NORTH CAROLINA DEPARTMENT OF INSURANCE

RALEIGH, NORTH CAROLINA

STATE OF NORTH CAROLINA
COUNTY OF WAKE

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

BEFORE: AMY FUNDERBURK, HEARING OFFICER

TRANSCRIPT

OF

HEARING

VOLUME VII - P.M.

Raleigh, North Carolina

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Reported by: Audra Smith, RPR, CRR, FCRR

APPEARANCES OF COUNSEL

ON BEHALF OF NORTH CAROLINA RATE BUREAU:

NORTH CAROLINA RATE BUREAU
BY: MARVIN M. SPIVEY, JR., ESQ.
BY: BRIAN O. BEVERLY, ESQ.
BY: LISA LEEAPHORN, ESQ.
3101 Glenwood Avenue
Raleigh, NC 27622
919.782.6860
mickey.spivey@youngmoorelaw.com
brian.beverly@youngmoorelaw.com
lisa.leeaphorn@youngmoorelaw.com

ON BEHALF OF NORTH CAROLINA DEPARTMENT OF INSURANCE:

NORTH CAROLINA DEPARTMENT OF INSURANCE
BY: TERENCE D. FRIEDMAN, ESQ.
BY: SHANNON WHARRY, ESQ.
3200 Beechleaf Court
Raleigh, NC 27604
terence.friedman@ncdoi.gov
shannon.wharry@ncdoi.gov

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 1:30 p.m., before Audra Smith, RPR, CRR, FCRR and Notary Public.

I N D E X

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P R O C E E D I N G S

MS. FUNDERBURK: Thank you, Counsel. It is 1:30, and we are back on the record.

Are there any preliminary or administrative matters we need to address before we resume?

MR. SPIVEY: Your Honor, may we approach the bench to talk about scheduling?

MS. FUNDERBURK: Yes.

(Bench conference was had off the stenographic record.)

MS. FUNDERBURK: Thank you, Counsel.

We're back on the record to resume cross-examination of Mr. Ericksen.

Mr. Ericksen, I'll just again remind you, you do continue to be under oath.

Mr. Friedman, please proceed.

PAUL ERICKSEN,

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

CROSS-EXAMINATION

BY MR. FRIEDMAN:

Q Mr. Ericksen, I'm going to turn to the charts that were produced yesterday, that is RB-30.

A Okay.

Q Everybody there?
I don't want to know your communications with who at the Rate Bureau prepared the charts but who did?
A But what?
Q Who at the Rate Bureau prepared those -- the charts that are on the first four pages? I don't want to know what you said to them, but who at the Rate Bureau did?
A My understanding is Mark Ford. Mark Ford.
Q Okay. Is he an actuary?
A No. I -- no. No.
Q So looking at the first page, when this chart shows the rate changes, only the year of the rate change is shown; is that right?
A That's correct.
Q Does that lead to the impression that the rate increase was in effect for the entire year?
A No, it would not be. It would be from whatever actual effective date, which could be anywhere during that calendar year.
Q Okay. Does it suggest to the average reader that that is the rate that had been in effect the entire year just based on the way it appears

since you didn't specify when in that year, the rate increase actually occurred?

A I wouldn't want to assume what a reader might takeaway from it. I can certainly clarify that the year that's shown is the year that the rate change went into effect. My understanding is that counsel may have provided to the Hearing Officer the effective dates associated with each of those.

Q I have -- actually, that was in -- all the effective dates are in Mr. Anderson's chart regarding the CAR. Are you familiar with those effective dates? I can lead you to --

A I've definitely seen them. I don't have them off the top of my head.

Q Well, let me ask you this: Why does the graph only show the year the rate change went into effect instead of the actual effective date?

A I presume just for conciseness.

Q How so?

A I don't have a reason.

Q Do you think it would be a more accurate chart if it showed how many months in the year the rate was at the new level?

A It would definitely add more information.

Q Okay. Meanwhile, it is comparing the rate, the new annual rates to a full years' worth of net rate; is that correct?

In other words, so the -- you don't mention the effective dates of the manual rate increases, but you are reflecting a January to December 31st period for the level of the consent to rate?

A So the percentage rate changes were simply just showing what was the approved rate changes that...

Q So, for example though, the last bar, first page -- not very good with colors, but the 2023 bar. That's an entire year's worth of CTR experience there, correct?

A Correct.

Q Okay. I'm going to have to ask you to turn to RB-21, which is in the first book. It is Mr. Anderson's support for CAR.

MS. FUNDERBURK: Mr. Friedman, can you tell me, again, which exhibit you're referring to?

MR. FRIEDMAN: Sure. It is RB-21, and everything I'm going to be referring to is on the first page of RB-21.

THE WITNESS: I'm there.

MR. FRIEDMAN: Madam Hearing Officer, are you there?

MS. FUNDERBURK: Yes, uh-huh.

BY MR. FRIEDMAN:

Q So if you could look at the top under 2020 HO, actually let's start with the -- do you see the 2018 HO toward the bottom? Or even -- I'm sorry. I'm getting myself confused.

Let's start with the 2017 homeowners at the bottom. Does that show an effective date of October 1, 2018, for the rate change?

A Yes.

Q Okay. And so that rate change was only in effect for about -- would you say -- a quarter of the year?

A Yes. And then the one thing -- that is a correct statement. The one thing I would just mention -- I think this might have been brought up -- was that the announcement of the approved rate change would have been dispersed months before when it went into effect potentially earlier in the year. So companies -- insurance companies could have been acting -- insurance companies will typically issue renewal policies and make decisions in a matter of months, a couple months, before the effective dates.

So insurance companies could have been making business decisions earlier than the effective date that the rates actually went into effect.

