

NORTH CAROLINA DEPARTMENT OF INSURANCE
RALEIGH, NORTH CAROLINA

STATE OF NORTH CAROLINA
COUNTY OF WAKE

IN THE MATTER OF:

BEFORE THE
COMMISSIONER OF INSURANCE

THE FILING DATED
JANUARY 3, 2024 BY
NORTH CAROLINA RATE BUREAU
FOR THE REVISION OF
HOMEOWNERS INSURANCE RATES

COPY

DOCKET NO. 2157

BEFORE: AMY FUNDERBURK, HEARING OFFICER

TRANSCRIPT

OF

HEARING

VOLUME XIII - A.M. SESSION

Raleigh, North Carolina

November 1, 2024

9:05 a.m.

Reported by: Audra Smith, RPR, CRR, FCRR

APPEARANCES OF COUNSEL

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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 the North Carolina Department of Insurance, 3200 Beechleaf Court, Raleigh, North Carolina, on the 1st day of November, 2024, at 9:05 a.m., before Audra Smith, RPR, CRR, FCRR and Notary Public.

I N D E X

PAGE

ALLAN SCHWARTZ

Redi rect Exami nati on by Mr. Fried man

2021

LAUREN CAVANAUGH

Di rect Exami nati on by Mr. Fried man

2072

1 P R O C E E D I N G S

2 MS. FUNDERBURK: We're back on the
3 record. It is 9:05 a.m., November 1, 2024.
4 Counsel, are there any matters we need to
5 address before we resume testimony this
6 morning?

7 MR. SPIVEY: Not to my knowledge.

8 MS. FUNDERBURK: Please turn your
9 microphone on.

10 MR. FRIEDMAN: Your Honor, we will be,
11 over the week if it's acceptable to
12 Your Honor, creating a redlined version of
13 Mr. --

14 MS. FUNDERBURK: Schwartz.

15 MR. FRIEDMAN: -- Schwartz's report
16 just to show the things that he testified to,
17 if that is of use, or if you don't think
18 that's necessary. I thought it might be of
19 use to the Court in seeing exactly what words
20 he took out -- or changed, or numbers that he
21 changed.

22 MS. FUNDERBURK: It would be helpful
23 for me to see them all in one spot, a
24 redlined version. I've taken notes on where
25 those changes are, but it would be helpful

1 for me to have that copy.

2 MR. FRIEDMAN: Okay. Well, we --

3 MS. FUNDERBURK: Go ahead.

4 MR. FRIEDMAN: I think we can have that
5 done and circulated to the parties by Friday.

6 MS. FUNDERBURK: Next Friday?

7 MR. FRIEDMAN: Yes.

8 MS. FUNDERBURK: Okay. Speaking of
9 corrections, are you making headway on errata
10 sheets?

11 MR. FRIEDMAN: I've done some work,
12 Your Honor.

13 MR. BEVERLY: We've conditioned our
14 witnesses, Your Honor, on what will be
15 required of them. Admittedly, we have not
16 made tremendous headway this week but expect
17 to double down next week.

18 MS. FUNDERBURK: You'll have a little
19 more time next week. When everybody goes to
20 conference, counsel will still be in Raleigh
21 working on North Carolina ratemaking. Okay.

22 Anything else that we need to address
23 before we begin?

24 MR. FRIEDMAN: No, ma'am.

25 MS. FUNDERBURK: Now, Mr. Friedman, you

1 provided everyone a copy of the 2014 -- I
2 think it may have come out in 2015, but it
3 was related to the 2014 Rate Filing.

4 MR. FRIEDMAN: I have, Your Honor.

5 MS. FUNDERBURK: Is this going to be
6 introduced as an exhibit? I don't have a
7 sticker. What are we doing here?

8 MR. FRIEDMAN: I wasn't planning on it
9 since it is published authority that's
10 available as a public record. I was just
11 going to be asking about certain language in
12 it. So whatever your preference is,
13 Your Honor. Usually --

14 MS. FUNDERBURK: I just need you to get
15 closer to your microphone.

16 MR. FRIEDMAN: Whatever your preference
17 is, Your Honor. Normally, I would not,
18 before questioning a witness about a
19 published decision offered as an exhibit.
20 I've certainly had judges say they prefer it
21 not be an exhibit. Whatever your preference
22 is.

23 MS. FUNDERBURK: All right. Let's get
24 started for the day. We left off yesterday.
25 The Rate Bureau had concluded cross of

1 Mr. Schwartz. We did not begin redirect by
2 Mr. Friedman.

3 Mr. Schwartz, please return to the
4 stand. I'll remind you, sir, that you do
5 continue to be under oath. And it looks like
6 your microphone is on. Just please be sure
7 you are speaking into the microphone.

8 Mr. Friedman, please proceed.

9 ALLAN SCHWARTZ,
10 having been previously duly sworn, examination and testimony
11 continued as follows:

12 REDI RECT EXAMI NATION

13 BY MR. FRIEDMAN:

14 Q Good morning, Mr. Schwartz. I placed
15 in front of you a -- or the Court of Appeals of
16 North Carolina decision affirming the 2014
17 Homeowners decision by the Commissioner of
18 Insurance, and you had testified in those
19 proceedings before the Commissioner.

20 And the questions I'm going to be
21 asking you about and parts I'm going to be reading
22 from the opinion have to do with what I believe the
23 opposing counsel was trying to imply in some of his
24 questions of you.

25 So let me ask this first: In the

1 1990 -- excuse me. In the 2001 audit, did you -- do
2 you recall that case?

3 A Generally, yes.

4 Q Do you recall performing a comparable
5 earning analysis for that case?

6 A Yes.

7 Q And do you recall whether it was
8 accepted by the Courts of Appeals?

9 A I believe that the Commissioner
10 adopted, essentially, my profit methodology in the
11 2001 Auto case, and the Court of Appeals accepted
12 that.

13 Q Okay. And then in 2014, did you use a
14 combined earnings methodology to determine the
15 profit provision as well?

16 A Yes. I consistently used in North
17 Carolina, during this time period, a comparable
18 earnings analysis. And when it's gone to a hearing,
19 I believe the Commissioner has accepted my
20 methodology; and when it was appealed, I believe the
21 Court of Appeals affirmed the use of my methodology
22 for profit.

23 Q And in the current filing, is your
24 methodology for determining profit the same as it
25 was in the 2014 Homeowners Filing and in the 2001

1 Auto Filing?

2 A It's effectively the same. It's really
3 the same except for this issue about agents'
4 balances where, I think between 2001 and 2014, the
5 Commissioner changed how he considered it, and for
6 this filing, I included agents' balances, but also
7 other considerations in determining how much the
8 invested assets were. But other than that, it's the
9 same type of methodology of comparable earnings
10 analysis.

11 Q And you testified, I think, a great
12 deal yesterday about the agents and the other factor
13 and how you included those?

14 A Yes. Mr. Spivey asked me a number of
15 questions about it, and I explained why that was --
16 my methodology was the appropriate one to use.

17 Q Could you turn to what's marked in the
18 upper right-hand as page 10 of the decision?

19 A Okay.

20 Q And this would be the second full
21 paragraph down that begins with -- it's on the
22 right, first of all, and it begins with "Upon
23 review."

24 I'm just going to go ahead and read
25 that into the record and then ask you a couple of

1 questions.

2 "Upon review of the Commissioner's
3 findings, we do not think the profit method in the
4 instant case was the same as that rejected in 1996
5 Auto. First, there is no indication that either
6 Schwartz or the Commissioner tested their
7 underwriting profit provisions by adding the profit
8 earned from investing capital and surplus to the
9 profit earned by the insurance operations to compare
10 total returns, as was held to be error in 1996
11 Auto."

12 "Second, the Commissioner clearly
13 indicates in the order that his profit methodology
14 is in keeping with the Commissioner's Order
15 following the Bureau's 2001 Auto Filing, which this
16 Court upheld in 2001."

17 And regarding what I just read, in this
18 case, did you test your underwriting profit earned
19 by insurance operations to compare it to total
20 returns, as was error in 1996 Auto?

21 A No, I did not do the calculation that
22 the Court, I would say, found objectionable in 1996.

23 Q Okay. The next thing I'm going to read
24 is at the following page, 11, in the upper
25 right-hand corner, and I'm going to be reading

1 the -- let's see.

2 MR. FRIEDMAN: One second, Your Honor.

3 BY MR. FRIEDMAN:

4 Q All right. In the upper -- almost at
5 the top on the left side, and this is discussing the
6 2001 Auto decision in 2014 by the Court of Appeals.

7 "This Court distinguished the
8 Commissioner's ratemaking formula in 2001 Auto
9 that, 'rather than attempting to find the total
10 return, the Commissioner set the return on insurance
11 operations as his target.' "

12 In this case, have you set your return
13 on insurance operations as your target?

14 A Yes. I used a target -- I used a
15 return on insurance operations as the target. I
16 mean, you could see that from Schedule AIS-15 at the
17 very bottom in the boxed line, it says "Selected
18 target return on operations as a percent of
19 premi um. "

20 So I was using a target based on the
21 return from operations.

22 Q Do you recall Mr. Spivey's questions
23 yesterday about whether you had complied with
24 ASOP 38 given that you didn't calculate your profit
25 provision according to the definition of "total

1 return" in that same ASOP? You want to go to
2 ASOP 38?

