NORTH CAROLINA DEPARTMENT OF INSURANCE

RALEIGH, NORTH CAROLINA

STATE OF NORTH CAROLINA
COUNTY OF WAKE

IN THE MATTER OF:

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

BEFORE THE
COMMISSIONER OF INSURANCE

COPY

DOCKET NO. 2157

BEFORE: AMY FUNDERBURK, HEARING OFFICER

TRANSCRIPT

OF

HEARING

VOLUME VII - A.M.

Raleigh, North Carolina

October 24, 2024

9:03 a.m.

Reported by: Audra Smith, RPR, CRR, FCRR

Noteworthy
Reporting Services, LLC

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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, continued after the lunch recess on the 24th day of October, 2024, at 9:00 a.m., before Audra Smith, RPR, CRR, FCRR and Notary Public.

I N D E X

*****

P R O C E E D I N G S

MS. FUNDERBURK: Good morning, everyone.

MR. SPIVEY: Good morning, Your Honor.

MR. FRIEDMAN: Good morning.

MS. FUNDERBURK: Thank you. As you can see, we've adjusted some of the locations of the equipment to make the audio just a little easier to work with. It is 9:03 a.m. October 24, 2024. We are back on the record.

Yesterday when we recessed, Mr. Friedman, you were conducting your cross of Mr. Ericksen.

Counsel, are there any administrative matters we need to address this morning before we resume?

MR. FRIEDMAN: No, Your Honor.

MR. SPIVEY: I don't believe so, Your Honor.

MS. FUNDERBURK: Okay. All right. Mr. Ericksen, I'll just remind you, you do continue to be under oath. Thank you, sir.

Mr. Friedman, please proceed.

MS. WHARRY: Your Honor, his microphone is off.

MS. BENJAMIN: Mr. Ericksen -- I don't think his mic has been turned on.

MS. FUNDERBURK: Oh. I'm sorry. Let's get you turned on.

Thank you.

PAUL ERICKSEN,

having been previously duly sworn, was examined and testified as follows:

CROSS-EXAMINATION (CONTINUED)

BY MR. FRIEDMAN:

Q Good morning, Mr. Ericksen. I'm going to go just briefly back. We were discussing the issue of the bureau data calls at some point yesterday. And I'm going to try very much -- we have a lot to cover today -- to keep all of my questions as much as I personally can, which is hard, to ask for yes-or-no answers. By all means, I don't want to make you feel compelled to cut your answers short. We talked about yesterday that -- the data call that the bureau sends at least every year.

My question is: Has that data call ever included a request from the members for the price of their -- the premium prices they pay for reinsurance in the state?

A That type information, my understanding is "no" to that answer and that question, and also calls for any statistical plan request, for any line of business for any state, for any of the agents, that information is not -- the insurance information is not included in any type of statistical data call.

Q Well, this is a data call between the bureau and its members.--

A Oh, I'm sorry. I was thinking the data call from the statistical agents. From the bureau, I'm not aware that they've requested that information.

Q Have you seen in any of the data requests a request for members to provide all of their fixed expenses for homeowners, tenants, and condominiums but split out?

A No, I've not seen that.

Q Are you aware that that -- wasn't that the practice in the past of the bureau's?

A I'm not aware. The fixed expense, the general expenses, other acquisition expenses, the types of expenses that we've relied upon, my recollection is I've only seen that information for all policy forms combined.

Q When -- is it true that when there are insurance offices in any state, they may sell various lines of insurance, including but above homeowners, tenants, and condominiums?

A Lines in addition to those?

Q Yeah.

A Yes, yes.

Q And are you aware of whether, let's say, for a life insurance line, say you've got a producer's office. They have life insurance. They have drivers, homeowners, and tenants, and condominiums. And, you know, actually, that example works better on a grander scale. You've got a company.

Have you ever seen -- this is better. Sorry about that.

On a national scale, you've got a company with various subordinate companies of any sort. One of those subordinate companies sells life. The other company sells auto. And they're both doing operations in one state, and in that state, the company makes a filing for a rate increase. And they use -- they're in the same buildings. These people selling life, alternatively selling property. And the company has to file separate requests for rate increases because they're filing -- they're selling separate types of line.

How would they split up their fixed expenses since they're using the same facilities?

A So I can answer from my perspective. In that type of a situation -- and there are insurance groups that will write both life and property/casualty. It's my understanding, at least in everything I've seen, there will usually be separate insurance companies within the group. So you'll have some insurance companies that will write the property/casualty, and they'll have separate insurers, insurance companies that will write life insurance.

So for purposes of a rate filing, and you need to support that expense experience, they would use and what they would provide to the insurance department would be all the expense experience that has been allocated on an accounting basis to the property/casualty company.

How separate companies are -- how expenses might be allocated between separate companies, I have no information about that.

Q But assuming they're both in the same building, using the same water room, would they be able to allocate the expenses for that rent for the office building that they both got their desks in?

A I have no insight into that process.

Q All right. We're going to be talking now about the historic database in terms of the years included in it, as well as the types of coverage included in it.

We were talking yesterday about the turnaround time -- I'm going to call it -- for when ISO begins receiving data from the bureau members, and then when it -- and from other statistical organizations and then begin -- and is able to process it.

And you mentioned to me that in 2021 -- rather, in 2022, around, I believe, March you were able to, within -- March of 2023, you were able to have in your hand the 2022 data; is that correct?

A 2022 data, which is not data included in the filing, ISO would first receive that information from all these companies --

Q I misspoke --

(Overlapping speakers.)

MS. FUNDERBURK: Mr. Friedman, let him complete.

Do you need to reword the question?

MR. FRIEDMAN: I do.

MS. FUNDERBURK: Okay.

BY MR. FRIEDMAN:

Q The 2021 loss data, I believe you said that took about 13 months to be able to be presented to the bureau.

A Thirteen months after the March -- so 2021, accident year data; evaluated as of March 31, 2022. I would say it would have probably been 13, potentially 14 months after that March 31st date that that data was finalized.

Q Okay. Sorry about the confusion there. I didn't mean to interrupt you.

And as for the 2022 data, it's -- after 18 months, it's still being worked on?

A That's correct.

Q Has the Rate Bureau ever asked you to urge -- you testified yesterday that certainly there are circumstances when there are known upcoming filings that might feel more pressure to get it done in order to meet the deadline.

Has -- is that internal pressure, or has the bureau ever asked you to please try to ramp things up?

A So the expectation is if we went

multiple years without making a filing, we would still collect the data each year. We would still go through the editing process. We'd still finalize the data each year, even if there were no filings.

As far as the timing of the conclusion of preparation of that data, it certainly is tied to how that data would be used in future filings. And as I mentioned the other day, the entire schedule of events that took place in 2023 was established, I would say at the beginning of 2023, going backwards from the target filing data of January 1, 2024.

So we had established dates of when the committee meetings would be and when data would be -- needed to be assembled in preparation for those meetings. And we essentially stuck to that schedule. All of the consultants involved, you know, met those different delivery dates.

We have not established a -- any specific target filing date for a future filing because of the current status of the pending filing. So we don't have a specific date. The expectation is it will be completed, but there has not been established a target date that I'm aware of.

Q Put this another way. Have -- when you feel like when -- that is, ISO feels like there's a rush on the job to get it done as quickly as possible because you've got a known filing date coming forward, is that all sort of internally driven pressure, or have you ever been asked to speed it up by the Rate Bureau?

(Overlapping speakers.)

Q Excuse me.

A I'm sorry.

Q No. I was just going to say, we're told that it needs to be finished within a certain range of time.

A So I would say the situations probably vary over time, but I would say probably a combination of both. We do set our own internal targets and schedules, and we reach out to insurance companies to have them correct data.

If we have resistance from an insurance company, if there's a delay, we will reach out to NCRB staff and they have connections with insurance companies, and they will expedite the process. But if we were falling behind a schedule of when we would have data available, we would have pressure from the NCRB, so they would pressure us on that.

Q And who would be -- if some of the data was missing from a statistical -- or that one of the other three shift data to ISO, who reaches out and tells them it needs to get done and get in the hands of ISO?

A So the process would usually -- usually we are the first -- ISO staff would be the first to reach out and try to resolve issues. When we fear that the timing or the responsiveness of an individual company would jeopardize the schedule, we will reach out to the NCRB and keep them appraised of the situation, and they're usually more than happy to help contact the company and help expedite the process.

Q And are those -- when the Rate Bureau calls you for the -- and says we need a rush job on this data, y'all are responsive because the Rate Bureau is your client; is that fair?

A That's correct.

Q And likewise when -- how exactly do the other statistical organizations get paid for the time they spent gathering their data and then getting it to you, "you" as in ISO?

A I don't have any information on that.

Q Okay. But are they responsive, in your experience, to, when ISO calls them up and says, "Hey, for the other part of the market that you've got, we're going to need it sooner"?

A My general understanding is that they have been reasonably responsive. I'm not the one speaking with them on a week to week or, you know --

Q Uh-huh.

A -- so maybe there's a little bit more pushback than I'm aware of.

But I have -- I don't recall recent times a major issue from one of the other statistical agents.

Q Okay. Have you ever worked on a filing that took only six or seven months to go out?

A I'm sorry?

Q Have you ever worked on a bureau filing that took only six or seven months to go out?

A That took only six months?

Q Yeah, six months. Between six and seven.

A And when you say six to seven months to go out --

Q Start out from the beginning of the data recovery and its analysis to being ready to file.

A So when the data is completed, let's say in that April time period, through --

Q I mean, at the time --

A I just want to make sure. There's lots of activities that go on. I just want to make sure when you say six to seven months I understand what activity is at the beginning of that time period and what activity is at the end of that time period.

Q What's the shortest time you've seen a filing go out from the beginning of gathering the data to analysis, to the actual filing?

A For the NCRB or --

Q For the NCRB.

A I'm trying to recall. For the NCRB, it's very unique in the sense that there are multiple parties involved with decision-making authority at different steps. So in particular because of the various committee meetings that review information, and decisions from one committee meeting impact the following steps of an analysis that will then be discussed at another committee meeting, so what ends up happening is the process that -- the process will typically take several months. Six to eight months, I would say, is not out of the ordinary.