Q But they couldn't be charging more than the new annual rate until the effective date?

A Correct. But I'm just saying people -- they might have been making decisions about what to renew or not renew 90 days, 60 days before the rates went into effect.

Q Do you know whether any North Carolina homeowners -- member companies were, in fact, making those decisions with regard to what CTR they were charging?

MS. FUNDERBURK: Mr. Ericksen, be sure you talk into the mic.

A Can you repeat the question?

BY MR. FRIEDMAN:

Q Yes. Do you know whether any North Carolina member companies were, in fact, making those decisions that you mentioned?

A I don't have any actual knowledge.

Q So is it correct since the effective date for 2017 was October 1, 2018, that the impact of that 4.4 percent rate change was only about

1.1 percent in 2018?

A That's right, which would lead you to think that if the rate change had gone into effect earlier in the year, January 1st, it could have had a much bigger reduction and had a much bigger impact -- a bigger, positive effect in terms of reducing the consent to rate if it had happened earlier in the year. The fact that it only happened in October would have mitigated the reduction that we actually saw. So that the actual favorable benefit of the rate change would have been more material on the consent to rate if it had occurred earlier in the year.

Q Is that your speculation? This is based -- as I understood it, these are based on actual data.

A It's based on my opinion. So I guess just think this through. If the rate change went into effect on October 1st and the hypothesis is that by increasing rates it will have a downward effect on the consent to rate. And we do see that correlation.

If that rate increase only occurred during the last three months, it had some reduction on the CTR. It would be a logical conclusion that if that rate increase happened earlier in the year it would have had a bigger, larger material effect on consent to rate. So I would view these reductions that we're seeing in the consent to rate as really only a partial effect. And it would have had a much larger benefit.

And, in fact one would then also conclude that the bar for the subsequent year would have been even higher if the consent to rate hadn't been -- if the rate increase hadn't been applied.

Q But those are your hypothesis, right?

A Well, I would view it as stronger than hypothesis. I would say it's a logical conclusion based upon my opinion.

Q But this is based on actual data and according to the actual data, it was only a 1.1 percent impact for 2018?

A You're exactly right. This is based on exact actual data that illustrates it, and that's an actual reduction based upon the limited time that the rate increase was in effect.

Q And then for 2019, the -- would it be correct that the impact of that rate change of the prior year's rate change was 3.3 percent? And that's 1.1 -- it's 3.3, rather an overall 3.3 being taken out of 4.4?

A I'm just not -- where --

Q I'm sorry, sir.

So the overall -- the rate change on October 1, 2018, was 4.4 percent. And you just testified that the effect of that in 2018 would have been 1.1 percent.

A I didn't say it was 1.1 percent.

Q Okay. Let me ask. You just testified that it was -- the rate change was only in effect for about a quarter of 2018?

A Well, if it went into effect on October 1st, it would have affected a quarter of the written premium, but it would have affected even less of the earned premium.

Q For the recorded premium, is one-quarter of 4.4, 1.1 percent?

A One-quarter of 4.4 is 1.1 percent.

Q And that's the impact of -- at least on, I believe you said, the written premium in 2018. That's the impact of the rate change?

A I just want to clarify for myself whether the premiums are written or earned premiums.

Q Yeah, that was a distinction you introduced.

A Exhibit -- for me, taking a look, it doesn't -- it's hard -- it doesn't -- oh, it says "written premium." So, yes, I would say it's a percent of written premium, so I would agree with you, 1.1.

Q And would that mean since the impact on the written premium was 1.1 percent in 2018 that the remaining impact of that 4.4 percent rate change in 2018, the remaining impact in 2019 was 3.3 percent?

A I think that's reasonable.

Q Would that make it correct, first of all, if the average written rate level was 1.1 percent higher in 2018 than it was in 2017?

A Can you just repeat the question?

Q Yes. Is it correct the average written rate level was about 1.1 percent higher in 2018 than in 2017? And the graph does show, I believe, 2017.

A So if we're measuring rate change in this context with regards to written premium level, I think that's reasonable, standard.

Q Okay. And then would the average written rate level for 2019 be 3.3 percent higher than in 2018?

A I'd have to do the exact math because you're going to be -- it's a little bit more complicated because you sort of have to on-level the premiums for each year. So I don't think it would turn out to be exactly that amount, but it would be on that order of magnitude.

Q Okay. So is it correct that although that while the average rate level in 2019 is along the order of 3.3 percent higher than in 2018, nonetheless the percentage of business written as CTR didn't decrease from 2018 to 2019?

A But at the same time, companies are making decisions based upon the information that they have at any point in time. So the approval of the rate increase went into effect in 2018, and that's what would be influencing business decisions, starting then and on a prospective basis.

So they would be making their decisions based upon the information that they learned at the time that that rate change ultimately got approved or settled and implemented.

So it's hard to say once that information becomes known, companies are starting to make their decisions about are renewing, nonrenewing. So it's hard to distinguish between actions that are taking place several -- a year down the road because at that point it was known for a year. Companies are starting to make their decisions at the time that the rate change would have gone into effect.

Q Regardless of the company's decision, just in terms of the numbers, is it correct that the amount of business written as CTR from 2018 to 2019 didn't increase?

A So my --

Q Excuse me. Let me rephrase that. Did not decrease?

A It did not decrease, and at the same time -- but really the question would be what would that bar have been if that rate change hadn't gone into effect. We see that the rates have not changed in the past couple years, ever since 2022. In 2023, there's been a large spike upward.

To me, what this would show is that even those higher bars that we see in 2019, 2021, there's still an upward trend even with these rate increases, but that upward trend would have been even steeper if these rate increases hadn't been implemented.

Q So when you say "upward trend," do you agree that, in fact, the percentage of business written as CTR increased from 2018 to 2019?