3 A I don't think -- I don't think it was
4 ASOP 38. I think it was ASOP 30.

5 Q Thirty, you're right. You're
6 absolutely right. Would you like me to go there?

7 MR. FRIEDMAN: Your Honor, that's at
8 12, page 50. So I'll rephrase my question.

9 BY MR. FRIEDMAN:

10 Q Do you recall Mr. Spivey's questions
11 yesterday about whether you had complied with ASOP
12 30 by not calculating your profit provision
13 according to the definition of "total return," also
14 in ASOP 30?

15 A I think the issue was that ASOP 30
16 talks about using the cost of capital, and I did not
17 use a cost of capital because my understanding is
18 that the courts in North Carolina have found that
19 the use of a cost of capital includes investment
20 earnings on capital and surplus, which is not
21 allowed in North Carolina.

22 BY MR. FRIEDMAN:

23 Q Wouldn't it have created a catch-22 for
24 you if you had included in your report an analysis
25 of the cost of capital alongside your combined

1 earnings?

2 A Yeah. I would have used the cost of
3 capital in North Carolina because actuaries, in
4 their analyses, are required to follow the
5 applicable law. And my understanding of the
6 applicable law is that investment earnings on
7 capital and surplus, which are included in the cost
8 of capital analysis, is not allowed in North
9 Carolina.

10 Q All right. Turn to page 12 in the
11 upper right-hand corner --

12 A Are we back to the Court of Appeal's
13 decision?

14 Q Yes, sir, yes, sir. This -- I'm going
15 to be reading from the bottom full paragraph on the
16 right.

17 "The bureau first challenges the
18 Commissioner's rejection of the filed net cost of
19 reinsurance provision. The bureau contends the
20 filed net cost of reinsurance provision based on the
21 procedure developed by Appel, which the bureau now
22 refers to as an economic model, was reasonable and
23 supported by the evidence."

24 Just to clarify what went on in 2014,
25 was the bureau relying on a procedure that Mr. Appel

1 developed in order to calculate the alleged net cost
2 of reinsurance?

3 A Yes. In 2014, Dr. Appel did the
4 calculation of the net cost of reinsurance using,
5 essentially, the same type of procedure that the
6 Rate Bureau was using, in this case, of a
7 hypothetical reinsurance program, which wasn't
8 supported by any actual data or documents. And then
9 doing a theoretical analysis of what he believed the
10 price of that reinsurance should be relative to the
11 expected loss recoveries.

12 So in the current filing, from a
13 technical aspect, may be trying to estimate some of
14 those parameters in a different manner. But the
15 current filing is, essentially, the same procedure
16 by the Rate Bureau in 2024 as in 2014.

17 Q So now if you could turn to page 14 in
18 the upper right-hand of the page of the decision,
19 and I'm going to be in the right-hand column, toward
20 the bottom of the sentence -- of the page, reading
21 from, I guess, what's quoted as paragraphs 448, 449,
22 and 452 of the Commissioner's 2014 decision.

23 448: "Schwartz has proposed a factor
24 of 10 percent of premium, based upon an analysis of
25 historical countrywide data of the entire homeowners

1 insurance industry over the last 28 years."

2 449: "Schwartz testified... that
3 pursuant to North Carolina General Statute
4 58-36-10(2), countrywide data may be used where
5 North Carolina experience is unavailable."

6 And then 452: "Schwartz provides a
7 reasonable measure to set the net cost of
8 reinsurance of 10 percent of premium given that we
9 do not have actual composite North Carolina data
10 available, and that the countrywide data... provides
11 a reasonable benchmark to North Carolina because of
12 similar measures of risk."

13 My question is: Just as in the 2014
14 decision, have you, in this case, based your
15 analysis on historical countrywide data of the
16 entire homeowners insurance industry, and
17 specifically your net cost analysis?

18 A Yes. That's shown on Schedules AIS-20
19 and AIS-21.

20 Q You made that testimony in 2014. Since
21 then, have you had an additional 10 years of
22 experience in reviewing filings that include net
23 cost of reinsurance provisions?

24 A There are additional years, and so if
25 you go to -- depending upon which set of data are

1 used, you know, there's different levels of
2 information. So on AIS-20, now that shows 44 years
3 of data, going from 1980 to 2023.

4 Q So is it --

5 A I'm not done.

6 Q Oh, excuse me.

7 A And on AIS-21, which is a different
8 type of data, it's organized in a different manner.
9 It reflects the same thing: Countrywide homeowners
10 insurance, but it's just organized and reported in a
11 different manner. Goes from 1992 to 2023. So that
12 would be 34 years of information.

13 Q Versus the 28 years in 2014 that you
14 have?

15 A Yes.

16 Q Do you recall Mr. Spivey's questions
17 yesterday about your curriculum vitae?

18 A Yes.

19 Q And do you recall questions regarding
20 your experience -- basically regarding your
21 testimony about your -- about whether you had enough
22 experience in reviewing the net cost of reinsurance
23 to be testifying credibly here?

24 MR. SPIVEY: Objection. I don't think
25 that's even a close characterization of my

1 questions, plus I believe it was probably two
2 days ago, not yesterday.

3 BY MR. FRIEDMAN:

4 Q Do you recall Mr. Spivey's extensive
5 questions about your experience with reinsurance
6 particularly?

7 A I recall Mr. Spivey asked me questions
8 regarding reinsurance.

9 Q Okay. And I'm going to read now from
10 the 2014 decision, as I said, on page 15, or on the
11 left-hand side, the left-hand column.

12 And in the third paragraph it states:
13 "Regarding the testimony by Schwartz, the bureau
14 claims that Schwartz did not meet the requirements
15 of Rule 702(a) of the North Carolina Rules of
16 Evidence and Daubert for the admissibility of expert
17 testimony."

18 And then there's citation to the North
19 Carolina Rule of Evidence and to Daubert, the
20 decision.

21 "Specifically, the bureau contends that
22 because Schwartz testified that he has never been
23 engaged on a professional basis by a reinsurer,
24 reinsurance broker, or primary insurer to price a
25 reinsurance policy, has not individually been

1 involved in a transaction for the purpose of
2 reinsurance, and has never in a professional
3 capacity recommended or calculated hurricane average
4 annual losses per use by a reinsurer or reinsurer
5 insurance broker, Schwartz lacks the knowledge,
6 skill, experience, training, or education to be
7 competent to testify on the cost of reinsurance. We
8 disagree."

9 Then I'm going to read into the
10 following paragraph that bleeds from the right over
11 into the top on the left. At the second-to-last
12 sentence on the lower left-hand column, last
13 paragraph: "Although Schwartz may not have been
14 qualified to develop the reinsurance model, there is
15 a significant difference between developing a model
16 to project reinsurance costs and comparing modeled
17 results to actual reinsurance data. Based on
18 Schwartz's reinsurance designation and experience as
19 an actuary, having participated in numerous rate
20 cases, we hold Schwartz was competent to testify on
21 the subject of reinsurance, and the Commissioner did
22 not abuse his discretion in considering or giving
23 weight to Schwartz's testimony."

24 And my question for you is: Is it your
25 understanding that the reinsurance designation that

1 the Court of Appeals is referring to there is the
2 same designation that you were questioned about by
3 Mr. Spivey?

4 A Yes. I mean, once that designation is
5 awarded, it stays with you.

6 Q Have you ever claimed that you have the
7 expertise to develop a reinsurance model like that
8 of Dr. Appel, which you've stated Ms. Mao is
9 essentially still using?

10 A I haven't claimed that for
11 consideration in this case. Whether I may have done
12 it elsewhere, I don't think is relevant because I'm
13 not testifying in that regard in this case.

14 Q In this case, does your analysis of the
15 hurricane losses and -- which affect the modeled
16 reinsurance -- the modeled cost, net cost of
17 reinsurance, simply compare North Carolina Rate
18 Bureau's modeled results for the net to actual
19 reinsurance data?

20 A For reinsurance, I didn't do a
21 comparison. For reinsurance, what I found is just
22 relying on North -- on the same information that the
23 Court of Appeals found to be relevant in the last
24 case.

25 Yeah, in the Court of Appeals decision

1 on page 16, it says the Court of Appeals -- up in
2 the left-hand corner, the second line, the sentence
3 says -- well, it looks different on the screen than
4 what I have.

5 But the sentence that begins: "While
6 10 percent may not be an exact calculation,
7 Schwartz's recommendation and the Commissioner's
8 selection of 10 percent for the net cost of
9 reinsurance was based on a reason analysis with a
10 rational basis in the evidence."

11 And then the Court goes on to summarize
12 that evidence, and at the end of the paragraph, it
13 says: "Upon review, it is clear that Schwartz's
14 analyses was well reasoned and constitutes material
15 and substantial evidence. Furthermore, it supports
16 the Commissioner's findings and conclusions. Thus,
17 the Commissioner's selection of the 10 percent net
18 cost of reinsurance was not arbitrary."