Q Okay.

A One thing I'll just point out is that

with this filing in particular, if there was a desire to file it sooner than January 3rd, I'm sure that could have been achieved. You know, I -- I'm not saying it could have been filed July 1st or anything like that of 2023. But the prior settlement stipulated that they couldn't make a filing in 2024.

So in this particular case, the first committee meeting was on May 25 of 2023, the filing -- so if you define that as a start, maybe you could even back it up a month from there, you know, but -- so roughly from April through beginning of January of 2024, that time period was almost outside of NCRB's control because they couldn't file before January. They might have been able to expedite the process and file it sooner if permitted by...

Q I'm going to talk briefly about statistical plans in North Carolina. Do you work with ISO in any respect or have to review its statistical plans for it as a statistical organization?

A Let me be careful. ISO has a team of people that work on a statistical plan both in designing a statistical plan and collecting the data, editing the data, and then it goes -- and then it gets moved on to different areas within the organization for different purposes.

I have not -- I have never worked in any of those specific areas involved in designing, collecting the data, editing the data. I would consider myself to be more of a user of the data within the organization. So I'm familiar with aspects of the statistical plan but more as -- more as an outside user, rather than a detailed expert on the stat plan itself.

Q Do statistical plans for statistical organizations -- keeping myself from saying "stat orgs." Do statistical organizations, do they have instructions on how soon the organizations have to report their data to the commissioner?

A I don't have the specifics, but I would expect -- yes, I would expect that to be the case.

Q Now, in your understanding of statistical plans, are those developed and drafted by the commissioner or by the statistical agents themselves for approval by the commissioner?

A I don't know the full details. But my general understanding is there are aspects of the statistical plan and the specific data call. And this would apply for all stat agents, there are certain elements of the statistical plan, certain data that needs to be collected to comply with reporting standards. And as part of that process, the data calls, the statistical plan, is filed with the department and approved.

My general understanding is that there are other aspects of -- there are other information that statistical agents might collect in conjunction with the statistical plan. And that supplemental information, I don't know the process, if -- I'm not familiar with the process as to how the department approves that.

Q A clarifying question. The statistical plan that the commissioner adopts, who takes the first whack at creating that? The insurance companies themselves or the commissioner?

A I would -- I would think it would be the statistical agents themselves.

Q Okay. And then is it your understanding they submit it to a commissioner with their own terms that they've put in their own document for approval?

A I haven't gone through the process and I don't think I've been explicitly told, but that would be my expectation.

Q Once the statistical organizations have presented a statistical plan to the commissioner and it has been approved, are you aware whether they can move to amend the plan?

A My understanding is that -- my understanding -- well, I don't fully know the answer to that. Like I was suggesting before, my understanding is that there are certain elements of the plan that are absolutely required, minimum elements to comply with regulatory reporting, and there's supplemental information that statistical agents might request for additional information above and beyond.

Insurers wouldn't be, I suppose, required to provide that extra information. Statistical agents might provide some benefit in return for receiving that data. Those other data elements, since they're supplementary in nature, I suppose could be viewed as an amendment to the statistical plan and those elements might not be subject to approval by the department.

Q So I'm making a distinction between the data that the statistical organization presents to the commissioner and the underlying plan that contains the details about what shall be in that data and when it shall be imported.

So do you know whether statistical organizations, once they've got their own -- they've got a version that was started off by them, approved by the commissioner, whether because some detail of their process in that plan isn't working, they can amend -- they can contact the commissioner and ask to amend that statistical plan?

A I would imagine that could be done, yeah.

Q Moving on to the composition of the Beach Plan. Turning to your report and that's in Exhibit RB-5. That's RB-5.

Do you have that in Book 1?

A Yes.

Q Going to page 4.

A Okay.

Q All right. Finding my place.

Okay. Toward the bottom, seven lines up, the middle of the page.

A What page?

Q I'm on page 4. And I was just counting up the lines from the bottom of the page.

The sentence is: The ratemaking data

reflected in Exhibit RB-1 is in general based on the aggregate homeowners' experience of the individual insurance companies that write homeowners policies in North Carolina together with the experience written on homeowners insurance policies in the Beach Plan.

What is -- what are you referring to by "experience" there?

A It would be -- it would consist of the statistical data that was being reported. So examples of that would be premium --

(Reporter requested clarification.)

A I'm sorry. Historical premium information, historical losses, that type of information.

BY MR. FRIEDMAN:

Q Are expense -- are expenses in their LGNA, for example?

A So expense information is not included in statistical data cost.

Q Well, how does the bureau learn of the expenses of its members?

A So for underwriting expenses, including general expenses, they send a data call to its member companies to request that information.

Q Is that part of the one annual data call or a separate data call?

A It's part of a data call that they submit. It would be on an annual basis because that information is ultimately derived from financial statement information, which is provided on an annual basis.

Q All right. Once the expense administration -- expense data comes in from the bureau's members, what does -- does the bureau ever seek to gain access to the Beach Plan's fixed expenses?

A My understanding is, no, because that's not the intended purpose of the -- of the filing. The filing would be made on behalf of member companies.

Q So you're saying the filing is not in part intended to -- are you saying that the filing won't affect the Beach Plan if it obtained the requested rate?

A My understanding is there are separate statutes that govern the rates that are charged by the Beach Plan.

Q Right. But those Beach Plans -- you work with the Beach Plan; do you not?

A I do.

Q What's your -- and for the FAIR Plan?

A I have done consulting work for --

Q And what sort of consulting work have you done for them?

A The consulting work that I've done, I've done a few projects over the years. The most recent couple years I've helped develop the loss cost multipliers for their commercial lines, not personal/residential.

Q So with regard to access of their loss costs, are you aware that -- first of all, are you aware that those are not -- although the bureau aggregates each plan exposure data and loss data and perhaps premium -- it doesn't aggregate their premium; is that right?

A Premium information is not -- reported premium information is not used from the --

Q Why isn't the premium information used?

A The reason that premiums -- reported premiums wouldn't be used is because we're trying to test the adequacy of the NCRB's rates. And the actual premiums that individual insurers would charge could be consent to rate, they could be deviated in some manner. So since we're trying to test the adequacy of base rates, we use -- we essentially do the rate level at the base coverage level and adjust everything to on a [indiscernable] --

(Reporter requested clarification.)

A I'll just start, again.

Just repeat the question, please?

BY MR. FRIEDMAN:

Q Sure. I was asking about whether the bureau --

MS. FUNDERBURK: I'm going to get you to repeat the question. I'm going to adjust your microphone a little bit. During the morning break, we'll make some adjustments to the audio.

THE WITNESS: Yeah, I'm louder -- I'm louder now.

BY MR. FRIEDMAN:

Q We were talking about why the Beach Plan premium isn't included, but their -- but its loss history and loss adjustments expenses are included.

A Right. The very simple answer is the actual premiums that are reported reflect deviations, consent to rate, and since that's not --

we're not testing the adequacy of consent-to-rate premiums, we're testing the adequacy of the Beach Plan's premiums, Beach Plan rate level. We don't use the actual premiums that are being reported.

Q Okay. For calculating the premium factor, however, do you use -- I mean, you do use consent to rate and the manual rate in calculating the premium or the profit --

(Reporter requested clarification.)

BY MR. FRIEDMAN:

Q Or the profit. Either the premium or the profit.

Do you?

A I don't understand the question.

Q Okay. So I know that for some purposes the bureau does mix -- for instance, in the historical database the experience from premium policies from CTR -- or from manual policies, CTR policies are both lumped together; is that correct?

A I'm not aware that that's being done in the work that we're doing.

Q One second.

(Discussion off the stenographic record.)

BY MR. FRIEDMAN:
Q So the losses from the Beach Plan, CTR plans, and the plans written at the manual rate are all included; is that correct?
A Correct, yeah.
Q Okay. And the exposures as well?
A Correct.
Q And -- but when it comes to fixed expenses, are the fixed expenses of both CTR plans and manual plans included together?
A My recollection is we would apply an extension of exposure technique, which would rerate the policies using the bureau's rates. So we would not be using the actual reported premiums that might be on a consent-to-rate basis.
Q All right. But you -- I guess at any case, the Beach Plan premiums are not included?
A The Beach Plan reported premiums I do not believe would be used.
Q Okay. What's the -- what's recorded versus what?
A First, my understanding is that reported premiums by any insurer are not being used explicitly. Instead, we would use the reported exposures and derive a premium using the approved

rates for the bureau.

Q We're not talking about the premium that you're seeking. I'm just talking about what's in the pot from which you derive the profit trend, or the premium trend-- a little better said.

So in terms of what goes into the pot, it's my understanding that CTR policies and annual policies go into the pot; is that correct?

A Exposure information, I'm not sure -- my recollection is reported premiums would not be.

Q Okay. Are reported premiums used for any purpose in the Rate Bureau's filings?

A I'm hesitant to say no because maybe there is someplace that would -- it wouldn't surprise me if we're showing it. It's not coming to me. Maybe there is a place that I'm just not -- a tangential place. But my recollection is what I've stated already.

Q Okay. So you're saying, then, the premium trend is developed -- or it sounds like you're saying your understanding is that there isn't any actual premium dollars in the model but that -- so how is the premium trend derived?

A Well, I guess what I would ask is if you direct me to the exhibits where premium trends -- if you have any specific questions about it, we can walk through that.

Q Okay. I'll do that.

Okay. Now, we did agree, at least, that the Beach Plan expenses are not included -- its fixed expenses are not included at all in the database; is that correct?

A That is my understanding, correct.

Q And are its loss adjustment expenses included in the database?

A I would think no, because I think loss adjustment expenses is also based upon the data call from the NCRB, and that's all they sent to its member companies.

Q Okay. Turn to page 3 of your report.

MS. FUNDERBURK: Mr. Friedman, if you could lean into the microphone, please. Thank you.

BY MR. FRIEDMAN:

Q Yes, sir. Could you turn to page 3 of your report?

A I'm there.

Q Third paragraph down, I'll read it into the record, the first sentence: In essence, the bureau makes rates based on the aggregate policyholder attributes and loss experience of all the homeowners policies written in the state.

Loss experience would include loss adjustment expenses, correct?