MR. SPIVEY: Objection. He's already asked and answered that question.

No, I said didn't increase. I'm asking him that that could have meant stayed the same or increased.

Now I'm asking him whether it, in fact, increased?

MS. FUNDERBURK: Go ahead and respond, Mr. Ericksen.

A What I would agree with is that there's a general upward trend influenced by the effect of rate -- what appears to be influenced by the effect of rate changes.

BY MR. FRIEDMAN:

Q So let's go on to talking about the 2020 manual rate increase. Looking back at RB-2021, do you see that it says the increase took effect on June 1, 2022?

A That's correct.

Q All right. So I understand -- I know you didn't create this. But why does it show only the year the rate change went into effect instead of the actual effective date? Your understanding of whoever created this?

A I'm sorry, repeat that?

Q Yes. What is your understanding of why the graph only shows the year the rate change went into effect instead of the actual effective date?

A I think the idea was to simply overlay the historical rate changes on the graph, which this does.

Q Okay. Well, regarding the May 1, 2020, change in the manual rate, would you agree that was only in place for about two-thirds of 2020?

A So it went into effect on June 1st?

Q Yes.

A So it would have been in effect for seven months out of the year.

Q So about two-thirds?

A A little less.

Q A little less, okay, a little less than two-thirds.

A Closer to 50 percent. You can see 7 divided by 12. I'll leave it at that. It's 7/12ths.

Q That's fine.

A About 58 percent.

Q What would that make the impact of the 4.0 rate change for 2020?

A Well, the story's going to be exactly

the same as what we just went through for 2018 we can repeat it for this year and the next one, too. But it's going to have a smaller effect on the overall rate change on a written premium basis for that year, which, as we discussed before, would have a dampening effect on the benefit of the CTR that we see, in this case 2020, and had it been implemented on January 1st, I would have expected to see a larger reduction.

Q Is it correct that the impact of the 4.0 rate change in 2020 was only about 2.5 percent?

MR. SPIVEY: I'm sorry. Are you talking about the 2022 change and not the 2020 change?

MR. FRIEDMAN: Yes. We're talking about the 2020 change.

THE WITNESS: How do you get that percentage?

MR. FRIEDMAN: Well, let me ask you -- Mickey, I may be misreading or perhaps the report RB-21 is misstating. It lists -- no, it's the 2020 change because that's when the filing was made, but it took effect on June 1, 2022. Is that --

If you'll look at the way Mr. Anderson

phrased it to the far left, fourth row down, 2020 homeowners, and that I've asked whether the effective date was June 1, 2022. And now I'm asking -- oh, I see what you're saying.

MR. SPIVEY: I was thinking you had shifted back to the one in the middle here.

MR. FRIEDMAN: No. But -- let me move on from that. I see I really should have been asking about 2022, and '23, the effect in those years.

BY MR. FRIEDMAN:

Q I'm sorry. I may have been misleading you.

For the effective date for the 2018 homeowners filing, that was May 1, 2020?

A Yes.

Q So would you agree then -- I think you said that the impact of that 2.9 percent rate -- I'll drop that whole line of questioning. I'm going to move then to -- well, the whole line of questioning about 2020.

Let's go to 2022. On the graph, it shows a rate change for the total market of 8.2 percent.

A Yes.

Q If you can look at RB-2021, the effective date of that 8.2 percent increase was June 1, 2022?

A Yes.

Q Okay. Would you -- is June 1, 2022, did that leave about 58 percent of the year in -- it was in effect for about 58 percent on 2022?

A On a written premium basis, that's correct.

Q Written premium basis. All right.

Would that make the impact of that 8.2 rate change in 2022 only about 4.8 percent?

A About 4.8 percent, yes.

Q And the remainder of that rate change took place in 2023?

A It would have flowed through to the next year on a written premium.

Q Would that have meant that the impact of the 8.2 rate change in 2023 was about 3.4 percent?

A Well, like I said, companies are making decisions on whether to write on a consent-to-rate basis. At the time, they would have had information about what the approval was so they would have started to make decisions -- future business decisions on what the approved rate level which would have gone into effect in 2022.

The fact that it was only 4.8 percent, lower than the 8.2, suggests that there would have been a larger reduction in 2022. And in the absence -- in the absence of the rate increase, that would have flowed through to policies written in the beginning part of 2023. In the absence of that rate increase, we would have seen the bar even higher in 2023.

Q Do you even know whether the businesses were making those sorts of decisions that you just mentioned?

A Well, I know that companies make business decisions based upon the rate level.

Q So North Carolina companies, particularly in 2022, do you have any knowledge of ones that were already making business decisions based on the increased manual rate?

A I would think insurance companies make decisions about the manual rate level, yes.

Q Can you name me a single company that you say for a fact is making -- was making those business decisions in 2022 or 2023?

A Well, I would -- for my opinion, I

can't imagine any insurance company not making a business decision based upon the rate level that they're charging.

Q My question is a yes or no question: Can you name me a specific North Carolina member company that was making those business decisions you just described somewhere between 2022 and 2023?

A I have not had active conversation on that.

Q Okay. Would that -- so you do agree that the impact, just in terms of numbers -- not these other things that you assume are happening -- the numbers would mean that the 8.2 rate change was about -- had an effect of about 3.4 percent in 2023?

A Approximately, yes.

Q Is it correct then that the average written rate level was about 4.8 percent higher in 2022 than it was in 2021?

A Yes. That's what we just said.

Q You're right. I asked that question twice.

Is it correct that the average rate level was higher in 2023 than in 2022?

A Since the rate level that went into effect in 2022 was only in effect for part of the year in 2022, but in effect for the entire 2023, the average rate level on a written premium basis would be higher in 2023 than 2022.

