premium dollar are not available to invest. So, this  
14    calculation deducts those quantities that are not  
15    available. That's the intention.

16           Q.     Besides prepaid expenses and agent  
17    balances, what other portions of the premium dollar do  
18    you consider unavailable to invest?

19           A.     So are we talking about the -- under  
20    premium reserve?

21           Q.     I'm asking -- I mean, so --

22           A.     Well --

23           Q.     -- is that another one that you consider  
24    unavailable to invest?

25           A.     So the premium dollar comes in, and it --

1 various portions of it might be used for expenses.  
2 Portions of it are used for -- for underwriting  
3 expenses. Portions of it are used for purchasing  
4 reinsurance, and there are also balances that are held  
5 by agents, so -- so those aren't received. And there  
6 are also reinsurance recoverables that are not  
7 available to invest as well.

8 Q. So what you've just discussed, those are  
9 for your, in your opinion, the parts of the premium  
10 dollar that are unavailable for an insurance company to  
11 invest.

12 A. Well, it's not -- not necessarily an  
13 exhaustive list, but those are the major components.  
14 Yes.

15 MR. FRIEDMAN: Your Honor, if I could  
16 have about five minutes to just go back over my  
17 questions, and then I may be at the end.

18 HEARING OFFICER FUNDERBURK: Okay.

19 MR. FRIEDMAN: I'll just turn this off.  
20 (Discussion off the record)

21 MR. FRIEDMAN: Your Honor, back on the  
22 record, and those are all (inaudible) questions I  
23 have -- is my microphone active now? Did you catch  
24 that last bit? No? Okay.

25 I'm ready. Back on the record, Your

1 Honor, and that concludes my cross examination of  
2 Dr. Zanjani.

3 HEARING OFFICER FUNDERBURK: Mr.  
4 Spivey, redirect?

5 MR. SPIVEY: Your Honor, may I ask that  
6 we take about, let's say, ten minutes. So we break  
7 out and I'll determine whether I have anything or  
8 not. I'm thinking I have a very, very few  
9 questions. So I'm thinking we could do that and  
10 not endanger 4 o'clock at all.

11 HEARING OFFICER FUNDERBURK: Okay. So  
12 you're asking for a true recess of about ten  
13 minutes so you can go in the breakout room and have  
14 some discussion?

15 MR. SPIVEY: Yes, please.

16 HEARING OFFICER FUNDERBURK: Okay. We  
17 are in recess at 3:32 p.m. We'll go back on the  
18 record at 4:42.

19 MR. SPIVEY: Thank you.

20 HEARING OFFICER FUNDERBURK: Thank you.  
21 (Recess taken from 3:32 p.m. to 3:42 p.m.)

22 HEARING OFFICER FUNDERBURK: Madam  
23 Court Reporter, Madam Clerk, we're back on the  
24 record.

25 I'll remind the witness, you are still

1 under oath from being sworn in earlier.

2 Mr. Spivey, do you have redirect?

3 MR. SPIVEY: Your Honor, I do have just  
4 a few questions, and thank you for the -- the short  
5 break.

6 HEARING OFFICER FUNDERBURK: Oh, you're  
7 welcome. Please proceed.

8 MR. SPIVEY: All right. Are we ready?

9 REDIRECT EXAMINATION

10 BY MR. SPIVEY:

11 Q. Dr. Zanjani, on cross examination,  
12 Department counsel asked you a number of questions. As  
13 I recall, it pertained to it's what I would call the  
14 topic of agents' balances, and he asked you questions  
15 pertaining to whether you understood that companies  
16 often sweep from agents on a regular periodic basis,  
17 maybe you said monthly. Do you recall that set of  
18 questions generally?

19 A. I do.

20 HEARING OFFICER FUNDERBURK: Mr.  
21 Spivey, I believe they may be having a little  
22 difficulty hearing you in the microphone. You want  
23 to move that closer? And I -- I empathize. I get  
24 fussed out for this on a regular basis.

25 MR. SPIVEY: Okay.

1 HEARING OFFICER FUNDERBURK: So if you  
2 could just have it a little closer. Thank you.

3 MR. SPIVEY: Do I -- would you like me  
4 to repeat --

5 HEARING OFFICER FUNDERBURK: Just have  
6 a little closer to the microphone. Is that better?

7 MR. SPIVEY: Do I need to repeat my  
8 question?

9 BY MR. SPIVEY:

10 Q. Dr. Zanjani, if we assume that companies,  
11 in fact, conduct sweeps on some kind of periodic basis,  
12 will the results of that practice be reflected in the  
13 annual statement data that I believe you testified you  
14 looked at?

15 A. It is my understanding that they would.

16 Q. All right. There were also several  
17 questions from Department counsel regarding your table  
18 on page 10 in Exhibit RB-22, your pre-filed testimony,  
19 and a number of questions there pertaining to,  
20 specifically the Kroll CAPM method? You recall,  
21 generally, those questions?