A It doesn't have to.

Q In this context, did you intend for this to mean all loss adjustment expenses within the state?

A I think the intent is loss experience, loss.

Q And that -- were you meaning the term "loss experience" in this sentence to include loss adjustment expenses?

A There are a number of elements that go into the premium, including underwriting expenses, the insurance costs, lots of different elements. I'm going to take my paragraph here as written. I think loss means loss, and that's it.

Q So is it not typical of actuaries to refer to loss experience as being both the losses and the loss adjustment expenses added to it?

A In my practice -- when I mean that, I would say loss and loss adjustment expenses. If I mean loss, I say loss.

Q Okay. Go to page 6 of your report.

Okay. Third -- well, I guess third -- well, fourth paragraph, about middle way: It is actuarially appropriate and necessary to include the residual market data with the voluntary data to ensure that the rates developed are representative of the entire markets since every policy has the potential to be written in the voluntary market.

MR. SPIVEY: I'm sorry, can you point us again where you're reading from?

MR. FRIEDMAN: Sure. From the bottom of page 6, it's up -- the third paragraph up, the paragraph begins "Loss of exposure data," and the sentence I'm reading from is the second sentence in that paragraph. If you want me to read it into the record again, I'm happy to.

MR. SPIVEY: All right. Thank you. I see where you are now.

BY MR. FRIEDMAN:

Q And are you there?

A Yes, I'm there.

Q So why isn't it actuarially appropriate to include Beach Plan expenses, if it is -- I mean, let me ask this. You're --

MS. FUNDERBURK: If you could turn

towards the microphone, please. Thank you.

THE WITNESS: We need one of those like the singers have.

BY MR. FRIEDMAN:

Q The residual market data you say that's actuarially appropriate and necessary to include residual market data alongside the voluntary data so that the rates are representative and actuarially sound.

I'm just paraphrasing there.

And yet the data does not include the Beach Plan's expense data, correct?

A That's correct.

Q And it doesn't include -- you believe that it doesn't include its premium data.

A Well, it would include the exposure data that underlies the premium data so...

Q Explain to me what the difference would be.

A Well, the exposure information would include all of the information about the underlying policies, including coverage limits, construction types, that information.

We would account for -- if we were going to do an extension of an exposure technique, we would include -- we would include the exposure elements in the analysis, which -- can be a proxy for premiums.

Q But are you including the actual premiums that the homeowners are paying if they've got a Beach Plan policy?

A As I said before, actual reported premiums for any company, not explicitly used.

Q So without that data from the Beach Plan, do you believe that, in accordance with your statement there, what you do include as far as expenses, loss adjustment expenses, and -- actually, I'll say what you don't include as expenses, loss adjustment expenses, and the dollars of premiums for the Beach Plan. By not including those, isn't the -- does that undermine whether the rates developed by the entire market reflect the entire market's experience?

A I'm going to take a step back. I think there's a lot of issues going on. I think the question to me is a little bit confusing.

Q Sure.

A I think there's multiple issues as to whether we're talking about with or without the Beach Plan, what types of information we're including, whether it's loss adjustment, general expense, or all these different things. So maybe we can just take a step back and have you pose more targeted questions.

Q You did just testify that you're not aware that the loss adjustment expenses from the Beach Plan are included in the budget.

A That's my understanding.

Q Okay.

A We include a provision for loss adjustment expenses, a loss adjustment expense ratio. So a ratio of loss adjustment expenses to losses, and that ratio we've derived based upon the data call.

Q Okay. So you're assuming that the Beach Plan's -- you are assigning a number to what would be the Beach Plan's loss adjustment expenses when you include their losses, correct?

A So I think -- this paragraph that you directed me to is discussing the issue of including experience from the Beach Plan. I would suggest -- ask you to repeat the question -- repeat the question precisely.

Q Sure. The loss data that ISO is putting together for -- that -- in aggregating for the purposes of reflecting the market, in particular -- as I said, the loss cost data and then, I guess, if you want to separate them out, the loss adjustment expenses. As I understand it, you're including the actual Beach Plan losses, not including their loss adjustment expenses; is that correct?

A That's correct.

Q And as far as the Beach Plan's loss adjustment expenses, they are those -- as I understood it, you said that those were being basically being estimated according to a formula?

A So is the question about a formula?

Q No. The question is --

(Overlapping speakers.)

BY MR. FRIEDMAN:

Q The question is whether you were including the actual dollars that the Beach Plan spent on paying out claims and handling them, or are you creating an imagined dollar based on a formula?

A I'm trying to think where to start because there are so many issues going on here.

Q You represent the building, the Beach Plan, correct?

A On other matters.

Q You never represented them with regard to the data that they're collecting and giving them to the bureau?

A No.

Q Or to ISO?

A No.

Q Are you aware of how they collect their loss adjustment data?

A Generally. I think they follow similar procedures as other companies.

Q Does that procedure include designating what expenses are loss adjustment expenses?

A Presumably, yes.

So taking a step back. I'll try to address a few different issues here.

So for lost adjustment expenses -- let's focus on that for a moment. Loss adjustment expenses are not reported in the statistical data that ISO collects, and that's true for commissions and general expenses as well. So loss experience is reported, and that's why when I referred to loss before, I probably meant loss.

All those other expense items, general expenses, commissions, and loss adjustment expenses, since it's not in statistical data, it needs to be included by way of a data call or a supplemental data request. So that's what the NCRB sends out on an annual basis.

Q I'm sorry to interrupt you. But that would be the supplemental data request sent out to bureau members?

A Yes. Which is -- and this is another issue, because we're talking about Beach Plan and including that. So that's -- in some ways that's a separate issue that we'll get to.

So on the -- I just want to sort of finish off on the loss adjustment expenses; that since it's not included in the statistical data we need to do the supplemental data call. So we would include a provision based upon member companies.

(Reporter requested clarification.)

A Member companies, which the Beach Plan is not a member company.

And I think that gets to the crux of the issue here in terms of why it's appropriate to include the Beach Plan data and why it's appropriate for us to -- Beach Plan -- it's appropriate to include the Beach Plan loss experience because the intent of the -- the statutory intent, as I understand it, is to develop a rate -- an average rate for the composite industry and the entire loss experience for all policies in -- that could potentially be written in the state.

This filing -- and this is the crux. From my perspective, this is the crux, actuarial issue. Is that this filing is intended to be -- the rates derived from this filing is intended to be used by member companies. The filing is made on behalf of the member companies, and it's appropriate to include provisions for general expenses, commissions, loss of adjustment expenses for the member company.

(Reporter requested clarification.)

BY MR. FRIEDMAN:

Q Sorry for the interruption.

A Now there is a separate statute that addresses what the rate should be charged by the Beach Plan. And that separate statute, it's outside of the scope of this filing. This filing is to develop rates for member companies. If you're not a member company, you're not subject to this filing.

Now, the statutes for the Beach Plan do address how their rates need to be calculated but it's outside of the scope of this filing. So the question as to whether it would be appropriate to include Beach Plan expenses, from my perspective, it's irrelevant because that's not the intent of this filing. This filing is intended to be developed rates for member companies not the Beach Plan.

Q So I'm going to look -- it will take me a second here. This is not one of the pages I specifically looked up. But there is a point in your report -- maybe you can help me find that point -- where you specifically address the Beach Plan rates, and you say -- if I'm not wrong -- that they depend on the manual rate.

A That is correct because that's how the statute addresses the rates for the Beach and FAIR Plan. So the statute does address how their rates are tied though these rates, but it's still a separate matter as to what the intent of this filing is.

If it was decided to establish rates for the Beach Plan not using those multiplicative factors, that would be a separate issue, which can be addressed from a statutory perspective regarding the Beach Plan. But the intent of this filing is still for the member companies. It's not to establish -- I'm not here to establish rates for the

Beach Plan specifically.

Q I may be mistaken. Were you here for Mr. Spivey's opening?

A The first day I was not.

Q Okay. Well, I believe -- correct me if I'm wrong -- that he addressed the fact that what is going to be decided here has -- will directly affect the Beach Plan and the FAIR Plan as well because their charges, their premiums begin to be measured by the manual rate.

Would you agree with that?

A Yes.

Q Okay. And yet particularly for the Beach Plan, you're only including a small picture of their data, and it just happens to be in some ways -- you're only including a small picture of their data in calculating the manual rate. That is --

A Can you clarify?

Q Sure. The loss experience.

A We're including their loss experience in the same manner as we would include the loss experience for other insurers.

Q But you're not including the fixed expense, the loss adjustment expense, and potentially the premiums in the same manner that you would a member company?

A The premiums, I'll just -- that's separate. But with regards to loss adjustment expenses and underwriting expenses, we're including a provision based upon the member companies because this rate -- the ultimate rate is intended to be appropriate for the member companies assuming they wrote the composite entire industry experience.

If the bureau has lower underwriting expenses, maybe they have higher reinsurance expenses, whatever their expense experience from an actuarial perspective, the Beach Plan -- from an actuarial perspective, the Beach Plan might have a different rate than what comes out of the NCRB's rate for its member companies.

Unfortunately or fortunately, however you look at it, the statute specifies what the Beach Plan must charge, and that's a separate matter outside of the scope really of the indicated rates for member companies here.

Q And does -- do you have any idea or have you ever seen what the Beach Plan expenses for -- the fixed expenses and the actual loss adjustment expenses are in your work for the Beach

Plan?

A Yeah. The work for the Beach Plan I definitely have looked at -- I have definitely looked at their underwriting expenses. My work was focused on the commercial lines so we would have focused on commercial lines, but I would have reviewed that information as part of that other project.

Q Do you have an impression of how they are as compared -- how much they are as compared to how much the voluntary market fixed expenses and loss adjustment expenses are?

A I did not put them side-by-side. I was working on them independently. And much of the work was done by someone on my -- someone else on my team. I reviewed the results in the end.

I can speculate.

Q If you have seen them and have a general impression, by all means give me that general impression. But if you -- it's pure speculation -- I can't stop you from answering. I'm not going to urge you not to speculate.

But I really am looking as to whether you have -- not speculating, but a general impression.