Q Okay. And nonetheless according to the graph, the CTR increased from 2022 to 2023?

A Which is exactly the issue I was saying before, that that increase would have been even higher in the absence of the rate change. So what we would have likely have seen, if there was no rate change -- so what we would have seen --

Let's just focus on the 2022 rate change that you're talking about. So if we start with 2021, that blue column that says 49.3. In the absence of the rate increase that went into effect in 2022, that brown column I would not expect to see a decline. In fact, I would expect it to be somewhere in between the blue line for 2021 and the gray line for 2023. I would expect to see a steady increase. And, in fact, the column all the way in the right for 2023, I would have expected it to be even higher.

Instead what we see is we see a blimp down in 2022, because of the rate increase. And we see 2023, it is what it is, but we don't know what it would have been in the absence of the rate increase. It would have likely been even higher.

Q You said twice there it would have likely been in even higher. That is your speculation, right?

A These are all my opinions.

Q Looking at the second -- can you turn to transcript volume 3, that would be 9th -- October 9th in the a.m.?

MS. FUNDERBURK: It will actually be in one of the transcript books, Mr. Ericksen. I believe Ms. Wharry's also going to put it up on the screen so you'll be able to view it that way.

THE WITNESS: Thank you. What was the date?

BY MR. FRIEDMAN:

Q It's volume 3:00 a.m., it is October 9th.

A October 9th, 9:00 a.m.

Q And particularly at page 375. I'm going to read into the record the statement by the hearing officer beginning at line 18 and going into 25: With the change in percentages you saw when there was an increase in premium and a corresponding decrease in policies written -- and I'm sorry --

premiums written on a consent-to-rate basis, did that result in an overall production of the amounts paid by consumers or -- and, again, to the extent you're aware, how did that actually impact consumers in North Carolina?

Do you see that? Do you need to think about it for a second?

A I read that paragraph.

Q Do any of these graphs actually address that question? And, if so, how?

A I think it addresses it -- parts of it but not every -- not specifically all aspects of the question.

Q Okay. Then one more transcript cite. The -- I'll leave that one alone.

So this is not something I'm conceding but just assuming for the sake of argument that the graphs on the first four pages present an accurate picture of any correlation between how carriers -- what they're charging in CTR, how that might vary according to increases in the manual rate, just assuming that that is what the charts actually say.

They don't show any comparison of how much is actually being charged CTR policies; is that correct? They don't say anywhere between 1 percent and 250?

A So on the first two sheets, it's -- the first page does not address dollar amounts. It's -- it is what it is. It's percent of premium subject to CTR. So it's getting at the question of relatively -- what portion of the industry's premium is CTR.

The second page, I think, it is related to dollar cost for the surcharge or the upward adjustment associated with CTR. So it's a little bit more related, but it doesn't -- it still doesn't answer the exact question.

Q So you can't look at pages 1 or 2 and see where between 1 percent and 250 percent the CTR is being charged?

A I'm sorry. Repeat the question?

Q You can't look at pages 1 and 2 and see where in that range a CTR between 1 percent and 250, how much is being actually charged?

A That information is all included -- or available in the tables at the back. And that's -- that's exactly why the decision was to include the actual data from the insurance department data calls. It's all the information available. So --

(Overlapping speakers.)

Q I'm just asking whether the chart --

MS. FUNDERBURK: Please let him finish answering the question.

MR. FRIEDMAN: Sorry.

A And those exhibits, I'll just point it out. So, like, the fifth page in that packet. So the first page after the charts.

So if we look at that first page, columns 3, 4, and 5, all relate to policies that were written on a CTR basis. Column 4 shows the manual premium level. Column 5 shows the actual premiums that were charged. So if you wanted to see in that year for policies that were consent to rate, what is the upward effect, you would just take column 5 and divide by column 4 and you could see what that ratio is. My recollection was that for the whole state it was about 33 percent upward adjustment.

BY MR. FRIEDMAN:

Q But that's not reflected on any of the four graphs, is it?

A For the graphs, I don't believe we show that, but we included all of the underlying data for complete transparency.

Q Is there anything in this packet that

would show how much in terms of dollars policyholders had saved in the past due to these increases -- excuse me -- due to the CTR allegedly lowering in response to an upward manual rate change?

A My understanding is that is not specifically addressed in this question. My recollection is that that was even raised yesterday by the hearing officer asking for additional follow-up information which I think we all agreed yesterday would something that would be still investigated. But that information, as we discussed yesterday, wasn't in here.

Q Assuming the graphs are correct, the reduction in the CTR in the years when the rates go up is a small fraction of the rate increase, would you agree?

A Can you repeat that question?

Q Sure. The reduction in the CTR in those years when the manual rates go up, is not a dollar-for-dollar trade-off?

A I haven't analyzed it. It might not be, but I haven't analyzed it exactly. But it wouldn't necessarily be a dollar-for-dollar trade-off.

Q And by looking at the graphs you discern that it's really just a small fraction of the rate increase that by which the CTR goes down?

A Well, these are a little bit of an apples-and-oranges issue here, you know. I don't -- there's a lot of other issues that are going into account. A good example would be we're not showing here what the indication -- the indicated rate change was. We're showing what the approved change of 4.2 percent -- I'm sorry -- 8.2 percent say.

The indication could have been in the 30s or 40 percent. I don't have that in front of me.

As such, you know, a 1 percent increase in the rate level doesn't necessarily mean that the consent to rate will also fall exactly 1 percent. I just don't think the math plays out that has to be a 1-to-1.

Q Regardless of what the indicated rate was, the actual rate increase that took effect, according to your graphs, shows a very small fraction of the -- the CTR goes down by a very small fraction of the percent by which the annual rate goes up. Would you agree?