19 Then in the next paragraph -- I won't
20 read into the record -- it talks about what the
21 bureau alleged that I did and that the Court
22 concluded that -- well, I'll read from the middle of
23 that paragraph where it says -- the Court says: "It
24 is clear the bureau misconstrues the data and
25 Schwartz's testimony."

1 Q Okay.

2 A So I would just say my --

3 MR. SPIVEY: I'm sorry. Could you
4 point us to the last passage you read?

5 THE WITNESS: Okay. The paragraph that
6 says, "The bureau looks to the same
7 countrywide data."

8 MR. SPIVEY: Thank you.

9 THE WITNESS: One, two, three, four,
10 five, six, seven, eight, nine, ten, eleven,
11 twelve, thirteen, fourteen, fifteen, sixteen.
12 I think it's about 16 lines down where it
13 says, "It is clear the bureau misconstrues
14 the data and Schwartz's testimony."

15 Anyway, the analysis --

16 MS. FUNDERBURK: Hold on.

17 Mr. Spivey, were you able to find it?

18 MR. SPIVEY: Yes, thank you.

19 MS. FUNDERBURK: I have the version
20 Mr. Friedman gave me, but my actual personal
21 notes copy is the version from the Court. So
22 if you need notations on that, that's where
23 I'm making these. I can give you page
24 numbers from that version, if you need it.

25 Please continue, Mr. Schwartz.

1 THE WITNESS: Thank you.

2 A I just wanted to say that the procedure
3 that I'm using in this case is the same one that the
4 Court concluded was a reasonable analysis and a
5 rational basis of the evidence. Other than it
6 includes more years of experience, and actually for
7 this case, you know, where the Court in the 2014
8 case found that 10 percent was reasonable. In this
9 case, I'm using 15 percent as a number. So the
10 value I'm using is 50 percent higher than the value
11 that the Court found reasonable in 2014.

12 BY MR. FRIEDMAN:

13 Q I'm going to move on to a different
14 question. Do you recall Mr. Spivey's questions to
15 you yesterday about an NAIC publication?

16 A Yes.

17 Q And was your understanding of those
18 questions basically whether you had calculated your
19 profit and provision in keeping with what that NAIC
20 publication stated?

21 A And I think the question and my
22 testimony dealt with whether I used the same
23 methodology that was set forth in the NAIC report.
24 And then I said the NAIC report used a certain
25 methodology for the analysis they were doing in the

1 context of their analysis.

2 You know, in the context of a rate
3 filing I used a different analysis, which I believe
4 is more comprehensive, and it's consistent with
5 what's required in rate analyses in California by
6 the insurance department and also consistent with at
7 least one decision of the Massachusetts Division of
8 Insurance regarding whether those other items need
9 to be taken into account.

10 Q Are you aware of any publications by
11 NAIC suggesting that the North Carolina Commissioner
12 of Insurance is required to calculate profit in
13 keeping with any alleged NAIC standard,
14 notwithstanding North Carolina law?

15 A I mean, the NAIC actually doesn't have
16 any authority to impose standards on insurance
17 departments. The NAIC can make recommendations for
18 model laws and model regulations. But until a state
19 adopts that model law and regulation, the insurance
20 department in that state is not bound by the NAIC
21 models.

22 Q And in terms of, if you're familiar
23 with them, any agreements that a Department of
24 Insurance makes with NAIC in order to join it, are
25 you familiar with any of those?

1 A I mean, the NAIC doesn't require
2 insurance departments to follow procedures that it
3 may set out in reports as a requirement for being a
4 member of the NAIC.

5 Q Okay. Thank you.

6 Regarding your independent work on your
7 report -- and Ms. Lauren Cavanaugh, who has
8 submitted the other actuarial prefiled testimony for
9 the department, have you ever reviewed
10 Mr. Cavanaugh's report?

11 A No, I have not read her report.

12 Q Okay. Did you collaborate with
13 Ms. Cavanaugh in any way on either the content of
14 your report as you were drafting it, or her report
15 as she was drafting it?

16 A No, we did not collaborate.

17 Q Okay. And otherwise -- so you
18 drafted -- as you testified, you drafted your own
19 report by yourself?

20 A Yes.

21 Q Are there -- do you think that's an
22 advantage?

23 A Again, my report is like an independent
24 report of my opinion, and it's not influenced by
25 what other people might have been telling me.

1 So it completely represents my opinion,
2 as opposed to a group report, which might reflect
3 the opinions of a bunch of different people and
4 other, you know, people influence each other on what
5 to put in the report.

6 Q Okay. You've reviewed the testimony of
7 Ms. Mao, Mr. Anderson, Mr. Ericksen, and
8 Professor Zanjani?

9 A Yes.

10 Q Okay. Do you recall testimony that
11 they had conversed prior to signing off on the final
12 copies of their reports?

13 A It's my understanding that the
14 consultants for the bureau did have conversations
15 with each other and provided inputs to each other,
16 to varying extents, depending on who you're looking
17 at.

18 Q In the case, for instance, of
19 Mr. Anderson or Mr. Ericksen, do you recall
20 testimony to the effect that they had been
21 conversing for months before their respective
22 reports were signed?

23 A I do not remember a particular time
24 frame.

25 Q Okay. What is your opinion of three

1 actuaries and an economics professor strategizing
2 one another's work product --

3 MR. SPIVEY: Objection.

4 MS. FUNDERBURK: State your grounds.

5 MR. SPIVEY: I think the
6 characterization is inappropriate. There's
7 no basis in the evidence for that
8 characterization. It's inappropriate, and
9 there's no basis for evidence in this case
10 for that characterization.

11 MR. FRIEDMAN: Your Honor, a couple
12 things and -- but I am going to rephrase.
13 But I will say that there was testimony that
14 they came and sat in on one another's
15 presentations to the committees. There was
16 testimony that they reviewed the essence of
17 one another's work product before they signed
18 off on their own.

19 And I think in my -- for me, the most
20 telling detail that they were strategizing --

21 MS. FUNDERBURK: Well, and I think the
22 objection is less as to what type of
23 cooperation and review may have taken place
24 versus the characterization.

25 Did you reference it as "collusion," or

1 what terminology --

2 MR. FRIEDMAN: "Strategizing."

3 MS. FUNDERBURK: "Strategizing."

4 MR. FRIEDMAN: I'll withdraw the
5 question.

6 MS. FUNDERBURK: If you could rephrase
7 in an objective manner, please rephrase your
8 question and proceed.

9 BY MR. FRIEDMAN:

10 Q What's your opinion of three actuaries
11 at least and an economic professor reviewing one
12 another's work in detail before actually signing off
13 on their respective expert prefilled testimonies?

14 MR. SPIVEY: Objection. Again, I don't
15 think that's an accurate characterization of
16 their testimony. No one has testified that
17 they reviewed each other's work in detail
18 before completing their own work.

19 MR. FRIEDMAN: I'm happy to rephrase
20 without the word "detail."

21 MS. FUNDERBURK: We had some
22 questioning, Mr. Spivey, from the bureau
23 yesterday about peer review, which could
24 constitute reviewing each other's work. I'm
25 mindful of what your concern is, but I also

1 think Mr. Friedman is allowed to carefully
2 ask about the techniques used by others when
3 they're completing their work. So --

4 MR. SPIVEY: I don't disagree he can
5 ask -- I object to his characterization of
6 the work in the manner he's trying to portray
7 it. There's no basis in the evidence for
8 that.

9 MR. FRIEDMAN: So as I'm -- Your Honor,
10 as I understand it, the objection is not to
11 the word "review," but to the
12 characterization of it as "extensive review"?
13 I just want to know whether I can use the
14 word "review" at all.

15 MS. FUNDERBURK: Go ahead and restate
16 your question and proceed.

17 BY MR. FRIEDMAN:

18 Q Mr. Schwartz, what is your opinion of
19 the fact that at least three actuaries who were
20 witnesses for the bureau and one economist who is
21 also an actuary reviewing one another's work before
22 they sign off on their own respective individual
23 prefilled testimonies?

24 A I would say that preparing the report
25 could be done on your own as a completely

1 independent person, as I've done, or it's not
2 uncommon for professionals, actuaries, to talk to
3 each other while they're preparing a report. And I
4 think it's up to the Hearing Officer to determine if
5 and how that might affect the credibility of their
6 testimony.

7 Q Thank you.

8 Now I'm going to move on to questions
9 about, first, your testimony versus Dr. Zanjani's
10 testimony, and then your -- and that includes your
11 calculation of the profit provision versus his.

12 Do you recall Mr. Spivey asking you
13 yesterday about the various historical profit values
14 you displayed on Schedule AIS-15?

15 A Yes.

16 Q And do you recall him asking you how
17 you picked your 8 percent operating profit value?

18 A Yes.

19 Q If you had not applied your actuarial
20 judgment and simply picked one of the numbers from
21 the Total All Lines Averages, what would have been
22 the result?