A I have definitely seen the numbers. I have not put them side-by-side. My expectation, broadly speaking, is that FAIR Plans typically will have lower types of underwriting expenses than traditional insurers, generally speaking.

Q And you said "by FAIR Plans," here you mean the Beach Plan?

A That's correct. Broadly speaking. And I've seen opposite situations where maybe the residual market mechanism will be very small and because of just the small size, have very high underwriting expenses, just because of the small nature of the company.

But it's typical -- a residual market mechanism doesn't have all -- doesn't perform the full range of functions that typical insurance companies will do.

Q Okay. Did you read the reports of Mr. Schwartz and Ms. Cavanaugh?

A I have read them.

Q Did you notice in there that they relied on the expenses of the Beach Plan and the FAIR Plan, or at least -- I don't know that they relied on them, but they did point out that their expenses were roughly, I think -- I feel like -- I

don't have it in front of me, somewhere in the 70- to $80 range per policy, while the voluntary market's expenses were 130-something per policy.
Do you remember?
A I don't recall those numbers, but that differential wouldn't surprise me. I would accept that.
Q If the actual Beach Plan expense numbers were being used in the calculation of the indicated rate, the bureau's calculation of the indicated rate, could that drive down the loss experience assuming they are lower than the average voluntary market rate, or the rate of the expenses for the average -- the rate -- average rate expenses for the voluntary market? Sorry.
A Right. It wouldn't have any effect on the loss expense, but on the expense side.
So I'll answer it sort of two ways here. I would sort of view that as a hypothetical question because -- and "hypothetical" in the sense that I don't think that is the intent of this filing. The intent of the filing is to develop rates for the member companies and to include an expense provision that's reflective of member companies. So that is what I believe is the

appropriate scope for this filing.

But answering your hypothetical question as to if one were to include the expense experience from the Beach Plan, which I don't think would be right -- it would have a downward effect on the expense dollars per policy as you expressed it.

Q Okay. It would have a downward effect, if I heard you correctly?

A From the situation -- compared to the situation of not including the Beach Plan.

Q Okay. Do you know the statutory language that the Beach Plan relies on in order to justify including the Beach Plan losses?

MR. SPIVEY: I'm sorry. Can you repeat that?

BY MR. FRIEDMAN:

Q Yes. He may very well not know this, but I'm asking -- he said that he had carefully reviewed Article 36 yesterday.

And my question is: Do you know or have an idea of the statutes that specifically -- that the bureau relies on in order to justify including the Beach Plan losses?

A I have read the statutes. My

interpretation was that it was the matter of including the Beach Plan expenses -- not Beach Plan expenses -- Beach Plan losses was appropriate. That particular issue, I've been provided guidance from the NCRB counsel that the interpretation is that the intent of -- the intent of the rate filing is to view the rates for a composite industry experience as if it was all written by member companies.

Q Are you aware of whether the commissioner in 2014 did essentially a broad, broad statement that the failure to include -- well, let's just say that the whole unaggregated mix of Beach Plan, CTR policy, and manual policy losses were grounds for him adopting a lesser rate, and then he went on in different manners to adopt that lesser rate based on more specific findings. But that he ruled that the whole premise of the bureau's rates, losses -- of its loss calculations were undermined by having crammed together the Beach Plan, the CTR policies, and the manual policies.

Are you aware of whether he's addressed that?

A I am not aware that he has.

Q Are you aware of any attempt in this filing to separate out the -- from the losses, or

just the general experience, the CTR experience, the Beach Plan experience, and the manual rate experience?
A There is not a separate separation. My understanding is it's -- the way the data is reported and through the statistical plans, it's not possible to fully separate out all the components that we need.
Q But the way the data is reported is dictated by the bureau?
A Well, reported through -- that plan is not -- the statistical plan is not under the -- the bureau doesn't specify the details of the staffing.
Q Didn't the bureau ask the members to please provide it those numbers separated out according to the CTR and manual?
A I'm not sure what -- I'm not sure what the right protocol of who would have to initiate it, but certainly changing statistical plan data submissions is something that could be done.
Q Okay. And then as far as the Beach Plan data, if it gets globbed together with the CTR and the manual rate data, that's simply available from the Beach Plan; is that correct?
A The loss experience, yes. It gets a

little bit complicated with the Beach Plan because the Beach Plan -- they're writing wind-only policies, and there will be a counterpart ex-wind policy in the voluntary market or, you know, outside of the Beach Plan.

Our analysis is done looking at it on a full coverage basis. So it's not as simple as simply saying, Take out policies that are written in the Beach Plan because there's a counterpart policy that's written in the -- of the ex-wind for a policy that's written by voluntary companies.

So separating out even Beach Plan policies would not be a simple exercise because of that splitting of the policy into the wind and the ex-wind components.

Q Okay. Splitting of the policy into the ex-wind -- the two components, I'm sorry. You just said were the ex-wind component and the --

A Wind-only component.

Q Wind-only component.

And are either of those -- they may be on different policies, but are either of those provided by a voluntary market member?

A So the ex-wind component would be provided by a voluntary member.

Q Okay. But --
A You wouldn't have a direct way to match individual policies. So if one house has an ex-wind policy with a voluntary company and a wind-only policy with a Beach Plan, we wouldn't have a way of merging that single policy.
Q But the Beach Plan losses from the -- I forget what -- from the whole plan, from a full risk plan are available and are loaded into the -- dropped in the bucket; is that fair?
A I'd have to refresh my memory if they're writing just -- many of the policies are wind-only policies.
Q So when you have -- in the various states, it has losses from the Beach Plan included. Are you suggesting that many of those would be wind-only?
A Could you repeat the question?
Q Sure. So my very general understanding of the losses that are represented in the filing are the historical losses, are that they are the losses of the beach policy on the homeowners' policies. I was -- is that your understanding?
A Maybe it's just me. Can you just repeat that question one more...

Q Sure. My understanding is that when we see the category "Loss Costs" in a filing, that reflects loss costs from policies written at CTR, loss costs from policies written at manual, and also the loss cost from the Beach Plan policies.

A The loss experience includes the loss experience reported by both voluntary companies outside of the Beach Plan and the Beach Plan. Within the voluntary markets, we include loss experience for both manual rates and consent to rate in exactly the same way.

Q Okay. And as far as --

(Overlapping speakers.)

A We treat all the losses the same.

BY MR. FRIEDMAN:

Q And as far as the Beach Plan's loss experience, is -- you know, I understood you to be saying that some of it is only ex-wind experience or...

A No. Just a very -- yeah, so maybe -- maybe I'm the only one being confused. I'm probably not being clear here.

So there are three types of policies. You can have a full policy, a full policy which includes coverage for wind and nonwind perils. In the coastal regions of the state where the Beach Plan writes business, a policyholder has another option. They can buy a wind-only policy that just provides coverage for wind. They can buy that from the Beach Plan. Then they are required to also purchase an ex-wind policy from the voluntary market.

So a policyholder can have essentially one or two situations. One policy is a full policy. Or they have two separate policies, one would be for wind, one with the -- a voluntary company for the ex-wind.

Our analysis, the rate analysis is really not at the complete, full policy basis. So when we collect data, when we collect loss experience, we're collecting -- and for a case where there was two separate policies, a wind-only and an ex-wind, we're collecting those losses from those two separate companies.

So we're essentially building up the experience, as if everyone -- as if every policy had was written at a full basis. But from a practical matter, that information is coming from two different sources for some of those policies.

Q Okay. But they're all mixed in

together?
A They're all combined to create one composite industry data, and from a loss perspective, it's all combined as if it was on full policy basis.
Q And it is -- obviously, you look at the Beach Plan loss experience before you dumped it in the pot; is that fair?
A Correct.
Q So it would be possible to split that out, if necessary?
A Well, that's where it's tricky because if you're talking about splitting out -- since we're doing the analysis on a full policy basis, we don't have a counterpart in the aggregate. We have the policy data for the ex-wind policy. We don't have the ability to merge them and say "This policy over here versus this policy over there." So in that sense, it's not possible to say --
Q I'm talking -- I'm not talking about the larger concept. The ex-wind and the excess wind are the one that's in the voluntary market versus the Beach Plan are -- need to be merged. I'm talking about just taking out that policy that is in the Beach Plan and separating it, whatever its

numbers may be, from the CTR and the manual rate provisions.

You have that number and you put it in the pot. You can then take that number out, could you not?

A On the loss side, yes, sir, I believe we could do that on the loss side.

Q Okay.

A The premium side, which is the -- the exposure side, which is the other half of it, picture, you need both to do the rate analysis. That's where it's not as simple because the exposure -- we do it on full -- we look at it on a full coverage basis. So on the loss side it would be -- it could be isolated, but on the full exposure side, I don't think that the data is fairly available to do that, is my understanding.

Q Okay. On the loss expense -- I'll just stop.

Turn to page 6 of your report.

A Okay.

Q Third paragraph: Over the years, the Beach Plan's large market share reflects the fact that voluntary companies are unwilling to write in the beach and coast due in large part to the inadequacy of the bureau manual rates in those areas. This high market share has occurred despite the fact that the legislature intended the Beach Plan to be the "market of last resort" in those areas.

Do you know what percentage -- I think it's definitely in here. I don't know the page but -- in the beach territories, what percentage of -- roughly, does it Beach Plan write of the total homeowners policies?

A Yeah. I don't recall the exact numbers. I do believe they are included in the filing. I have seen those numbers. But I don't want to get it wrong.

Q Okay. I feel like that 43 percent number is actually in your report, but I'm not finding it.

A I don't believe it's in my testimony, but I do believe -- I believe it's included in the full filing submission.

Q Okay. Does 43 percent sound more or less right?

A It does, yeah. I don't want to quote the exact number, but the ballpark number is consistent with my memory.

Q And for the coastal territories where the Beach Plan writes homeowners, do you recall the number being at or around 47 percent?

A I just don't recall the exact number.

Q In your years of representing the Rate Bureau, has there ever been discussion of trying to gain -- the voluntary market members trying to gain or compete with market share that is of the Beach Plan? Basically, trying to compete with the Beach Plan for those -- for homeowners business in those territories where the Beach Plan writes policies?

A So just make sure I understand. So the question is, am I aware of voluntary companies trying to compete in those areas?