A Well, let's think about this.

So this chart just simply shows what percent of premiums coming from consent to rate. And there could be a lot of different scenarios.

If all of that -- you know, 47 -- in 2022, if all 47 percent of the premium was -- that was consent to rate, if those insurers had thought that it was more than an 8.2 percent upward deviation from the manual rate, well then I would say, well, this 8.2 percent would have no effect on the consent to rate because they would still need to have consent to rate. The amount that they would increase would be smaller.

On the other hand, the flip side, if all 47 percent of those consent-to-rate policies were only an increase of, let's say, exactly 8 percent. Well, in that extreme situation, I would say if you raise rates by 8.2 percent, then the consent to rate should go to zero.

Those are two extreme situations that one extreme says the consent to rate wouldn't decline at all. The other scenario would show that the decline should go to zero.

The actual amount that the consent-to-rate percent will drop will be a function of the distribution of the actual rate differential

by policy.
So it's a complicated question. But the answer is not as simple as you're saying it should be 1 percent, it should track exactly.
Q But my question was: According to the charts, the rates, the CTR drops only a small fraction of the amount of the rate increase for the manual rate. I'm not talking about what else is happening but just according to these charts.
A I think my answer sort of answered that question.
Q Did it?
According -- would you agree then that it's significantly less than a dollar-for-dollar trade-off?
A We're not looking at dollars on this page, so I can't make any -- we're not making any assessment on dollars as you pointed out. This is percent of policies that are consent to rate.
Q Okay. So let's go to the issue of -- well, first of all, I'm going to revisit demand surge very briefly but not discuss anything confidential.
Do you have any expertise in the assumptions that the modelers built into the demand

surge function of Aon? Excuse me, not Aon. Excuse me. Of the AIR models?

A I don't have any proprietary information about their development of the models.

Q Do you have then any knowledge period about their -- the actual assumptions that go into the demand surge function?

A I have information about their assumptions. The document -- the confidential document that was provided yesterday provides many of their assumptions and discussions and methodology --

(Overlapping speakers.)

Q Outside of that document, any other knowledge?

A Well, that document is very important. It provides -- that is their mechanism of communicating the assumptions underlying the demand surge that they provide to their customers. So that's the critical document on that topic.

Q I'm not trying to diminish what the document does or doesn't say. But do you have any other specific knowledge besides what you saw in that document?

A With regards to how they developed the model?

Q The demand surge function.

A I believe I've read documents. I've read their Florida -- their submission to the Florida Hurricane Loss Projection Methodology. So I mean I have general knowledge outside of that paper.

But I would re-point out that on that topic that paper is the definitive source of information regarding the demand surge. So I have seen assumptions regarding the demand surge, and they're documented in that paper.

Q So everything that you would know is subsumed in that confidential document?

A No. No, I mean, like I said, I've worked with hurricane models for many years, 20-some-odd years. I've used demand surge. It's come up in various times. I'm familiar. I've read documentation on it.

The modeling firms over the years I've seen that they will provide material to actuaries. I've received it where they document aspects of the model, demand surge included. So I would have been knowledgeable about aspects of their demand surge function.

But I would say to the document that

you introduced into evidence yesterday would be, at least with regards to the AIR model, the definitive source of the documentation for it.

Q Okay. You just said, as I understood it, that you have general knowledge outside of other things with regard to the AIR model besides what's in the document or just the document sums it all up?

I'm using --

A I'll repeat what I said.

Q No --

MS. FUNDERBURK: Do not interrupt. Let him finish what he's saying.

Go ahead.

A I've worked with them almost for 20 years, output from the models in many jurisdictions. I've read material over those years, some of which is part of other rate hearing proceedings. I'm generally familiar with the concept and high-level approaches with regards to demand surge. I've done, as I testified yesterday, my own independent assessment of the effect of demand surge by looking at cost indices.

So I would say it's something that I have -- I don't have a great deal of proprietary knowledge, but I would have a high level of knowledge for a typical actuary. So I had knowledge on demand surge before receiving that document.

Like I said yesterday, I've had access to -- I don't know if it was the exact same date but a document similar to that as part of my prior work. But I would point to that as a definitive source with regards to the AIR model on demand surge, which is what they provide to their customers to document the methodology and assumptions underlying that component of the model.

BY MR. FRIEDMAN:

Q Okay. Well, do you know -- what specific knowledge do you have about the assumptions behind the demand surge function in the RMS model?

A I have less information, but I have reviewed -- I mean, I think the general economic concepts are similar. But I've reviewed -- not as part of this rate filing, but I've reviewed material from AIR -- sorry -- from RMS. Certainly, I've reviewed their submission to the Florida Hurricane Loss Projection Methodology.

I've also referred -- I received some documentation they provide to actuaries to help actuaries comply with ASOP 38. The modeling firms will have documentation that they will provide.

There's sections -- my recollection is there's sections on demand surge. So I -- the information I have felt very comfortable about.

Q Can you tell me the specifics of any of that information you have reviewed of the RMS demand surge function?

A Not specifics, I don't have it at my disposal here.

Q All right. If you could turn to your report that's in Book 1 at RB --

MS. FUNDERBURK: Please lean into the microphone.

BY MR. FRIEDMAN:

Q At RB-5.

A I'm there.

Q At pages 27 through 28 -- well, let's start with 27. I'm going to read into the record the question and then the first sentence of the answer at the bottom of the page.

The question you posed to yourself was: Can reinsurance payments by each company writing in North Carolina be allocated and aggregated for use in this filing?

Your answer to your question was: No. It is not possible to measure reinsurance costs for the various insurance companies applicable to -- specifically to homeowners insurance written in North Carolina.