23 A So looking at Schedule AIS-15, you
24 could see in the averages for the Total All Lines
25 that everyone of those average numbers is lower than

1 the value I picked. The value I picked was
2 8 percent. Those averages vary from 4.4 to
3 6.2 percent. So if I had just mechanically picked
4 one of the average numbers, it would have been a
5 lower target operating profit, which would give a
6 lower underwriting profit and, therefore, a lower
7 rate level.

8 So my application of judgment resulted
9 in a higher indicated rate than it would have if I
10 just picked one of the historical numbers.

11 Q So was your use of actuarial judgment
12 in that instance favorable to the Rate Bureau in
13 terms of deriving a higher rate level?

14 A Yes. As I just explained, if I picked
15 one of the historical numbers and did the
16 calculation based on that, the indicated rate level
17 that I would have derived would have been lower.

18 Q Let me turn you to the -- it would be
19 the transcript-- if you don't have the transcripts,
20 I'll get up and bring them to you, or at least this
21 one. But the transcript from Day 1 of the hearing,
22 October 7th, in the morning's, the A.M..

23 Does anybody else need a copy of the
24 transcript?

25 MR. SPIVEY: How much are you going to

1 read from?

2 MR. FRIEDMAN: One paragraph.

3 Actually, it's one paragraph of three
4 sentences.

5 MS. FUNDERBURK: Do you have it on your
6 screen, Ms. Wharry? Okay.

7 Okay. Oh, there it is. Oh, you've
8 already got it around the room, thank you.

9 MR. FRIEDMAN: Page 7.

10 BY MR. FRIEDMAN:

11 Q If you go down to the page -- it starts
12 with "The bureau selected."

13 MR. FRIEDMAN: Your Honor, I am sorry,
14 I have misdirected us to that transcript. I
15 got entirely the wrong citation.

16 MS. FUNDERBURK: Okay. Which
17 transcript do we need?

18 MR. FRIEDMAN: It's not a transcript,
19 actually. We're going to turn to
20 Dr. Zanjani's -- to his prefiled testimony,
21 which is at RB-22. And that is RB-22 at
22 page 7. Sorry for the confusion.

23 Is everybody there? It's on the screen
24 now.

25 BY MR. FRIEDMAN:

1 Q So I'm just going to read the paragraph
2 into the record.

3 MR. SPIVEY: Which paragraph?

4 MR. FRIEDMAN: It's the paragraph
5 beginning with, let's see -- could you go
6 down?

7 There. "The bureau selected the
8 9 percent provision."

9 MR. SPIVEY: Thank you.

10 BY MR. FRIEDMAN:

11 Q "The bureau selected the 9 percent
12 provision. I participated in the bureau's property
13 rating subcommittee meeting for the discussion of
14 the profit portion of the rate review. I described
15 for the committee my pro forma profit analysis and
16 provided arrays of underwriting profit provisions
17 and their associated returns on net worth, both
18 without including investment income on surplus and
19 including investment income on surplus. The returns
20 shown in those arrays spanned the range of the cost
21 of capital that I had provided. Following my
22 presentation and the committee discussion, the
23 committee selected the underwriting profit factor."

24 And my question for you is: Whether --
25 did the North Carolina Rate Bureau's filing in this

1 case include those arrays of underwriting profit
2 provisions that Dr. Zanjani, in his prefiled
3 testimony, said he provided the subcommittee?

4 A No, I did not see those arrays for
5 underwriting profit provisions.

6 Q Did the Rate Bureau provide any
7 testimony, either written or oral, from anyone on
8 the property rating subcommittee that explained how
9 the committee selected the underwriting profit
10 factor based on those arrays of underwriting profit
11 provisions?

12 A My understanding is that the bureau did
13 not provide anyone from the rating committee to give
14 an explanation of how they selected an underwriting
15 profit factor based on those arrays of underwriting
16 profit provisions that they were provided with.

17 Q Okay. And do you recall Mr. Spivey
18 yesterday asking you questions about the cost of
19 capital?

20 A Yes.

21 Q All right. We're still on RB-22. And
22 if you could turn to page 10. And that table there,
23 does that show an array of values for the cost of
24 capital provided by Dr. Zanjani?

25 A Yes.

1 Q As far as you can tell, did Dr. Zanjani
2 select "single cost-of-capital value" from that
3 array of values?

4 A I don't recall him suggesting one
5 particular cost-of-capital value.

6 Q All right. So with regard -- so you'll
7 see there on the left-hand side of that table, the
8 references to Kroll. I think he refers to numbers
9 from Kroll in six instances, and then the Damodaran
10 On-Line method in one instance.

11 Did he explain the formulas used by
12 Kroll or Damodaran in his testimony?

13 MR. SPIVEY: Objection. We're on
14 redirect. There were no questions of Mr.
15 Schwartz in my cross-examination regarding
16 Dr. Zanjani's testimony, Dr. Zanjani's
17 calculations. This would be a matter for his
18 direct testimony, not redirect.

19 MS. FUNDERBURK: I agree, Mr. Friedman.
20 Do you believe there are grounds for
21 this on cross? Because I'm not seeing
22 them -- or, I'm sorry, on redirect, not
23 cross.

24 MR. FRIEDMAN: I do, because there
25 were, yesterday, perhaps two hours' worth of

1 cross about the cost of capital, and that
2 cross implicitly is that Dr. Zanjani's --
3 either the Rate Bureau's calculation was
4 correct and Mr. Schwartz's calculation was
5 incorrect. I think I --

6 MR. SPIVEY: I disagree. It's
7 interesting that you just said Mr. Schwartz's
8 calculation of the cost of capital, though.

9 MR. FRIEDMAN: I said --

10 MR. SPIVEY: I didn't ask any
11 questions --

12 MS. FUNDERBURK: I'm not going to have
13 commentary back and forth between you-all.

14 MR. SPIVEY: I didn't ask Mr. Schwartz
15 any questions about Dr. Zanjani's cost of
16 capital. I didn't ask him any questions that
17 get into his calculation. I asked him, "Did
18 he perform a cost of capital?" That's the
19 extent of the discussions on
20 cross-examination.

21 MS. FUNDERBURK: But he was asked about
22 his own calculations, not as they compared to
23 Dr. Zanjani's; is that your recollection,
24 Mr. Spivey?

25 MR. SPIVEY: Yes.

1 MS. FUNDERBURK: If you feel
2 differently on the break, Mr. Friedman, we
3 can go back and look at the transcript and
4 determine if there were additional questions.
5 But that is my recollection as well. We're
6 getting outside the scope of redirect with
7 the questions regarding comparing
8 Dr. Zanjani's results to Mr. Schwartz's
9 results.

10 Again, when we take a break, which I
11 anticipate would probably be in 15 minutes or
12 so, to take a quick morning break since it's
13 a short day, you're free to look at the
14 testimony. I'm happy for you to tell me I'm
15 wrong.

16 But to revisit this, I would -- I need
17 you to do that.

18 MR. FRIEDMAN: Okay.

19 MS. FUNDERBURK: Please proceed.

20 You can respond to Mr. Friedman's
21 questions.

22 MR. FRIEDMAN: Your Honor, I don't want
23 to ask something that is contrary to what --
24 your instructions just now. So we'll talk
25 about that at midday.

1 BY MR. FRIEDMAN:

2 Q Do you recall Mr. Spivey asking you
3 questions about reinsurance?

4 A Yes.

5 Q We'll move on to actually the issue of
6 the contingency provision.

7 Do you recall Mr. Spivey asking you
8 questions related to the indicated rates?

9 A Yes.

10 Q Okay. Which indicated rates was
11 Mr. Spivey referring to?

12 A I believe he was referring to the
13 bureau's indicated rates as a basis for why the Rate
14 Bureau believes a contingency provision is
15 appropriate.

16 Q What's your understanding of the
17 position the Rate Bureau is taking regarding whether
18 its indicated rates are more important or relevant
19 than the indicated rates that the Commissioner of
20 Insurance in this case will eventually determine are
21 consistent with the law?

22 MR. SPIVEY: I'm not sure it's an
23 objection, but --

24 MR. FRIEDMAN: Would you like me to
25 read that?

1 MR. SPIVEY: -- does that relate to
2 contingency?

3 MR. FRIEDMAN: Yes, it is. I'm asking
4 him, given your cross-examination, what does
5 he understand the Rate Bureau to be saying
6 about its own derivation of its indicated
7 rates, versus whatever the Commissioner of
8 Insurance may determine in this case to be an
9 indicated rate that is consistent with the
10 law.

11 MR. SPIVEY: Objection. The questions
12 I asked this witness about contingency
13 yesterday had to do solely with court
14 opinions that he had discussed in his direct
15 testimony.

16 MR. FRIEDMAN: Your Honor, I recall at
17 least a good hour discussing the issue of
18 indicated rates, and I don't think it was
19 limited to the context of his memory of the
20 two cases he discussed.

21 MR. SPIVEY: I'm sorry. Maybe I'm
22 misunderstanding. I thought this was in the
23 context of the contingency provision which he
24 had just asked this witness if he recalled my
25 questions about.

1 MR. FRIEDMAN: So, Your Honor, all of
2 the indicated rate issues, in my
3 understanding, are related to the
4 determination that the bureau has made that
5 they're entitled to 1 percent contingency
6 provision.