Q Yes.

A I don't have explicit knowledge about North Carolina, but I can speak broadly on this issue. I've done consulting in a lot of coastal states, and I've done consulting for companies over the years that have been wind-only business, they concentrate.

And my understanding -- broad understanding is that there's a wide range of risk appetite by insurers. There are many insurers that want to stay far away from the coast and have no intent to compete there. And there are many insurers -- well, there are insurers that take the opposite opinion and have a high appetite for coastal business.

So I would say there's a segment of the market that would be happy to write business on the coast and take that risk if they felt the premium was adequate.

Q So specifically with regard to Rate Bureau numbers. In your years of working for them, has the issue of competing for Beach Plan market ever come up?

A I have not had any discussions around specific companies' strategies in North Carolina in that regard.

Q Any discussions regarding the Rate Bureau's strategies, whether it intends to allow its members to better compete with the Beach market, Beach Plan market by increasing the manual rate, for example?

A I have not had any conversations around strategies in that regard, but the conversations that I've had have always been around establishing an actuarially sound rate for the member companies so that if they choose to write business at the coast, will have actuarially sound rates to do so.

Q You said you reviewed parts of the commissioner's 2014 homeowners order.

Did you review the part that dealt with the 72 percent of premium in 2014 that was being written by the Beach Plan in the beach territories?

A I don't recall that.

I just want to clarify how I portrayed my reading of the order because I don't want to over- -- when I say I don't recall, I don't recall a lot, and sometimes it might be that I never knew the answer, and I'm simply saying "I don't recall now."

But I did not review that order as part of this proceeding. So it's not something that I -- I didn't even try to refresh my memory on it. It's not something I read.

I think I -- I think -- I'm quite sure I read aspects of it four years ago so... And so I'm going to say I don't recall in those situations where, in reality, I might never have known it in the first place.

Q Certainly, I have advised my own clients to say I don't recall if they don't recall the specifics. So that's nothing to be self-conscious about.

The -- do you know whether in the ten years since 2014 the voluntary market has gained a share of what had been the Beach Plan market?

A I don't know.

Q Okay. So we were discussing yesterday the statistical organization data that ISO ultimately ends up excluding because of either not being reported in time to ISO or else they're being anomalies.

Do you recall talking about that?

MS. FUNDERBURK: Are we shifting gears, Mr. Friedman?

MR. FRIEDMAN: Yes, ma'am.

MS. FUNDERBURK: I'm just looking at the clock. It appears to be a good time for our mid-morning break. If you're shifting gears, that will work to not interrupt your flow.

MR. SPIVEY: That's fine.

MS. FUNDERBURK: Anything we need to address before we go off the record?

MR. SPIVEY: No, Your Honor.

MS. FUNDERBURK: It is about 10:27. We're going to do a 15-minute recess. I will see everyone back in 15 minutes.

First, I'll again remind Mr. Ericksen you continue to be under oath when you come back on the stand.

We're off the record. Thank you.

(A recess was taken from 10:27 to 10:49 a.m.)

MS. FUNDERBURK: Thank you, everyone. We are back on the record, and we will resume Mr. Friedman's cross-examination of Mr. Ericksen.

Mr. Ericksen, you remain under oath. Thank you.

Mr. Friedman, please proceed.

MR. FRIEDMAN: Thank you.

MS. FUNDERBURK: Yeah, you have to -- there you go. You have to press the button right in the middle. It can be a little finicky.

BY MR. FRIEDMAN:

Q Mr. Ericksen, just what we were talking about, so is it your understanding that the rate filing includes Beach Plan losses, no premium data from the Beach Plan, modeled loss adjustment expenses -- and I say "modeled," but just something you obtained through a formula, but not actual loss adjustment experiences from the Beach Plan. Is that, in your understanding, about what from the Beach Plan is in the filing?

A I think there are a few different things that you're asking about in that one sentence.

Q Sure, I'll just start with -- okay. So it's your understanding that the data in the filing includes the Beach Plan losses.

A With regards to losses, we include losses from the Beach Plan and the voluntary market in exactly the same manner.

Q Okay. And with regard to the general expenses, those are not included in the filing, the general expenses of the Beach Plan, that is?

A So in the underlying statistical data that's reported, no -- no underwriting expenses are reported. When including a provision for general expenses, we include a provision based upon the data call sent to member companies.

Q Okay. So no Beach Plan general expense data.

A Beach Plan expense data is not used.

Q Okay. And then, finally, as to the loss adjustments expenses, you do a calculation for an estimate of the Beach Plan's loss adjustment expenses rather than get the loss adjustment expenses from the Beach Plan?

A With regards to loss adjustment expenses, it's treated in a consistent manner as with general expenses. Loss adjustment expenses are not reported in the statistical data by any company, but a provision for loss adjustment expenses is included based upon the data call sent to member companies.

Q So when you say for any company, let's pretend you're representing a single company in another state, a homeowners carrier. When they make a filing and request their loss adjustment expenses, how do they determine those?

A For an individual?

Q Company. Yeah, a homeowners carrier in another state.

A Typically, what will be included in a rate filing would be the loss adjustment expenses that would be assigned based upon their annual statement experience. And companies have internal accounting procedures that will allocate cost by expense item, loss adjustment expenses being one of those items.

Q So is it that they're actually keeping track of the loss adjustment expenses or that they are looking at a sum of expenses and allocating some of it to a loss adjustment expense?

A Well, different companies can and do do it differently. It's traditional to break loss adjustment expenses, split them in different ways. One way of classifying loss adjustment expenses would be allocated loss adjustment expenses and unallocated loss adjustment expenses. Allocated, as its name would imply, are typically assigned to an individual claim.

On the other hand, unallocated might be general overhead, staff of claims adjusters that go towards handling multiple claims, and those costs aren't allocated on a per-claim basis but may be in some broader allocation method.

Q Okay. How -- whether they're tracking -- the company is tracking allocated and unallocated, do they have simply entries for that, a running tab, if you will?

A That's probably more of an accounting issue of how a company might track their cost. I'm not sure what --

Q Okay. How about this? When you -- if

you were working for an individual company, do you receive a number that says, These are our loss adjustment expenses, or do you receive a larger number of -- constituting various things, maybe even a loss in a loss adjust- -- and one number representing the losses.

Do you use that number to determine with some formula what the loss adjustment expenses are from that loss? Or do you actually receive the data that says, This is what we spent on our underwriters, this is what we spent on our adjusters for each claim?

A Well, each project can be different, you know, in terms of how companies organize and provide data to a third-party consultant like myself. I would say -- the most common situation that I've seen is if we were -- if we were receiving an expense or from the customer, we would receive a claims file that would include for each claim what the loss amount is and whatever basis is being reported.

And typically, not always, but typically we will also have an allocated loss adjustment expense provided separately for each claim. Then outside of that claims file, we would often be provided with a separate estimate -- or separate number for unallocated loss adjustment expenses which are not specifically assigned to individual claims.

Q What do you receive from the bureau in terms of the allocated or unallocated losses of its members?

A So I'll answer that question, but I'll just provide a little bit more information for -- to make things -- sort of put it into perspective.

Oftentimes, for different lines of insurance, I've seen different levels of detail even provided. So, like, for example, on the statistical data that ISO uses, my recollection is that for liability lines, like general liability, we do collect allocated loss adjustment expenses along with -- separately, but along with loss experience. Unallocated loss adjustment expenses are not included because there's no way to assign it to individual claims, so that would be provided separately.

Q I guess I'm talking for --

A Yeah.

Q -- the purposes of this --

A Right, right, right.

Q -- homeowners filing --

A And that's what I'm getting to. Property lines, homeowners in particular, the ISO statistical plan does not collect any allocated loss adjustment expenses or loss adjustment expenses at all. So it's a distinction between a property line and a liability line.

So for property lines, and this is common outside of North Carolina for ISO loss cost, all loss adjustment expenses would be loaded as a multiplicative factor. And that is the same approach that's used in the NCRB's case, where the loss adjustment expense provision, which is expressed as a ratio of loss adjustment expenses to losses, is based upon the data collected as part of the data call, to a number of companies.

Q So is there, in what you receive -- has that factor already been applied and has an aggregated loss expense number been provided by the bureau to you, or does ISO create that loss adjustment number?

A The numbers are certainly shown in the exhibits that we prepare. My recollection, it's based upon the data -- the fundamental data is based upon the data from the data calls. We would show an aggregated loss adjustment expense dollars, an aggregated loss amount, and we would take -- calculate the ratio of those numbers. And all of those numbers would -- my recollection is those numbers are being provided to ISO, not from the statistical plan that we collect but directly from the bureau.

Q Okay. So, well, basically what I'm trying to get at is the loss adjustment numbers that are reflected in the filing for regular losses -- not hurricanes -- thinking of this like beans, is loss adjustment expenses that are reflected in the filing just the actual sum of all of the beans of loss adjustment expenses that each company has given, or is it a -- as you said, calculated according to a formula that ISO uses. Have you just added up --

A So --

Q -- all the beans or used a formula to derive that loss adjustment factor?

A So we simply add up all of the loss adjustment expenses --

Q Okay.

A -- that were reported to the bureau and provided to us and, likewise, with the losses and the denominator --

Q Okay.

A -- and we take a ratio.

Q Do you know how the member companies count up the bean that is -- or calculate the bean that is going to represent their loss adjustment expenses?

A So how they're calculating loss adjustment expenses that they're reporting to the bureau?

Q Uh-huh.

A My general understanding -- and, you know, I suppose there can be differences from company to company, but companies follow standard accounting procedures. There's ways of -- specified in the annual statement and accounting documents with standard procedures of allocating costs. My understanding is the companies follow that accounting guidance.

Q And is your understanding of that accounting guidance that in determining the loss adjustment expenses that they report to the bureau, they are just simply bean counting or that they are doing something else, such as using a formula to come up with an estimate?

A I don't have specific information about how individual companies report in the numbers.

Q Okay. So you just perceive the data and then add it up for the loss adjustment expenses?

A That's correct.

Q Okay. You mentioned yesterday -- or maybe even this morning also what -- that there is a percentage in the premium and loss experience that -- that the premium and loss experience in the filing only represents part of the market because there are certain carriers and/or certain statistical organizations that either get excluded because they're late or get excluded because their results are anomalous.