Do you recall -- I can go back to the specific transcripts -- that Mr. Anderson testified it was possible but burdensome?

A I do recall his testimony.

Q Do you remember Ms. Mao testifying that it was possible yet burdensome?

A I do recall that.

Q Do you still stand by that statement on page 27 that it is not possible?

A I will clarify a little bit here. The question is: Can reinsurance payments by each company writing in North Carolina be allocated and aggregated for use in this filing? From a practical -- period.

For this filing the answer is, no, because there is not collective reinsurance premiums. So even if you wanted to do it, it's not possible. So the simple answer, no, is accurate because the data doesn't exist.

Q That's because it hasn't been asked for by the Rate Bureau, correct?

A That's correct. So the answer, "No,

period" is a completely accurate answer.

The sentence that you pointed out: It is not possible to measure the reinsurance costs of the various insurance companies applicable specifically to homeowners insurance written in North Carolina.

And I would agree with Paul Anderson and Minchong Mao that --

(Reporter requested clarification.)

A I would agree with Paul Anderson and Minchong Mao that it is --

(Discussion off the stenographic record.)

BY MR. FRIEDMAN:

Q Sorry, sir.

A No problem.

And I would agree that when looking at an individual insurance company it would be possible to make that allocation, but -- and here's where the possible and the practical become the tricky issue. I guess, you know, anything is possible but what actually can be done is a separate question.

I was probably looking at this from the perspective -- from a practical perspective, it would be almost impossible to carry out, but it is possible. The reason I say that is that for it to be meaningful, for the reinsurance information to be meaningful, it would all need to be allocated on a consistent basis. We couldn't have one insurer allocate using the RMS model, another insurance company allocating using the AIR model. We'd have to have everybody allocated on a consistent basis.

If we're talking about if they have reinsurance across multiple lines across multiple states, potentially multiple companies within an insurance group, if we were going to say allocate your overall reinsurance cost to just homeowners in North Carolina, there will be such a wide range of methods to allocate that reinsurance premium. We would have -- that could result in a very wide range of answers.

It's my opinion that we would need to specify the method to allocate those costs so that they were on an apples-to-apples basis that we could use it in a meaningful way.

And that's where, I think, the practicality becomes very -- it becomes the burden that would be very hard to overcome because if we specified to allocate using the RMS model, well, there are companies that don't license it.

Likewise, we could say allocate using the AIR model, there are companies that don't license it. And very, very -- these models are very expensive to license. We can't force a company to license a model that they're not licensing. So it would be --

I was probably looking at it from that perspective. But I would agree with Paul Anderson and Minchong that these are -- it is theoretically possible. Certainly individual companies can make that allocation and they do make that allocation for their own purposes. But for purposes of aggregating on a consistent basis, that's where I think the burden would be very challenging.

Q With regard to -- we talked earlier, I believe, about fixed expenses for national companies doing business in North Carolina perhaps with multiple lines in one office. Do you recall that?

A I do.

Q Okay. And you stated that the -- I believe, your understanding was that, yes, those insurance companies in one way or another were allocating some dollar amount to their -- specifically, the fixed expenses for their homeowners business in North Carolina.

A As part of the data calls that the

bureau issues, they do make that allocation. And what I learned during the lunch break was that the insurance companies have to -- someone from each insurance company has to swear or sign that that allocation is being done appropriately.

Q Okay. But are the methods that each company uses the same for doing that allocation?

A Not necessarily. I would assume companies could apply a slightly different methodology. The difference with regards to this and reinsurance, because it's a similar topic, allocating, is that most underwriting expenses are -- the variability between underwriting expenses, it's a much more stable item. And the methods of allocating are typically in proportion to things like premiums or policy counts. It's something that the method of allocation will not impact the ratio in a material way.

Whereas the methods of allocating the insurance cost can be a more -- the answer can be a much more material difference.

Q Okay. Well, let's then use premiums. Premium experience. That's reported by the North -- the bureau members, correct?

A Correct.

Q And some of those members are national firms doing multiple lines out of business -- multiple lines of business in North Carolina, and, as I said, other states as well?

A Some of them would be, yes.

Q And how do they go about allocating their premiums to North Carolina from that homeowners business?

MR. SPIVEY: Premiums?

BY MR. FRIEDMAN:

Q Their premium history. I'm talking about the premium element that's reported by them -- by the carriers in response to the data call.

A Premiums is not so much an allocation issue. It is what it is. I don't think they have to -- they know the homeowners business that they're writing -- they know the homeowners policy is writing in North Carolina. There's no allocation issue there.

Q What other things are there an allocation issue with regard to in the data call responses that the bureau gives you?

A An item like general admin -- general expenses would be something where they would need to be some type of an allocation.

Q And general expenses is different from fixed expenses or?

A So there's different ways of classifying expenses. From an accounting financial statement perspective, it's typical to break expenses into different high-level categories. Commissions, other acquisition expenses, general expenses, premium taxes would be the four main expense components to look at.

Totally separately from a ratemaking perspective, it's oftentimes insurers will look at variable versus fixed expenses. So it's just a different way of classifying. Commissions, as an example, are typically contractually related to the percent of premium. You pay an agent 10 percent of the premium. That's their commission.