7 And in addition, I mean, Mr. Anderson's
8 RB-22, I believe it was, is comparing the
9 alleged regulatory delays in support of his
10 1 percent contingency provision. And all I
11 can -- I'm no actuary, by any stretch, but we
12 spent over an hour speaking about indicated
13 rates yesterday.

14 MR. SPIVEY: Your Honor, it sounds to
15 me like Mr. Friedman is getting -- is wanting
16 to ask questions related to Exhibit RB-21. I
17 had no questions of this witness related to
18 RB-21 at all on cross-examination.

19 MR. FRIEDMAN: Your Honor, I'm not
20 planning to bring up RB-21. I am simply
21 asking what Mr. Schwartz's understanding of
22 the Rate Bureau's apparent position is
23 following his cross-examination by
24 Mr. Spivey.

25 MS. FUNDERBURK: We've had a lot of

1 argument since you asked the question.

2 Restate your question for me.

3 BY MR. FRIEDMAN:

4 Q Following your cross-examination by
5 Mr. Spivey, what's your opinion about the position
6 the Rate Bureau appears to be taking with regard to
7 whether its own indicated rates are more relevant or
8 accurate than the rates that the Commissioner
9 himself may ultimately determine to be consistent
10 with the law?

11 MR. SPIVEY: Objection. Not related to
12 cross-examination in any way.

13 MS. FUNDERBURK: I tend to agree, and
14 it sounds like you're asking -- you're going
15 to ask the witness to formulate an opinion of
16 the Rate Bureau's position based on attempts
17 to solicit information from him.

18 I'm going to sustain the objection.

19 Please proceed, Mr. Friedman.

20 Would now be a good time for a
21 10-minute break and that will allow you time
22 to review your notes?

23 MR. FRIEDMAN: Sure.

24 MR. SPIVEY: Mr. Schwartz, again, I'll
25 remind you that you continue to be under oath

1 when you return to the stand.

2 We're in recess for 10 minutes. Thank
3 you.

4 (A recess was taken from 10:05 to
5 10:20 a.m.)

6 MS. FUNDERBURK: Thank you, Counsel.
7 We're back on the record and ready to
8 proceed.

9 Mr. Schwartz, you remain under oath.

10 Mr. Friedman, continue with your
11 redirect.

12 BY MR. FRIEDMAN:

13 Q Do you recall Mr. Spivey asking you --

14 MS. FUNDERBURK: Mr. Schwartz, if you
15 could turn your microphone on.

16 I'm sorry to interrupt. Please
17 proceed.

18 BY MR. FRIEDMAN:

19 Q Do you recall questions being asked by
20 Mr. Spivey of you yesterday about formulas you used
21 in your calculations in your prefiled testimony that
22 were not explicitly shown?

23 A Yes. He asked me questions about
24 various formulas that I used that didn't have a
25 complete detailed explanation in the exhibit or

1 testimony.

2 Q Could you, in book 1, turn to RB-22,
3 page 10?

4 Thank you. RB-22, page 10, does that
5 show an array of values for the cost of capital that
6 Dr. Zanjani provided?

7 MR. SPIVEY: Objection. It appears
8 we're going into the same line of questioning
9 you were discussing a few moments ago from a
10 different angle.

11 MR. FRIEDMAN: Your Honor -- I'm sorry.

12 MS. FUNDERBURK: Please respond.

13 MR. FRIEDMAN: Your Honor, Mr. Schwartz
14 was cross-examined up and down about whether
15 or not he had provided a sufficient detail in
16 his filing, and I think it is absolutely fair
17 to point to instances in the bureau's own
18 filings where they either had a very general
19 citation, which didn't specify the sort of
20 things Mr. Spivey was asking about on cross,
21 or where they didn't specify their methods.

22 MS. FUNDERBURK: How does that relate
23 to his actual testimony?

24 MR. FRIEDMAN: It relates to
25 credibility, in that Mr. Spivey tried to

1 undermine Mr. Schwartz's credibility by
2 asking about whether he included these
3 particular details.

4 And it's our position certainly that
5 actuaries understand one another, and that
6 actuaries commonly cite to a source without
7 necessarily saying which edition it was from,
8 what page was in it, and that they regularly
9 cite to sources that are combined, multiple
10 years of sources. Those were all explicitly
11 what he asked him about in an attempt to
12 undermine his credibility.

13 I'm pointing to these to show, in fact,
14 that that is how at least some actuaries
15 regularly do it, as exemplified by instances
16 in the Rate Bureau's own testimonies.

17 MR. SPIVEY: Your Honor, it sounds like
18 the department is trying to utilize my
19 questions where I was asking Mr. Schwartz to
20 explain some of the calculations from his
21 exhibits, which could not be ascertained from
22 his exhibits because he did not provide
23 enough information on those to even support
24 the values shown on that exhibit.

25 And his own testimony yesterday

1 disclosed that that information was not
2 there, and the actual calculations were
3 incorrect, which explains why we couldn't
4 duplicate them. That has nothing to do with
5 looking at Dr. Zanjani's display of
6 information he utilized in his testimony,
7 which counsel cross-examined Dr. Zanjani at
8 length on already.

9 MR. FRIEDMAN: Your Honor, I explained
10 why we think this is relevant and directly
11 responsive to the cross of Mr. Schwartz.

12 MS. FUNDERBURK: I'm sustaining the
13 objection.

14 BY MR. FRIEDMAN:

15 Q Regarding agent balances and prepaid
16 expenses, did Mr. Spivey ask you about your
17 treatment of agent balances and prepaid expenses?

18 A Yes.

19 Q And did you take those into account in
20 your calculations?

21 A Yes, I did.

22 Q Could you explain to me how?

23 A Yes. By looking at the total amount of
24 invested assets.

25 I'm just closing up book 1 and getting

1 out book 3.

2 MR. SPIVEY: Your Honor, if we may, can
3 we take down an exhibit that is not being
4 part of this discussion?

5 MS. FUNDERBURK: Yes. And we can...

6 MR. SPIVEY: Thank you.

7 MS. FUNDERBURK: Thank you.

8 BY MR. FRIEDMAN:

9 Q If you could tell us, Mr. Schwartz,
10 where you're going in book 3. I assume in your
11 report.

12 A So this is Schedule AIS-14, sheet 2,
13 and, again, it shows that the amount of invested
14 assets exceeded the total amount of unearned premium
15 reserve, loss, and loss adjustment expense reserve
16 and policyholder surplus, and, therefore, a hundred
17 percent of the unearned premium reserve would have
18 assets associated with it that are available to
19 invest.

20 And if agents' balances were going to
21 decrease the amount of invested assets, it would
22 show up in column 1. And so column 1 already
23 includes a deduction -- "Column 1" being the
24 year-end invested assets -- already includes a
25 deduction for any assets that aren't available for

1 investment because of agent balances or prepaid
2 expenses.

3 Q All right. Thank you.

4 MR. FRIEDMAN: Your Honor, I'm going to
5 be now turning to a specific page in the
6 filing that Mr. Spivey asked Mr. Schwartz
7 about. I'm not going to be referring back to
8 the testimonies or anything. We're just
9 going to be asking, saying, "Will you refer
10 to that page?" And then, "Could you explain
11 basically what you did?"

12 BY MR. FRIEDMAN:

13 Q So the page is -- well, the exhibit is
14 RB-18. On Exhibit RB-18, do you recall Mr. Spivey
15 asking you about this exhibit?

16 A No.

17 MR. SPIVEY: I would agree because I
18 did not ask him about this exhibit.

19 MR. FRIEDMAN: I may be mistaken.
20 AIS-18, Your Honor. I'm very sorry for the
21 confusion. This would be in notebook 3,
22 Exhibit 1. And we're going to specifically
23 AIS-18.

24 Is everybody there?

25 MR. SPIVEY: Did you say which sheet?

1 MR. FRIEDMAN: Sheet 2.

2 BY MR. FRIEDMAN:

3 Q Do you recall Mr. Spivey questioning
4 you about your calculations in AIS-18, sheet 2?

5 A Yes.

6 Q Could you explain further what your
7 calculations were in this sheet?

8 A Yes. So, first, I think there's some
9 confusion about this in terms of people may be
10 misunderstanding my testimony, as is apparent to me
11 by Mr. Spivey just saying there was an error in
12 this.

13 My recollection is when he asked me
14 about the standard deviation, I stated I thought it
15 was a sample, but I essentially -- maybe not exact
16 wording -- paraphrased it -- paraphrasing it said it
17 could have been the population sample. It was one
18 or the other. I thought it was a sample. It turned
19 out to be a population, but I misremembered.

20 But it's not an error. I mean, the
21 standard deviation there is calculated, you know, as
22 a population standard deviation. And maybe I should
23 have remembered it.

24 I would just say there are a lot of
25 things to remember in this case, and I know for the

1 purpose of this exhibit, as we discussed yesterday,
2 you get the exact same result for the relative risk
3 of North Carolina relevant to countrywide, whether
4 you do the population standard deviation or the
5 sample standard deviation. So in this case it
6 doesn't matter how you get the standard deviation.