Is that right? Do you recall that?

A That's a true statement, yeah.

Q Okay. And just ballpark, do you have an idea about how many in this filing were excluded for either of those two reasons?

A We include an exhibit in the filing that provides those numbers. I don't have it off the top of my head.

Q Uh-huh.

A You can point me to those, but we disclosed that as part of the process.

Q I'll look for it.

Okay. What sort of anomalies would lead a statistical organization's numbers to be excluded?

A Well, for -- if we're talking about a whole statistical organization, it would -- the situation would most likely be that the data doesn't include enough detail that would be needed for ratemaking purposes.

Q And does -- so is it that every client for that different statistical organization, different from ISO, will be excluded, or is it just that some of the clients of that separate statistical organization don't include enough data, and so ISO excludes only those clients of the separate statistical organization?

A So it's two separate issues there. My -- if it becomes necessary, we can go to the exhibit where we specify all of the details about, you know, what's being excluded. Just off the top of my head, my recollection is one of the statistical agents stated it is being excluded with -- very small.

Q Okay. But you're -- so in other words, if it's your understanding that the whole statistical organizations' results are excluded if -- you're not going company by company within --

A So there's two issues. There can and there are situations where an individual company's data, for whatever reason, is inappropriate, then individual company's data will be excluded. That would definitely be the case with some companies that report data to ISO.

I would suppose if that's the case -- it wouldn't surprise me if that's the case with other statistical agents, but I don't recall or I wouldn't know the detail necessarily.

There can be a separate situation, separate from the individual company basis, but it's possible that the entire data from a statistical agent is not being used because it's not provided, for whatever reason, in sufficient detail. Maybe they're just not collecting or providing -- able to provide the sufficient detail that would be needed for the analysis.

Q Okay. Can you give me an example or two of what details might be lacking so that the statistical organizations' results are excluded?

A I mean, I'm going to be hypothetical here because it's -- I don't have the --

Q That's fine.
A But examples could be what if they didn't provide the construction class or what if they didn't provide the territorial detail or, you know, some level of information that would be crucial to incorporate it into the analysis. But those are hypothetical. I'd have to defer to the actuaries that were working on the data as to -- unless it's specifically disclosed in the filing.
Q Okay. And in those circumstances, does ISO -- if one of those details is missing, does ISO reach out to the company and try to ascertain it, the numbers?
A Oh, absolutely, yeah. We regularly work with individual companies -- on the ISO side, we regularly work with individual companies that might have reporting issues to correct it.
So it's our objective to include as much of the data as possible.
Q Uh-huh.
A We go to long efforts to -- to try to include as much as possible.
Q Okay. And -- you said on the ISO side, are you talking about ISO clients?
A So where we would have active control

over speaking with individual insurance companies, that would be the set of companies that are reporting statistical data to ISO.

Q And where those clients are from -- are the clients who were reporting statistics to another statistical organization, do you reach out to them, too?

A We -- ISO would not reach out directly -- my understanding is that we would not reach out directly to an insurance company if they're reporting data to another statistical agent. That burden would be on that other statistical agent to reach out.

Q Do you ask the other statistical agents to contact their clients and try to get, clarify the missing details?

A We certainly have discussions with statistical agents in that regard. As far as -- I would say most of the questions that we have with statistical agents, other statistical agents with regards to this matter -- and this is my understanding because I haven't done it firsthand.

It's usually more around we've identified a potential anomaly in the aggregate experience that they reported to us. Because they won't -- for confidentiality, they -- if a statistical agent has data for 20 companies, they're not sending us the data individually for each of those 20 companies, it's aggregated.

But we might identify a potential anomaly in the aggregate experience. We would go back to the statistical agent. They would then research that issue and they might identify, oh, it's due to company XYZ, and they would pursue getting corrections so that -- I guess we have less -- ISO would have less control over other statistical agents mandating submission of data. You know, that's not within our control.

Q In ISO's collection of the data provided by other statistical agents is -- are those other statistical agents being compensated for -- by ISO or the Rate Bureau for taking the time to transmit their data?

A I'll speak broadly as to how ISO -- I don't know specifics about the statistical agents. But with regards to statistical agent functions, that's a service that ISO provides in North Carolina and outside of North Carolina. I don't know the details, but there is a compensation associated with that service that we provide.

Q So I guess my question should be: Is ISO providing compensation to those other statistical --

A Oh.

Q -- agents in return --

A No.

Q -- for them providing the data --

A I --

Q -- in return for them providing the data?

A My understanding is ISO does not compensate the other statistical agents, the other statistical agents are compensating ISO separate. I presume they're being compensated, and they're probably being compensated by their member insurance companies because the statistical agents are providing a service to those companies for fulfilling the statistical agent functions, which is not just reporting data here.

They're providing service in other states, other lines, and other reporting responsibilities, I'm sure. So their compensation, I presume, is based upon their member companies, you know, coming from.

Q So yesterday you testified about the

approximately 13 months it took for ISO to gather the data from its own clients, gather the data from the other statistical organizations, and then analyze it in -- for the purposes of making this filing.

Do you recall that testimony?

A Yes.

Q And I believe you said something along the lines of, you understood that, I mean, there was haste because they wanted to make this filing; is that correct?

A I wouldn't say there was haste. We established a schedule.

Q Uh-huh.

A We knew when we wanted to make the filing, and we established a schedule for all of 2023, the activities. And I wouldn't say there was haste. We established the schedule, and we went according to that.

Q Okay. And does that schedule pertain also to the other -- when the other statistical agents were expected to get ISO the data?

A So in terms of the dates of when the other statistical agents provide data to ISO, that -- it would have been built into the very original schedule. I'm not privy to the arrangement between ISO and the other statistical agents in terms of what established time frames are. I know the time frame has been November 30th, on or about, of each year that we would receive data from the other statistical agents. I'm not aware of any -- I'm just not aware -- I've never seen a contractual arrangement or anything that specifies.

Q Okay. In that 13-month example, I believe you said you had the 2021 data ready to go by around April of 2023; is that correct?

A At that time, it had -- that's the time -- around the time that all the editing and corrections and all of that process was concluded.

Q Okay. To get it done in that 13-week period, did you or somebody else at ISO reach out to the other statistical organizations and say, "We're in a hurry, let's try to aim for getting it done by April"?

A Well, we would have already received the data from them November 30th of 2022. So in terms of them getting us the data, we were -- already had it.

Q Uh-huh.

A But between November 30th and say --

November 30th of 2022 and April of 2023, to the extent that there were -- we identified anomalies, to the extent that they needed to have data corrected, we would have -- I'm sure we would have, you know, alerted them to time frames that we were working under.

I don't have any more.

Q No, that's fine.

And in terms of that November -- I think you -- did you say November 30th deadline or just November deadline?

A My understanding is we received data from the other statistical agents around November 30th.

Q Okay. And do you know who, whether it was ISO, NCRB, or the different statistical organizations, established November 30th or thereabouts as the deadline?

A I wasn't part of the process for that.

Q Okay. So I'm going to move on to loss and expense trends. And I can point to the filing if you like, but hopefully this is something you may remember off the top of your head. Do you agree that the bureau's expense trend calculation was based on Bureau of Labor Statistics data through

June 2023?

A June -- the end of June 2023 is the date that I believe we've relied upon information through.

Q Okay. And are you available that that Bureau of Labor Statistics data -- are you aware that the Bureau of Labor Statistics data is available now through June 2024?

A I would imagine it is. Yes, I'm sure it is.

Q Did -- are you aware of whether the bureau provided that updated information to the DOI?

A I don't know.

Q Okay. Did you ever see that updated information?

A It's definitely not something I've analyzed. I may have been copied on that. It's very late -- it's very likely it's something that's -- I've been provided a copy with or seen, but I'm not sure.

Q Let's talk about the fixed expense ratio for tenants and condominium forms versus homeowners forms.

Are you familiar with what percentage ratio the bureau included for tenants and condominiums versus homeowners?

A So when we look at that -- a dollar cost per policy, my recollection is we applied a 50 percent adjustment to the owners experience to develop a smaller provision for HO-4 and HO-6 policies.

Q Okay. And how did you arrive at that 50 percent number?

A So I'll give a little bit of a background on that topic.

So the idea here is fixed expenses -- expenses, in general, there's a lot of different ways that one can allocate that to individual policies. Fixed expenses you can think of as being, you know, rent that a company, an insurer would pay on their building or, you know, certain, you know, administrative-type expenses.

In my consulting practice, just observing different insurers, I've seen many approaches in terms of how individual companies could assign expenses to individual policies. You could load it all and say everything is a fixed dollar amount, everything is loaded in percentage to premium.

But when including it as a fixed

element, it's a common practice to observe that since an HO-4 and an HO-6 policy have lower average premiums, including the same fixed dollar of expenses, could result in a situation where an HO-4 and HO-6 policy might pay an unusually high percent of premium for those fixed expenses.

So I've observed -- you know, generally there will be a reduction in the expense component that's applied to lower cost HO-4 and HO-6 policies.

With regards -- so going into this exercise -- and this isn't new to this filing, it's something from the prior filing, too. Going into the exercise, it's one of those things where certainly having a lower fixed expense for renters and condos is appropriate. But expense experience that I've observed, we don't collect it on a per-policy form basis.

In particular, you know, how fixed expenses might vary or being classified is not something that we can point to and say, Oh, this data suggests it should be 40 percent, it should be 60 percent. So we -- directionally, the 50 percent is a judgmental selection. It was selected to improve directionally. It's an improvement upon 100 percent. But it certainly is an assumption that we fully disclosed.

I believe it was something that was discussed at the committee meetings, or a committee meeting, to make sure the committee members felt comfortable and -- you know, with that allocation.

My recollection is that that was discussed and -- I don't know if it was a formal voting, but certainly discussed and agreed to, that it was appropriate.

Q Okay. So when you say "judgmental," it was an estimate, is that --

A It was an estimate that in the absence of providing that estimate -- by providing that adjustment, it improved the situation that if we didn't apply that adjustment, but it is a judgment selection.