So certain expenses like commissions and taxes, licenses and fees are almost always represented as a variable expense because they're a percent of premium. Other costs, typically general expenses, it's viewed as a, quote/unquote, fixed expense because it's tying to things that are not necessarily related to premiums. They would be rent that you're paying on a building. So if you increase your rates, your rent's not going to go up

so you would treat it as a fixed expense.
Q So North Carolina bureau member companies that write homeowners are allocating their variable expenses to North Carolina? Those that have a national operation?
A They are -- presumably, yes. Yes.
Q And is there more than one method by which they might be allocating the variable expenses to North Carolina?
A I don't recall -- but probably. But I have not seen the data call. My understanding is that at least for some elements of the data call, the data call asks the insurer to specify which method they're using to allocate. So -- but I do not recall which specific elements of the data call are asking for those different methods. But --
Q So somewhere in the data call there is a request for how the companies are -- what method they're using to allocate the variables?
A That's my understanding.
Q Do you know whether they answer with different methods?
A I would presume. I haven't seen the results. But certainly by allowing them to choose, it would open the possibility that there are

different methods being chosen.

But as I said before, from an actuarial perspective, from a user of that information, the method of allocating underwriting expenses is not a material issue. We're talking maybe tenths of a percent effect, whereas the methods of allocating reinsurance could be 10 percentage points, you know, not a tenth of a percent.

So it's a -- from an actuarial perspective, the significance of the issue is not material regarding the allocation methods for underwriting expenses, it is a material consideration for -- if we tried to allocate reinsurance expenses.

Q Have you ever represented an individual homeowners carrier in a state other than North Carolina that has, as part of your work, reported -- given some dollar for its actual net premiums?

A It's a very broad statement, your question. But yes.

Q I mean, has your group worked on the filing for a homeowners carrier in another state that as part of that filing has been requested to state what its actual premium dollars are for purchasing reinsurance?

A Yes.

Q Okay. If in that same statement, you worked for more than one company that did the same -- in other words, if there was -- in 2001, you worked for one company in Nevada and then in 2003, you worked for another company in Nevada -- that had to identify its actual premium dollars for the net?

A For the net cost of reinsurance. Yes, I would have -- not Nevada. I don't think I've -- I'm not sure if I've done work there. But certainly, there have been states where I've done multiple insurance companies.

Q Have all those insurance companies calculated the -- their actual premium dollars or allocated them in the same way?

A Just to be precise, when you're saying "allocating premium dollars," are we talking about this allocating reinsurance premium dollars?

Q Yes.

A So for an individual insurance company, the methods that -- let me take a step back. For an individual insurance company, there are many business decisions that are being made by that organization, and many of those business decisions are interrelated. There's risk management that can deal with issues of how much reinsurance they want to buy. There can be underwriting decisions about where they're willing to write business. There can be rate analysis -- actuarial rate analysis where it's identifying what is the adequate actuarially sound rate level. A lot of these different functions within an insurance company are done separately, but they're all intertwined with the common set of assumptions.

And typically, what an insurance company will do is they'll be making their business decisions fundamentally around a certain common set of assumptions. And those assumptions could be one insurance company could say, We love the RMS model and we're going to use the RMS model. Another one could say, We're using the AIR model. We're going to use that consistently throughout our business plan. There could be other larger companies that are taking a blended approach of multiple models.

The important thing for that company is that they're managing their business in a holistic way where they're making a consistent set of assumptions for them.

Now, that doesn't mean that company A and company B are making the same set of assumptions. One could be using the RMS model. One could be using the AIR model. So the method for a given company, sure, it can differ between companies but they're approaching it in a holistic insurance company approach.

Q Okay. Where in this data, other than North Carolina, an individual homeowners carrier is asked for the actual premium dollar that it is paying in that state for reinsurance? Does it -- you talked about, as I understood, allocating that with a model? I mean, how -- do they use a model in order to determine the actual premium for the net that they're paying in that state?

A So with reinsurance contracts -- so when an insurance company will buy a reinsurance contract, it typically -- there can be caveats. But the typical situation is they're buying a reinsurance contract that's covering their whole company. So it could cover multiple lines of business, multiple states. They get from the reinsurer a premium, you know, a cost of, say, a million dollars, whatever it is, and the reinsurer is not allocating it. They're not saying, oh, you know, it's this much here, this much there. They're saying for the entire agregation of your exposures and for the layers of coverage that you're purchasing, the cost is $1 million.

For internal business decisions, for internal rate filings that they might provide support, companies will oftentimes perform some type of an allocation of that cost to different states.

So if I'm a national writer and I have catastrophe coverage for hurricanes, I'm not going to allocate it necessarily to the center of the country. Right? I'm going to allocate it to coastal states. And likewise, if I have, you know, the earthquake component, I'm not going to allocate that to a state that has minimal earthquake coverage. So there being an allocation exercise. Those allocation exercises would be done individually by a company and using the methods they deem appropriate which could be a range of different models or other assumptions that they might decide to make.

Q Okay. So you're saying that for the allocation exercise there's some carriers that are simply to determine how much needs to be allocated to whichever state are using the model to determine that?

A I guess the question is broad. I'm

trying to get...

If we went to an insurer and said, What is your reinsurance cost in 2021, they could turn around and say, Oh, my reinsurance cost was $1 million or whatever. But they -- there is not a number on a consistent basis that would say how much of that was for homeowners, how much of that was for North Carolina. And it's almost like --

And getting lost in the details here, we would need to know exactly what amount of coverage they were even purchasing. So forget about the fact that we're dealing with different states and different lines. We don't know, are they buying reinsurance at a very low level. Maybe -- some companies have very little circles and need to buy a huge amount of reinsurance at low level. Other companies might be buying a higher level.

It's almost like saying how much did I spend on -- I went to grocery store and I bought apples. And you said, Oh, how much did you spend on apples?

And I said, Oh, I spent $10.

Was that expensive or not?

Well, you don't know how many apples I bought. Was I paying $1 an apple or was I paying

$10 an apple?

And that's what we would see. If I just asked -- you know, if someone said, Oh, they're paying $1 million for reinsurance premium, I have no -- in order to make any meaningful assessment of that, I have to know how much coverage did they buy and all of the other risk components associated with that business.