22 A. I do.

23 Q. Dr. Zanjani, if you had not included those  
24 particular examples of the cost of equity from third  
25 parties or, for that matter, any of the others on that

1 page, what would the effect have been on your  
2 conclusions in this matter as you presented them in  
3 your testimony?

4 A. So the ultimate conclusion of my analysis  
5 was to compare the accounting return, derived from the  
6 selected underwriting provision without including  
7 investment income on capital and surplus. And I found  
8 that that return was 7.43 percent to 7.7 percent  
9 depending on what -- or 7.72 percent, I believe it was,  
10 depending on what assumptions were used.

11 That figure was below every estimate I had,  
12 ultimately, for the both the cost of equity and for the  
13 weighted average cost of capital. So removing any  
14 individual estimate, or any set of estimates even,  
15 would not have an effect on my conclusions.

16 Q. Dr. Zanjani, in providing your analysis to  
17 the Rate Bureau for use by the Rate Bureau in this rate  
18 review and then, obviously, the rate filing that  
19 resulted from that rate review, have you done anything  
20 or presented anything that you believe or understand to  
21 be illegal?

22 A. Not to my knowledge. No.

23 Q. In providing that analysis to the Rate  
24 Bureau, for its use in the rate review and this -- and  
25 this rate filing, have you done anything that violates



1 any professional obligation you may have as an  
2 economist?

3 A. No.

4 MR. BEVERLY: May we have a moment,  
5 Your Honor?

6 HEARING OFFICER FUNDERBURK: Yes.

7 MR. SPIVEY: Your Honor, that concludes  
8 my examination on redirect.

9 HEARING OFFICER FUNDERBURK: Thank you.  
10 Is there any recross?

11 MR. FRIEDMAN: No, ma'am.

12 HEARING OFFICER FUNDERBURK: Thank you.  
13 You're excused. Thank you for your testimony  
14 today. You may step down.

15 THE WITNESS: Thank you, Your Honor.

16 HEARING OFFICER FUNDERBURK: All right.  
17 Counsel, in reviewing our -- sorry, let me get the  
18 microphone a little closer to me -- pre-hearing  
19 order, it appears that we had still reserved time  
20 for Dr. Zanjani's testimony tomorrow morning. Will  
21 counsel -- will you be prepared to proceed with Dr.  
22 Anderson -- I'm sorry, Mr. Anderson and Ms. Mao  
23 tomorrow?

24 MR. SPIVEY: Your Honor, that is our  
25 expectation.

1 HEARING OFFICER FUNDERBURK: That's  
2 your expectation.

3 MR. SPIVEY: That we will proceed  
4 tomorrow with -- with Mr. Anderson first, to be  
5 followed by Ms. Mao.

6 HEARING OFFICER FUNDERBURK: Okay. One  
7 thing I will note, we don't need to address it now,  
8 but we will, at some point, need to address the  
9 various exhibits.

10 Mr. Friedman, you referenced several of  
11 the Rate Bureau's exhibits, and you referenced two  
12 of DOI's exhibits. The only exhibit that we've had  
13 admitted at hearing thus far was Rate Bureau  
14 Exhibit 4. So we don't need to address those now,  
15 but at some point, we will need to make sure that  
16 the record is clear and clean as to what exhibits  
17 have been introduced in.

18 MR. FRIEDMAN: And we can discuss among  
19 counsel whether we can agree to most of them. And  
20 we can certainly discuss among counsel whether we  
21 can agree to present to you, Your Honor, everything  
22 in one omnibus.

23 HEARING OFFICER FUNDERBURK: I'll --  
24 I'll let counsel discuss that and propose the  
25 options to me. Is -- are there any housekeeping

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matters we need to address before we recess for the day?

MR. SPIVEY: None from the Rate Bureau.

HEARING OFFICER FUNDERBURK: Any from DOI, Mr. Friedman?

MR. FRIEDMAN: None, Your Honor.

HEARING OFFICER FUNDERBURK: All right. Then I will recess us until 9:00 a.m. tomorrow morning. We will begin promptly at 9:00 a.m., so I'll ask counsel to be seated and prepared to go at 9:00 a.m. And if there are any housekeeping matters we need to address, which I don't expect, we'll address those first, and then we'll move into witness testimony.

Thank you for your time today. I'll see you tomorrow morning. And --

MR. SPIVEY: Thank you.

HEARING OFFICER FUNDERBURK: -- we're off the record. Thank you.

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(Hearing adjourned at 3:50 p.m.)

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CERTIFICATE OF REPORTER

STATE OF NORTH CAROLINA

COUNTY OF WAKE

I, Wendy Sawyer, court reporter, do hereby certify that the witnesses whose testimony appears in the foregoing hearing were duly sworn; that the testimony of said witnesses was taken by me to the best of my ability and thereafter reduced to typewriting under my direction; that I am neither counsel for, related to, nor employed by any of the parties to the action in which this hearing was taken, and further that I am not a relative or employee of any attorney or counsel employed by the parties thereto, nor financially or otherwise interested in the outcome of the action.

This, the 7th day of October, 2024.



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WENDY SAWYER, Court Reporter

Notary Public #202411500157

Commission Expires April 23, 2029