Q Are you aware as to whether there was a time when the Rate Bureau did ask its members to report back its fixed expenses according to form?

A I'm not privy to that.

Q Okay. Do you recall reading the 2014 order about -- in that order, how the commissioner treated the issue of the 50 percent ratio for tenants and condominiums?

A No, I do not remember that.

Q In other states, when you're working for an individual homeowners carrier, have you set -- also just judgmentally set fixed expense numbers for that carrier's tenants and condominiums?

A So when I've worked for other insurers, and that general issue has come up -- in isolated situations. I wouldn't say it's super common. From an actuarial perspective, I don't think it's always a right or wrong answer exactly how much you would say how much is the fixed dollar amount versus how much is loaded in as a percent of premium, say.

My -- in some of the -- I'm thinking of a consulting project several years ago where this issue came up. It was more of a company's business philosophy of how they wanted to allocate those costs.

From an actuarial perspective, my responsibility is to make sure the rates are actuarially sound so that we weren't double counting or undercounting. We were having it -- but there was the recognition that there should be a lower cost for HO-4 and HO-6. I don't recall the exact magnitude, you know, but conceptually it was a -- a lower provision was selected.

Q So in this work for other homeowners

carriers outside of North Carolina, where you have been looking at what the fixed expenses will be for tenants and condominiums forms versus homeowners, have you ever calculated the expenses, the fixed expenses for tenants and condos, based on what you understand to have been that company's actual expenses for tenants and condos?

A No, I don't think that they broke out -- in the example that I'm thinking of, they did not break out their general expenses separately for HO-4 and HO-6.

Q Okay. And you've only done this, then, on one -- is there only one time that you've actually worked on a project that involved setting the fixed expenses for tenants and condos?

A Well, I've done many filings dealing with tenants and condos in terms of developing a fixed expense. One project comes to mind.

Most of the underwriting expenses, for purposes of a rate filing, are generated -- are based fundamentally on financial statements. And as such, you know, financial statements have a homeowners line of business. It doesn't have it separately by policy forms. So it's typically not available by individual policy.

Furthermore, you know, if you think of the counterpart or the similar situation for losses, you have -- or loss adjustment expenses, you know, you have allocated loss adjustment expenses, which companies typically do track on a per-claim, per-policy basis. And you have unallocated loss adjustment expenses, which is aggregated at a very high level. And I think that's the approach that is taken for underwriting expenses as well.

I don't think that an individual insurer is tracking any of their expenses at a individual policy level. I've personally never seen that done. It would be some high-level aggregation.

Typically, you know, for -- for expense items typically, you know, they might just allocate it by premium or something like that.

Q Okay. In that one case that you worked on that comes to mind, do you know how the carrier determined the fixed expense ratio for tenants and condos, of like what's that carrier's process for doing it?

A So I wasn't involved in the specifics. My recollection was that they looked at it just in terms of the cost to producing a policy, what are -- like, what are the minimum expenses related to issuing a policy, and it was more on a business side of the operation.

Q And roughly, if you recall, how much was the fixed expense ratio for tenants and condos from that example you're --

A I don't recall. My recollection was it was directionally lower. But I don't recall the exact percent, nor would it be relevant. You know, one company's choice wouldn't be relevant to another company necessarily.

Q Do you recall whether it was higher or lower than 50 percent?

A I don't recall.

I know you didn't ask me a question, but just to elaborate. From my perspective, this is an area where we don't have actual data on making an adjustment. This 50 percent adjustment improves a situation from not having -- making any adjustment.

Q I'm sorry, I didn't understand what you just said.

A So maybe I shouldn't have brought this up again but...

But in the absence of applying an adjustment, the situation would be worse than applying some adjustment. We don't have actual data. There is no actual data on this available, so we judgmentally selected 50 percent, with the understanding that the resulting scenario situation is an improvement over not applying any adjustment at all.

Q Do you know whether, in year 2006 and the prior years, the bureau used a formula that did not result in -- I would say a nonjudgmental formula that resulted in fixed expenses for tenants and condominiums being less than 50 percent?

A I don't have information. I haven't reviewed that.

Q All right. If you could turn to -- I'm going to be going now to the issue of profit. And in particular, turning to some of the transcripts. I'm looking -- do you have the transcripts handy, sir?

A I don't think so. I don't have any in front of me.

MS. WHARRY: Can you clarify which transcripts you want and what days so that we can get them?

MR. FRIEDMAN: Sure, sure. But there aren't hard copies?

Okay. So this is volume -- I'm going

to be turning first to Volume I PM.

MS. WHARRY: What day?

MR. FRIEDMAN: That would be Thursday, October 7th, at PM.

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

MS. FUNDERBURK: Yes, please approach.

MR. SPIVEY: Can you clarify, I think you just said Thursday, October 7th?

MR. FRIEDMAN: Well, so I'm looking at it now, and it says -- the PM has Thursday on it. The a.m. does not. And I know that certainly was not Thursday, October 7th.

MR. SPIVEY: It was the first day of the hearing.

MR. FRIEDMAN: First day of the hearing PM, but it misleadingly has Thursday on it.

I'm going to be having a number of questions for the witness about the transcripts. Would it be acceptable to leave a hard copy of them, of all of them with him? It's that or stand up each time.

MS. FUNDERBURK: There are quite a few of them. It might be a little difficult for the witness to sort through them.

MR. FRIEDMAN: Okay.

MS. FUNDERBURK: It might be easier if they were handed, particularly the exhibits, that you're referring to.

MR. FRIEDMAN: Okay. I can go through right now and say what volumes I'll be referring to throughout the rest of his testimony if that would make Ms. Wharry have to stand up less. Whatever is easiest.

MS. WHARRY: October 7th, right, the first day?

MR. FRIEDMAN: Yeah. Do you want me to go through the other ones that I will be touching on today?

MS. WHARRY: Yes.

MR. FRIEDMAN: Okay. So Volume II AM.

MS. FUNDERBURK: What date?

MS. WHARRY: What day?

MR. FRIEDMAN: That would be Tuesday, October 8th. Monday, October 7th, AM.

MS. WHARRY: I got that one.

MR. FRIEDMAN: Thursday, October 10th, AM. Friday, October 11th. There's only an AM that day. All right. Tuesday, October 8th, PM, if that's not already there.

And let me check one thing I need to. Thursday, October 10th, AM. okay. Wednesday, October 9th, AM.

THE WITNESS: I'm guessing I should just take the whole stack.

MR. FRIEDMAN: I didn't want to say that or burden you with it. That's up to you. There are a number of volumes I'll be citing to.

I may have already done this, though I can't remember. Thursday, October 10th, AM. Tuesday, October 8th, PM.

THE WITNESS: Would it make sense maybe to start with a few, the first few that you were going to...

MR. FRIEDMAN: Well, they're in different orders.

THE WITNESS: Oh, okay.

MR. FRIEDMAN: So I would have to -- no offense, I'd have to be skipping around the outline, and that would rain chaos on me.

THE WITNESS: Thank you.

MS. FUNDERBURK: Thank you.

MR. FRIEDMAN: Would you like for me to keep going, Ms. Wharry?

THE WITNESS: They're nicely organized here, so I think I can go through them.

MR. FRIEDMAN: Thanks to Ms. Wharry.

(Pause off the stenographic record.)

MR. FRIEDMAN: So I may already have done this one.

MS. WHARRY: I gave him everything except yesterday.

MR. FRIEDMAN: Oh. Given him everything except for yesterday. Okay, great. No, I don't need yesterday. I haven't had a chance to see that myself. Didn't even know it came in.

All right. Thank you very much.

BY MR. FRIEDMAN:

Q All right. At Volume I PM, Mr. Ericksen, this is the testimony of Dr. Zanjani.

MS. FUNDERBURK: Please identify the date.

MR. FRIEDMAN: Yes. Monday, October 7th, although it does say Thursday, October 7th, on it. But this is the PM from October 7th.

A I have that book.

BY MR. FRIEDMAN:

Q Okay. And turning to pages 117 through --

MS. FUNDERBURK: And if you could go a little closer to the microphone.

MR. FRIEDMAN: Yes.

BY MR. FRIEDMAN:

Q Turning to pages 117 through 119. And if you could just take a second to read over those for yourself, Mr. Ericksen, that would be great. And tell me when.

A Yeah, I'm a slow reader. I'm still on page 117.

Q Take your time.

A Okay.

Q So do you see basically there that Dr. Zanjani is discussing what he terms three different components of the cost of capital? I think the word "components" is actually on 117.

A I'm on 117. Can you direct me to the line?

Q Line 18.

A Yes.

Q And one of those components is the historical excess return of the overall stock market over bonds. That's line 20 and -- 21 and 22 on page 117.

A So starting on row 21, there's a question. The question was: And the historical excess return over the overall stock market -- over bonds. That was part of the question.

Q Okay. Did you understand that to be one of the components he used? I called it methods, but --

A So let me just -- I'm just reading out loud to help myself.

Q Sure.

A So the question was -- we're at the same place.

Answer: So I don't use three methods. Those are three components.

Question: Sure.

And then the answer was: To calculating the cost of equity.

Question: And the historical excess return of the overall stock market over bonds.

(Sotto voce reading of document.)

I wasn't here that day, so I'm having a hard time putting this into context.

Q I will, as much as possible, divorce myself from the transcript for that day. But have

you ever calculated the cost of equity?
A Cost of equity?
I can't recall doing that.
Q Have you ever worked on a filing where another ISO person calculated the cost of equity for the client?
A I've performed -- or oversaw calculations involving ratios to surplus. I know there can be a difference between equity and surplus and different connotations. Technically, I don't think I've done a cost relative to equity to the extent that that's different than the statutory surplus.
Q Okay. Have you calculated cost of capital or have others on ISO calculated that for filings you've worked on?
A Cost of capital, no, I don't recall that being --
Q Okay. Have you ever calculated the historical excess return of the overall stock market over bonds?
A No, I have not done that.
Q Have you ever reviewed filings where another expert, whether at ISO or otherwise, calculated that?

A I'm trying to recall. I think there have been exercises where I've looked at financial statements, information that might have shown information separately for stocks and bonds, but, no, I don't recall if I've ever looked at it as a rate of return separately for those components in the work I've done or oversaw.