7 Mr. Spivey said -- I don't know if he
8 said he couldn't figure out how the numbers were
9 arrived at, or his consultants couldn't understand
10 how the numbers were arrived at. I find it very
11 difficult to believe that his consultants couldn't
12 understand how the standard deviation was calculated
13 because there are only two choices.

14 It's either the population standard
15 deviation or the sample standard deviation, and
16 they're both functions in Excel which only differ
17 from each other by one letter. So you could run the
18 calculation two different ways and determine how it
19 was done.

20 The idea that an actuary couldn't take
21 a set of numbers and calculate a standard deviation
22 both ways and figure out which one was used is just
23 preposterous.

24 And as far as the cite to NAIC
25 Profitability by Line and by State in 18, 2,

1 actuaries who work in this field know what the NAIC
2 profitability study is. They know where the values
3 for the insurance operating profit for homeowners by
4 state is contained within those reports. And they
5 know that each report contains ten years, and so
6 they'd have to look at a couple of different reports
7 to go back to this entire period.

8 So, again, I would say that for
9 actuaries who work in this field, the allegation
10 that they didn't know where these numbers came from
11 is just silly. It doesn't make any sense.

12 And it's the same thing that goes for
13 18 -- Schedule 18 -- AIS-18, sheet 1 where I list
14 Best Aggregates and Averages. Actuaries who work in
15 this field work with Best Aggregates and Averages
16 all the time, and they would know where you get
17 countrywide operating ratios from Best Aggregates
18 and Averages.

19 The idea that if I don't spell out
20 exactly what page from Best Aggregates and Averages
21 that this number came from, that the actuaries who
22 work for the bureau are going to be confused and not
23 have any idea where these numbers came from? As,
24 again, that doesn't make any sense.

25 So, you know, I understand that maybe

1 Mr. Spivey doesn't know where these numbers came
2 from, but I believe his actuaries who work for the
3 bureau certainly know where they came from.

4 But, you know, in future cases, in
5 order to eliminate any issue about this, which
6 really isn't an issue at all, I'll specify each
7 individual year, and I'll specify the pages from it,
8 to the extent it's available.

9 And I would just say that if I do that,
10 I would hope the Rate Bureau would also do that,
11 because they haven't done it in this case. They've
12 cited the sources without giving the year of the
13 source or particular pages with the source. And so
14 if they insist that I give each year and each page,
15 I would expect that they would comply with their own
16 requirements.

17 Q So regarding AIS-18, sheet 1, was your
18 use of the population standard deviation actually
19 beneficial to the Rate Bureau?

20 A No. Again, this is an instance where,
21 when you're doing a relative calculation -- well,
22 I'll just say, whether you use the population
23 standard deviation or the sample standard deviation,
24 when you're doing a calculation of one relative to
25 the other, you're going to get the exact same

1 result, whichever of those standard deviations you
2 use.

3 But, you know, in terms of using the
4 standard deviation, whether you do the population or
5 the sample, it's beneficial to the Rate Bureau in
6 that it shows that homeowners insurance is more
7 risky than average and, therefore, would support the
8 higher target operating return I used for homeowners
9 relative to countrywide numbers.

10 And, you know, there was also
11 confusion, I believe, on this page where I was asked
12 about why I used a weighted average instead of
13 unweighted. Weighted average is a common thing you
14 do.

15 I'm not going to cite the particular
16 parts in the Rate Bureau filing now, but if you look
17 at it, you see there are plenty of places where they
18 use a weighted average without giving some
19 explanation of why they use a weighted average
20 instead of a straight average, because, again
21 there's a common actuarial procedure that people
22 know about.

23 There was also a question about instead
24 of using the average standard deviation across
25 countrywide, what if I looked at essentially the

1 ranking of the states. And North Carolina was like
2 the 15th out of 51. And I would just say that, you
3 know, for some purposes you may use ranking to get
4 an idea of what's going on, which is related to the
5 median. And both of those give some information,
6 but they're not reliable, I would say, or need to be
7 used with caution when you have a distribution
8 that's not symmetrical, like a normal curve.
9 L-curve is symmetrical. In some of the things you
10 would get erroneous results from.

11 I'll give an example. The Rate Bureau
12 for the AIR model, I believe, gives average annual
13 losses around 600 million. If you said, Well, I'm
14 not going to use the average, I'm going to use the
15 median value, where half are above and half are
16 below, then the value you will get would be
17 \$2 million, about. And, therefore, that shows an
18 example of how it's just inappropriate to use
19 medians or rank value when you have a distribution
20 that's skewed.

21 And it's the same thing in what I've
22 done here is that, because it's not a symmetrical
23 distribution, and because some of the observations
24 have more credibility than the others, you should
25 use a weighted average to get an appropriate result.

1 And there was also a question from
2 Mr. Spivey about what would the number be if I apply
3 the same standard deviation formula to countrywide
4 data instead of using a weighted average of the
5 state data.

6 And you can do that calculation, but
7 you have to interpret it correctly. That is not
8 a -- if you try to compare what's happening in a
9 typical state, you want to weight the states
10 together, not use the countrywide number, because
11 that reflects the benefit of that diversification.

12 And as I said yesterday, that benefit
13 of diversification is something that decreases the
14 variability of losses and, therefore, would lessen
15 the need for reinsurance relative to what you would
16 need without diversification.

17 And I believe that the 2014 court case
18 actually mentioned that. And if you give me a
19 moment, I'll try and find it.

20 Well, I can't find it right now. I
21 don't want to waste the Court's time. I may get an
22 opportunity later to discuss it and find it during
23 the break.

24 But anyway, my recollection is that the
25 Court of Appeals did discuss diversification in

1 relation to reinsurance, in its 2014 order, based on
2 my --

3 MR. SPIVEY: Objection. It's a
4 completely different subject when he said
5 "reinsurance" on this exhibit he was pointing
6 to.

7 MS. FUNDERBURK: Response,
8 Mr. Friedman?

9 MR. FRIEDMAN: Your Honor, I'll agree
10 with that objection. Mr. Schwartz does not
11 need to testify as to what he appeared to be
12 testifying to in that moment. I think it
13 was --

14 MS. FUNDERBURK: At this point, why
15 don't you continue your questioning of
16 Mr. Schwartz.

17 MR. FRIEDMAN: Okay. In fact, that is
18 all the questions I have of Mr. Schwartz on
19 redirect.

20 MS. FUNDERBURK: Thank you.
21 Recross, Mr. Spivey?

22 MR. SPIVEY: May we have five minutes?

23 MS. FUNDERBURK: Sure. Are you able to
24 do that at the table or do you need to go out
25 of the room? It sounds like you need to go

1 out.

2 MR. SPIVEY: Maybe only eight to ten
3 minutes just to get there and back and that
4 sort of thing.

5 MS. FUNDERBURK: If I can ask
6 everyone -- because I'm mindful of what time
7 it is, I'm going to ask everybody else to
8 stay in the room unless you have to do
9 something. And we'll wait for you. Thank
10 you.

11 (A recess was taken from 10:44 to
12 10:49 a.m.)

13 MS. FUNDERBURK: All right, Counsel.
14 Thank you, Counsel.

15 Mr. Spivey, are you ready to proceed?

16 MR. SPIVEY: Yes, Your Honor. We have
17 no questions on recross.

18 MS. FUNDERBURK: Okay. Mr. Schwartz,
19 you're excused. Please step down.

20 THE WITNESS: Thank you.

21 MR. FRIEDMAN: At this point, the
22 department calls Lauren Cavanaugh.

23 MS. FUNDERBURK: And Ms. Cavanaugh is
24 going to need to return November -- later in
25 November.

1 MR. FRIEDMAN: Yes.

2 MS. FUNDERBURK: We'll have to discuss
3 some of that scheduling, and we may need to
4 do that next week over email, to figure out
5 exactly what that's going to look like. We
6 may just not have time to do that today.

7 Given that she's coming back in
8 November, I'm not extending the day as we
9 discussed. If we'd move along and it looked
10 like we were going to finish, I'd extend.
11 We're not going to finish. We're not going
12 to be close to finishing.

13 I'm going to have Ms. Cavanaugh take
14 the stand.

15 Ms. Cavanaugh, please come up, and I'll
16 get you sworn in.

17 We're going to finish today no later
18 than 12:00. If you get to a natural stopping
19 point before 12:00, I'm going to ask you to
20 signify that and we're going to go ahead and
21 recess for the day. It will be no later than
22 12:00, and if it's earlier than 12:00, we
23 need to go ahead and recess.

24 Yes, sir, Mr. Spivey.

25 MR. SPIVEY: Your Honor, may I take

1 30 seconds to change out my materials?

2 MS. FUNDERBURK: Absolutely. While
3 you're doing that, unless you have an
4 objection, I'm going to go ahead and swear
5 her in, but we won't start questioning. Does
6 that work for you?

7 MR. SPIVEY: Yes.

8 MS. FUNDERBURK: Thanks.

9 (Witness sworn.)

10 MS. FUNDERBURK: Thank you. The
11 witness has been sworn in.

12 Ms. Cavanaugh, as I reminded other
13 folks, when you step down today, you will
14 remain under oath when you come back to take
15 the stand in mid-November.

16 THE WITNESS: Okay. Thank you.

17 MS. FUNDERBURK: Mr. Spivey, were you
18 able to get your materials?

19 MR. SPIVEY: Yes, ma'am, thank you.

20 MS. FUNDERBURK: Thank you.

21 Mr. Friedman, please proceed.

22 MR. FRIEDMAN: Yes, ma'am.

23 LAUREN CAVANAUGH,
24 having been first duly sworn, was examined and testified as
25 follows:

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DIRECT EXAMINATION

BY MR. FRIEDMAN:

Q I believe -- Ms. Cavanaugh, first of all, state your name for the record.

A Lauren Cavanaugh.

Q And what is your profession?

A I'm an actuary.

Q And what level of actuary are you?

A I have a fellow of the Casualty Actuarial Society, and I'm a member of the American Academy of Actuaries.

Q Thank you.

Did you work for a period at the insurer Chubb?

A I did.

Q Approximately how long did you work there?

A Approximately three years.

Q Okay. And what was your experience working at Chubb? What did you work on? What did you learn?

A I started in the personal lines division of Chubb. And in that role, I was in their pricing predictive model role, so I assisted in developing predictive models for homeowners and

1 personal auto lines of business. And in that role,
2 also participated in compiling information needed
3 for rate filings related to that.

4 I also spent time in what Chubb used to
5 refer to as "specialty lines" and had a similar role
6 there, developing predictive models on their D&O,
7 EPL, and other lines of business.

8 Q Just for the record, could you tell me
9 what the D&O and the other acronym you just used
10 stands for?

11 A Directors and officers, employers
12 practices liability.

13 Q Thank you.

14 And coming from a thoroughly
15 nonactuary, could you very briefly explain what a
16 predictive model is?

17 A A -- I should say that predictive
18 models are used to assist in risk segmentation for
19 ratemaking, for property and casualty lines. So
20 predictive models are used to support the risk
21 classification.

22 Q And then did you go to work at an
23 insurer, Harleysville?

24 A I also worked at Harleysville, yes.

25 Q Approximately how long?

1 A Approximately two years.

2 Q And what experience did you gain at
3 Harleysville? What were you working on?

4 A So at Harleysville, I also assisted in
5 developing and updating predictive models for risk
6 segmentation. For Harleysville, this was in
7 primarily the commercial auto line, and BOP
8 policies, "business owners package" policies.

9 Q And you currently work for RRC; is that
10 correct?

11 A Risk & Regulatory Consulting, correct.

12 Q Which I'm just going to refer to as
13 RRC.

14 And when did you join them?

15 A In 2022.

16 Q And -- well, I guess if you could tell
17 me generally what RRC's -- I don't want to say
18 "mission," not mission, but what it generally does
19 as a practice.

20 A Yes, our firm primarily serves
21 regulator clients, though we also do serve
22 commercial clients as well.

23 But for our service-to-regulator
24 clients, we provide services related to actuarial,
25 which include assistance on rate filing reviews,

1 market conduct examinations, financial conduct
2 examinations, and we also have other professionals
3 that provide services on those examinations, as well
4 as other aspects.

5 Q And you personally, what has your role
6 for RRC been?

7 A So I have been a leader in the property
8 and casualty actuarial practice at Risk & Regulatory
9 Consulting, and in that capacity, I have led
10 financial examinations -- well, the actuarial
11 support of financial examinations, market conduct
12 examinations, and also, quite significantly, rate
13 filing reviews for a variety of different states.

14 And I should just mention for
15 completeness that that isn't -- that there are other
16 clients that I provide services to as well.

17 Q Are there instances when you were
18 working for other regulatory officials besides the
19 DOI where you are the only credentialed actuary
20 testifying or working on behalf of that state?

21 A There are instances for some of the
22 departments that we work for that -- where RRC
23 provides services, and they do not have any
24 credentialed actuaries providing those services.

25 Q And is your experience at RRC

1 concentrated in a particular region of the United
2 States?

3 A No. We have -- we provide services
4 across the country.

5 Q So you testified that you -- among the
6 things you do at RRC is review rate filings. What's
7 the typical scope of those reviews?

8 A Typically, we are asked to review the
9 rate filings to determine whether they comply with
10 the applicable statutes, apply with applicable
11 Actuarial Standards of Practice, and among the
12 statutes, typically is to determine whether the
13 rates are not excessive, inadequate, or unfairly
14 discriminatory.

15 Q Do you also review whether the rate
16 filing is appropriately supported by data?

17 A So we review -- in our review of
18 determining whether it's complying with what I just
19 described, part of that is the support for the
20 compliance with those statutes and standards, yes.

21 Q All right. Could you tell me what
22 SERFF is? And that acronym is S-E-R-F-F.

23 A I actually don't have the acronym
24 memorized, but I can explain --

25 Q What is your understanding of what the

1 SERFF or "SERFF" is, just by the acronym.

2 A Yes. So I can explain that this is a
3 platform that is used by at least most of the
4 departments of insurance so that companies can file
5 their filings for changes in rate rules and forms,
6 and that this is a platform that can be then used
7 for the departments to provide objections and other
8 correspondence, and it's all housed in that SERFF
9 platform.

10 Q All right. So what steps in working
11 for other states do you typically take -- or I guess
12 I should say "other regulators in other states" --
13 if you find that a rate filing is not appropriately
14 supported?

15 A So typically what we would do is, we
16 would provide what's called an "objection," and we
17 would either send that to the state regulator or
18 sometimes we are assigned in SERFF, and so then we
19 just -- but one way or another, it gets uploaded to
20 SERFF via objections.

21 And then the company typically returns
22 whatever has been requested, the objection, within a
23 week or two, is my experience, and then we can
24 review those responses. And if there are any
25 follow-ups, we can request additional information

1 via objection.

2 Q And do the companies typically provide
3 the responses to the second round, I guess, I could
4 say, of objections within a couple of weeks as well?

5 A Yeah, typically a couple of weeks. One
6 or two weeks is when companies would respond.

7 MR. FRIEDMAN: Your Honor, I'm going to
8 turn to a transcript, and if you'll give me a
9 second.

10 MS. FUNDERBURK: Please be sure you're
11 speaking in the microphone.

12 MR. FRIEDMAN: I'm going to turn to a
13 transcript, and if you give me a second, I'll
14 tell you which transcript.

15 I'm going to be referring to the
16 October 9th transcript of the A.M., that is
17 Volume III -- oh, the P.M. section, excuse
18 me.

19 Thank you.

20 Sorry. It is October 9th in the P.M.
21 session, and I'm going to be referring to
22 pages 479 through 480.

23 Are you there, Mr. Spivey?

24 MR. SPIVEY: I think so.

25

1 BY MR. FRIEDMAN:

2 Q So on those pages at, I guess -- let's
3 see. Look at the top of 479, lines 4 through 15.
4 I'm going to just read those into the record. This
5 is an answer by Ms. Mao in her testimony.

6 "So Aon's testing is really focusing on
7 the countrywide data" -- excuse me.

8 "Aon's testing is really focusing on
9 the countrywide testing. So we place notional
10 portfolios in all coastal states. For every state
11 we have in, we put in coastal as well as inland, and
12 we use those testing to look at the loss costs, the
13 logical relationship of modeled loss costs, as well
14 as the relativities of those loss costs. Those
15 relativities are especially important because those
16 are used by refiling. So we want to make sure the
17 relativities for different building characteristics
18 are reasonable."

19 Did you review -- first of all, is that
20 testimony -- oh, I'm sorry.

21 And then we're also going to read on
22 480, the answer at the top.

23 "Yeah, that shows up in our model
24 evaluation dashboard that I rely on to perform my
25 actuarial responsibilities."

1 So with regard to both of those pages
2 and our testimony there, did you review the model
3 evaluation dashboard Ms. Mao mentions?

4 A I didn't -- I did not see that in the
5 original filing or in the produced documents, the
6 evaluation dashboard that she references there.

7 Q And you reviewed the bureau's responses
8 to the department's data requests?

9 A I did.

10 Q And you reviewed the bureau's responses
11 to the department's written discovery?

12 A Yes. I recall reviewing those
13 documents.

14 Q So without the information Ms. Mao
15 referred to in her modeled evaluation dashboard, can
16 you make an assessment on whether an appropriate
17 validation of the models was, in fact, conducted by
18 Aon as it relates specifically to North Carolina?

19 A So Ms. Mao testified that her testing
20 really was countrywide testing, and then -- I won't
21 repeat it, but, you know, discusses that she did
22 this dashboard, which I just testified I did not
23 review.

24 And in my prefiled testimony, I
25 explained that a review specifically to North

1 Carolina is important here.

2 So my answer to your question is, no, I
3 wasn't able to review that specific analysis as it
4 relates to North Carolina in her -- in anything that
5 the bureau provided us.

6 Q And in the absence of that auto
7 evaluation dashboard or manner of validation, was
8 there any other view, any other data in the filing
9 or the responses to discovery or the data requests
10 that could reveal to you the reasonableness of the
11 hurricane models that Ms. Mao reviewed or used
12 specifically as to North Carolina? Do you want me
13 to rephrase?