Q Okay. Do you know what a DCF calculation is?

A I've heard of the term "DCF." I think it can refer to discounted cash flow.

Q Do you know how it's calculated?

A I'm generally familiar with the methodology and the terms.

Q Okay. What's it based on? Is it based on the present value of -- a discounted present value of dividends?

A Well, discounted cash flow method can be applied to any stream of money. The idea conceptually is you're trying to adjust future payments -- or monies to present value. So you discount a future dollar amount to the present value, using some discount rate. That could be applied to any dollar amounts of -- not necessarily dividends. It could be any sources of money.

Q Do you know -- is Kroll an accounting firm or some other sort of -- what type of firm is it?

A Um.

Q If you know.

A I might -- spell it, please.

Q K-R-O-L-L.

A I'm not familiar with it.

Q All right. I'll cut short a lot of this. How familiar are you with the -- an actuary -- with how actuaries, wearing their actuary hat, not their economist professor hat, calculate profit provisions?

A I'll try to be careful with my answer. I've certainly reviewed lots of rate filings as competitive research, where I've seen a wide range of approaches. I'm generally familiar with a range of approaches. I wouldn't say I have a ton of expertise in many of those because I've reviewed it. So I would say my personal knowledge is somewhat, somewhat limited, but consistent within a typical actuary that doesn't concentrate in that field.

Q And outside of North Carolina, for all the different filings where you've seen the calculation and reviewed it, of the profit provision, have they referred to cost of capital? Has at least one element of the profit provision?

A I just can't recall the details. I know there could be, you know -- return on surplus, there could be different. Whether I specifically saw cost of capital, I don't recall.

Q How many of those have you reviewed?

A I'm going to caveat this a little bit. Usually, when I've been viewing filings for this, I'm usually more interested in a final answer. You know, what was the underwriting profit provision selected and used by a range of insurers? So I might have seen dozens -- you know, maybe a -- dozens a year, you know, but I oftentimes am not scrutinizing the methodology that they use to develop the final answer. I refer to it for the purposes of what I've done. I'm more interested in compiling a range of profit provisions rather than focusing on the intricacies of how it was calculated because it wasn't necessary for the project we were working on.

So I've reviewed dozens, but not the level of detail that would probably be needed to answer the question today.

Q To what level of detail did you observe or review Dr. Zanjani's calculation of the profit load?

A Primarily, I was part of the committee meetings that he presented the results. I was provided a copy of his prefiled testimony, probably on or about the time that the filings were being made, so it would have been a very high-level review, not...

Q And I believe in your expert report you approved -- you stated that you approved of his calculation in reliance on him?

A I'm not sure if I said I approved of it, but I certainly did make reference that I relied upon it, and my words would speak for themselves but...

Q Uh-huh. Have you -- are you familiar with the term "total return"?

A I've heard of the term, yeah.

Q What does it mean to you as an actuary?

A Total return, my recollection is, pointed out in one of the ASOPs, my recollection is that's an accounting term when looking at historical results in the way of classifying.

Q And do those historical results include return on capital and surplus? Investments of capital and surplus, better said.

A Returns, no, I mean, that's not -- financial statements wouldn't show a return.

Q So you've never heard the term "total return" to refer to not only other types of profits, but particularly profits including profits from investments of capital and surplus?

A My thinking is total return, it's an accounting term to reflect historical earnings.

Q You don't know anything about what earnings from what sources total return contemplates for an actuary?

A Well, from an accounting historical perspective, the financial statements would show the underlying components.

Q I'm sorry, I missed your last answer.

A From an accounting perspective, it would reflect the financial statements.

MR. FRIEDMAN: Give me a second. One second, Your Honor, I just need to find --

BY MR. FRIEDMAN:

Q Could you turn -- this would be in Book 3.

A What day? Oh, oh, Book 3.

Q Yes, sir. And it is Exhibit 12.

And on page 50 --

MS. FUNDERBURK: Can you speak into the microphone? I'm not sure what you're referencing.

MR. FRIEDMAN: Yes, ma'am. On page 51 of Exhibit 12 in Book 3.

MR. SPIVEY: Is that the Bates-stamped page number?

MR. FRIEDMAN: Yes, the Bates-stamped page number.

THE WITNESS: 51 did you say?

BY MR. FRIEDMAN:

Q Yes, sir.

A Okay.

Q I'll read it into the record. First of all, do you recognize this as Actuarial Standard of Practice 30?

A Yes.

Q Okay. Have you ever reviewed this before?

A Yes.

Q Okay. And on page 51, looking at 2.12, the definition of a total return is the sum of operating profit and investment income on capital usually after income taxes, often expressed in percentage terms.

Is that your understanding of what a total return means from an actuary's perspective?

A 2.12, the sum of operating profit and investment income on capital, usually after income taxes, often expressed in percentage terms. Is that -- that's the sentence.

Q Yes. Is that your understanding of what total return means to an actuary?

A Well, it's definitely one definition. I'll just say that at the beginning of Section 2 Definitions, it says: The definitions below are defined for use in this actuarial standard Of practice.

So I don't think it's saying that that has to be the definition outside the scope of this specific actuarial standard of practice.

Q Okay. But it is the definition for the purposes of the treatment of profit and contingency provisions and the cost of capital in property/casualty insurance ratemaking.

A Yes. And I'll just highlight, you know, the words are the words so...

But in the definition of total return, the definition itself appears to provide multiple scenarios in the sense that I see the word "usually" and I see "often" expressed. So that suggests that could be alternative interpretations.

Q Yes. But regardless of whether it's expressed after income taxes or in percentage terms, the definition of a total return that is binding on an actuary for dealing with profit in contingency provisions and the cost of capital in property and casualty ratemaking is the sum of operating profit and investment income on capital.

Would you agree?

A That's the definition on this page.

Q Okay. So that would be binding on you if you were to be evaluating what the total return is, as an actuary?

A I would view the considerations -- this is a definition, so it's hard for me to say the definition is binding on me, but there's probably other considerations that would be more binding.

Q Aren't the ASOPs binding on actuaries?

A No, no, absolutely. I'm just saying this is a definition, it's not a -- it's not a verb, it's not telling me to do something. It's binding as a definition, I'll agree to that.

Q Okay. Thank you.

Is that the definition you applied when you evaluated Mr. Zanjani's use of the term "total return"?

A It would be a consideration that I would have taken into account to the extent that it's part of the ASOPs. My review -- like I said, it was at a very high level, so...

Q Is that the definition of total return that you understood him to be using, or when you read his report, you understood it to mean that term, which is binding on you in reviewing profit provisions?

A Can you just repeat that?

Q Okay. You're reading Dr. Zanjani's report. And do you recall that he used the term "total return" throughout that report?

A I believe so, yes.

Q And when you were reading it there, is the definition of "total return" that is binding on you as an actuary who is reviewing a profit provision, is that definition the one we just read from?

A I would say it's generally consistent.

Q Okay. But it's binding on you, too, when you're performing that capacity?

A I would say it's certainly a consideration to take into account.

Q That the ASOPs are binding?

A They're binding and they also provide guidance.

Q Thank you.

Are you aware of how North Carolina's homeowners insurance business has been profitable in the past ten years as opposed -- as compared to the nation's?

A I've seen some -- I've seen profitability or different measures over time --

Q Uh-huh --

A -- and countrywide-type information.

Q And that information is comparing North Carolina homeowners carriers' profitability to the national profitability of homeowners carriers?

A I've definitely seen that information. I recall seeing -- not as part of this exercise, but I've read reports from -- I think the NAIC publishes a profitability study by line of business by state. They provide that type of information. I have looked at that as part of other projects, so I know I've observed it. I haven't studied specifically with regards to comparing North Carolina homeowners, but I -- I've seen that type of information.

Q Okay. And you consider the NAI -- do you consider the NAIC's reports on profitability to be trustworthy?

A For the information that they display, I think it's -- I think for any given intended use of information from those type -- from that report, the use -- the use would depend upon -- or I -- no. I trust the data for what it is. How it's being used and in circumstances may or may not be applicable.

Q Okay. Do you know whether it's used by actuaries to determine the profitability of national homeowners carriers or state-specific homeowners carriers?

A I have seen -- that information referenced.

Q Okay. So in your opinion, is it acceptable for actuaries to rely on that information published by the NAIC, the profitability reports?

A I can't say that it would be appropriate in all use cases, but there could be certain use cases where it's appropriate.

Q Okay. Did you review Ms. Cavanaugh's expert report in this case?

A I have.

Q Okay. Do you recall her use of the NAIC profitability for ten years, from 2013 to 2022?

A The details of that, I don't have at my disposal, so I can't --

Q Okay. You don't recall her treatment of that?

MR. SPIVEY: Objection, Your Honor. It seems like we're suddenly asking a witness in the Rate Bureau's direct case to validate something that's not in evidence yet, that's coming in the department's case later? We're a little far afield now.

MR. FRIEDMAN: Yeah, I haven't put it in front of him, but he has said he's read it, and I'm simply asking him what he recalls about it. I'm entitled to do that because this is my opportunity to cross him.

MS. FUNDERBURK: And you can cross on what has been presented in direct. I'll allow you to continue to do cross on what's been presented in direct. If you need additional questions on things that were outside of direct, you'll need to call him as your own witness.

MR. FRIEDMAN: Okay.

BY MR. FRIEDMAN:

Q Let's move on to --

MR. FRIEDMAN: Your Honor, this is a good stopping point, if you want to, for lunch. I've got a whole new topic to get to.

MS. FUNDERBURK: I'm fine with that. We're right at the lunch hour. We'll recess for an hour and a half -- well, before we recess, any administrative matters we need to address?

MR. SPIVEY: Not from us, Your Honor.

MS. FUNDERBURK: Mr. Friedman?

MR. FRIEDMAN: No, ma'am.

MS. FUNDERBURK: Okay. All right. We will be in recess for an hour and a half. I'll see everyone back at 1:30. Thank you.

(The morning session recessed for lunch from 12:03 p.m. to 2:05 p.m.)

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 24th day of October, 2024.

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Audra Smith, RPR, CRR, FCRR
Notary Number: 201329000033
Commission Expires: June 26, 2025