14 A I think I can answer. So there was
15 some documentation that was provided regarding the
16 hurricane models, and there was a few exhibits that
17 showed information by state that I did review.
18 Maybe --

19 Q Was that -- was your review of that
20 sufficient to allow you -- was that data they
21 provided sufficient to allow you to determine the
22 reasonableness of the models, as used in North
23 Carolina?

24 A So the information that was provided
25 didn't really go into a level of detail for North

1 Carolina. And so I then -- I did some other
2 calculations. But like I said, there were some
3 exhibits in there that did look by state, but it
4 wasn't a full analysis validating the use of the
5 models in this particular case.

6 Q And why do you think it is important to
7 review the reasonableness of the models as they
8 relate specifically to North Carolina?

9 A So this filing, this particular set of
10 circumstances is unique, I would say, in that the
11 catastrophe model results are being used on risks
12 that are solely concentrated in one area; that's
13 North Carolina. And it's actually virtually all of
14 the risks that are insured by North Carolina.

15 So when you have risk concentration in
16 that, it's important to understand, while the models
17 might be validated on a countrywide basis, to be
18 able to validate it on -- to determine, you know,
19 the results of the models and be sure that they are
20 appropriate for use, specifically because of this
21 risk concentration.

22 Q Did you receive any support showing any
23 validation of considering the specific risk
24 concentration in North Carolina?

25 A I did not see any validation that was

1 specific to North Carolina in what I received.

2 Q And that what you received includes the
3 filing, there was data request responses and the
4 discovery responses?

5 A That's correct.

6 Q Are there some situations where relying
7 on the validation on a countrywide basis could be
8 appropriate?

9 A Yes. In fact, many insurers that write
10 business in North Carolina also write in many other
11 states. So when insurers are looking at their
12 overall -- like in capital modeling, for example,
13 they're using catastrophe models to look at their
14 overall risk. You know, validating on a countrywide
15 basis could be really appropriate in those
16 situations. And similarly, when reinsurers are
17 looking at those insurers, that that validation
18 could be appropriate.

19 Q All right. Do you recall reviewing
20 Ms. Mao's ASOP 38 AIR documentation?

21 A I do.

22 Q All right. And was Ms. Mao's ASOP 38
23 AIR documentation sufficient to establish that the
24 AIR model, particularly, should be used in this
25 case?

1 A In my opinion, it was not.

2 Q And why not? I'm sorry, I can
3 rephrase, if you need.

4 A Could you rephrase?

5 Q Yes.

6 Was one of the reasons that it was not
7 sufficient to establish that the AIR model, in
8 particular, was appropriate because the -- none of
9 the materials provided by the bureau had the details
10 about the validation for North Carolina losses?

11 A That's right. I don't think those were
12 my exact words in my prefiled testimony, and I don't
13 have my prefiled testimony in front of me.

14 Q Would you turn, then -- if you'd like
15 to see that, turn to Exhibit 2 in book 3. Is that
16 before you?

17 A Thank you.

18 Q Take whatever time is necessary to tell
19 me what particular part of this prefiled testimony
20 you just mentioned.

21 A So I'm looking at Section 12 of my
22 testimony that starts on page 31, and then I'm just
23 going to get to the exact reference.

24 So my conclusion -- and this is
25 summarized on page 36, line 9.

1 MR. FRIEDMAN: Wait one second, please.

2 So, Your Honor --

3 MS. FUNDERBURK: Please speak into the
4 microphone.

5 MR. FRIEDMAN: Your Honor, the page
6 she's about to testify to is a page where she
7 has incorporated data that was marked
8 confidential. And so in order for her to
9 testify to this, we would need to close the
10 courtroom.

11 MS. FUNDERBURK: All right.

12 MR. FRIEDMAN: Can I ask one thing,
13 Your Honor? If this is -- I know it's before
14 noon.

15 MS. FUNDERBURK: It's before noon, but
16 I think this is a good time for us to go
17 ahead and recess, and when we come back,
18 we'll start with a closed courtroom.

19 If there are things that she's going to
20 need to testify to that do contain
21 confidential data, I ask, to the extent
22 possible, those need to be grouped together
23 so that we're not opening and closing the
24 courtroom.

25 As I've said many times, this is a

1 matter of significant public interest.
2 Everything that can be public should be
3 public. The courts are open. This is a
4 matter of public interest.

5 So when we come back and resume her
6 testimony, anything that is confidential --
7 again, to the extent possible -- ask about
8 those things. If you start going into
9 territory that is not confidential, I'm going
10 to redirect you back to the things that are
11 confidential, to the extent that they can be
12 referred to without breaking your train of
13 thought or breaking Ms. Cavanaugh's train of
14 thought, because I assume that it's difficult
15 to keep everything together. Or I'll speak
16 for all the lawyers in the room. Maybe for
17 the actuaries it's easy to go back and forth.
18 For us, it would be difficult.

19 But just be mindful of that.

20 MR. FRIEDMAN: I'll group everything
21 for the start of the day when we resume.

22 MS. FUNDERBURK: I'll ask everyone to
23 let their folks who have not signed a consent
24 order know that when we start back on the
25 12th, we'll be starting with the things that

1 are confidential or proprietary. So if
2 they're remoting in via Webex, they should
3 wait until they get a signal from you to
4 remote in. We'll do the same thing we did
5 before, verify who's in the courtroom, verify
6 who's on the Webex.

7 Anything we need to address regarding
8 the confidential information?

9 MR. FRIEDMAN: No, ma'am.

10 MS. FUNDERBURK: Are there any
11 administrative matters we need to address
12 before we recess?

13 MR. SPIVEY: No, Your Honor.

14 MR. FRIEDMAN: I just wanted to
15 reemphasize, we will be circulating to the
16 bureau the redlined version.

17 MS. FUNDERBURK: Speak more into the
18 microphone.

19 MR. FRIEDMAN: Yes. I just wanted to
20 reemphasize, we will be circulating to the
21 clerk and to the bureau, the redlined version
22 of Mr. -- Mr. Schwartz's testimony on Friday.

23 MS. FUNDERBURK: And where are we as
24 far as responses back to the Rate Bureau for
25 the information they had requested, I

1 believe, Tuesday night?

2 MR. FRIEDMAN: So we discussed that,
3 and my understanding from my discussion with
4 Mr. Spivey yesterday is that that is on hold.
5 The requests aren't pending. I don't know if
6 they'll ask.

7 MS. FUNDERBURK: I don't want to get
8 too much into what the details are if they're
9 not going to be something that you share with
10 the Court. But is that moving along or do I
11 need to intervene?

12 MR. SPIVEY: Your Honor, what we
13 discussed -- I'm going to -- we were going to
14 reassess how much of that material we need,
15 and I'll get back with Mr. Friedman about
16 that.

17 MS. FUNDERBURK: Okay. Are there any
18 other outstanding requests between the
19 parties that I need to address?

20 MR. FRIEDMAN: No, ma'am.

21 MR. SPIVEY: No, Your Honor, not that
22 I'm aware of.

23 MS. FUNDERBURK: Okay. As I said, I
24 imagine next week we'll discuss some of the
25 scheduling needs and realistically how many

1 days we're going to need. I would very much
2 like to only use the days we have.

3 I'm very mindful -- we have 45 days
4 after we close the case to issue an order.
5 We close on the 14th. I don't know that I
6 want to be drafting an order on New Year's
7 Eve, for multiple reasons. But we'll address
8 scheduling and what is going to be realistic
9 as far as getting through the rest of this
10 case and the time -- what timeline we are
11 going to need. I think right now we have the
12 12th, 13th, and 14th reserved.

13 All right. We'll plan to resume at
14 9:00 a.m., November 12th, back here. And,
15 again, we'll start in a confidential session
16 at that point, and we'll deal with all the
17 things that are nonpublic, and then we will
18 reopen and move forward from there.

19 Thank you.

20 And, Ms. Cavanaugh, again, I'll remind
21 you, when you retake the stand on
22 November 12th, you will continue to be under
23 oath.

24 Thank you. We're in recess.

25 MR. FRIEDMAN: Thank you, ma'am.

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MR. SPIVEY: Thank you.
(The hearing was adjourned at 11:20 a.m.
and set to reconvene on Tuesday,
November 12, 2024.)

STATE OF NORTH CAROLINA)

COUNTY OF FORSYTH)

REPORTER'S CERTIFICATE

I, Audra Smith, Registered Professional Reporter in and for the above county and state, do hereby certify that the hearing was taken before me at the time and place hereinbefore set forth; that the proceedings were transcribed and recorded by me by means of stenotype; which is reduced to written form under my direction and supervision, and that this is, to the best of my knowledge and belief, a true and correct transcript.

I further certify that I am neither of counsel to either party nor interested in the events of this case.

IN WITNESS WHEREOF, I have hereto set my hand this 25th day of October, 2024.



Audra Smith, RPR, CRR, FCRR

Notary Number: 201329000033

Commission Expires: June 26, 2025