So it's an extremely -- you know, is an extremely challenging exercise. It's possible and it's done. And Minchong could testify on this way better than I could.

But these are sophisticated analysis that are done for one company to do an allocation exercise and to suggest that this allocation exercise should be done for 100 companies would be a burden that I think would be very challenging to achieve.

Q So my question is, outside of North Carolina are some homeowners companies to -- engage in that allocation exercise merely using models?

A I'm sorry. Can you repeat the question?

Q Yes. Outside of North Carolina, where homeowners, carriers are asked to provide their actual premium dollar for reinsurance, are they using purely models to determine that?

A Not necessarily.

Q Okay. What other methods would they use?

A I would say they should be using models. That would be the state of the art technique. You asked me what companies are doing? Are there companies doing other methods? I'm sure that there are lesser sophisticated companies and maybe for the intended purpose -- we don't know what the intended purpose is. They could be doing something and just allocating it in proportion to premiums which would be -- you know, it could be very inappropriate, right, because then you're allocating on a percentage basis the same hurricane exposure to Colorado as Florida, that wouldn't be right. But maybe there are companies doing that.

But that's the issue. We would need to standardize the approach that companies are allocating it for it to be meaningful. That is exactly the crux of the problem.

Q I guess then, in the end, elsewhere individual companies, one way or another, end up assigning a number to their actual premium costs for the reinsurance?

A Where?

Q In the examples you've given where you represented homeowners, carriers in other states, they end up, whatever their method -- whether it be purely modeled or in some other manner, they end up assigning a number?

A For their specific purpose, yes. And we would -- there would be a derived estimate of the allocation to that line and state where they're making a rate filing.

Q And the Rate Bureau doesn't even bother asking its members to assign a number however they may do it?

A Well, the issue in North Carolina is because it's a bureau state, insurers are required to use the bureau rates. They're not submitting rate filings in North Carolina where they would be doing this exercise.

In Florida, companies that are writing business, they're doing this.

It's not something insurers would be doing. So it would be -- it would not be something that I would expect companies would just have off-the-shelf because they would not have had an intended -- they're not submitting a rate filing in North Carolina where they would have needed to provide that.

Q Are they not doing it for the commercial property policies when they request -- because they file in North Carolina individual rate filings to request increases in commercial property policies, correct?

A They could be. They could be.

Q Okay. So they're already -- it's possible they're already doing it for commercial purposes?

A Well, in practice -- well, large national writers are going to write homeowners and commercial property. There are many, many personal lines writers that don't write commercial business. So I --

Q But are they members of the North Carolina -- are there North Carolina bureau members that both write commercial and residential property policies?

A I'm sure that there are member company -- national member companies that write many lines, personal and commercial property. I'm also quite sure that there are going to be many personal lines only writers, and there will be commercial-only writers.

It's not uncommon for -- especially smaller companies to concentrate in just personal lines or just commercial lines. But there will undoubtedly be large national writers and smaller writers that do write all, but not all.

Q Okay. And it's possible that some of those national writers that write both commercial and residential policies in North Carolina are having to assign a number to their -- to the premium dollars they pay for reinsurance?

A Not necessarily. You know, even if the company is writing commercial property only, we do not know their method of setting rates and filing for, let's say -- are they using independent rates? Are they using a loss cost multiplier? There could be a lot of different approaches.

My guess, is that some aren't and my -- you know, other companies, their approach to setting rates maybe are not explicitly making that allocation.

I'll use an example. It's not uncommon in ratemaking for an insurance company to set their rates based upon a competitive analysis. So I'm entering the state. I'm a writer. Some insurers will simply take the approach of I'm not -- they don't necessarily calculate an actuarially sound rate ground up. They might look at the competitive market, and they will select a rate in line with the competitors. Oftentimes like a me-too filing.

In that approach, since the rates are based more on competition, it's not necessary to go through the exercise of calculating the reinsure -- net cost of reinsurance and allocating.

So even for commercial lines writers, they may or may not have done an allocation. But from my perspective as a user of that information, even if they did that allocation, it's going to not necessarily be on a consistent basis from company to company.

Q Thank you.

You testified before that you testified in Massachusetts, and I believe you said that was on behalf of -- do they have the equivalent of a Rate Bureau?

A No. But the client I worked for -- I still work for -- it's the FAIR Plan so it would be the counterpart to the Beach and FAIR Plan here.

Q Okay. Did you testify last year in a

proceeding for that FAIR Plan in Massachusetts?

A I've testified in a few of their hearings. They have not submitted a rate filing in several years. So the last time I testified was several years ago. I've testified in a few of their hearings. I think all their filings have to go to a hearing. But the last one was several years ago, I believe. I don't remember exactly.

Q How quickly do those go to hearing in Massachusetts between the filing and the ultimate hearing?

A I don't recall. It's going to be at least a couple months' process.

Q As little as two months?

A What was that?

Q As short a period as two months or?

A I don't recall. I remember it goes through a number of different rounds. There's like a public hearing, and there's a number of different steps that I'm not really involved with. It could be longer than I'm thinking. It could be several months.

Q Do you recall what period it was between when you know the filing was made and when you had to show up in court to testify?

A Oh, gosh, no, I don't remember.
Q Six months or more?
A It could be. It could be.
Q In Massachusetts, does the FAIR Plan seek to a contingency fee based on that delay between the filing and the ultimate date of the hearing?
A So there's a little bit of a different situation. And my recollect -- so the rates that were being established for the FAIR Plan, they're a single company, whereas the rates that are being established for the bureau are for the industry.

And I think for the industry, you know, we would establish an effective date that would be, you know, reasonable for them.

My recollection for the MASS FAIR Plan, they would have selected -- they didn't have to speak to anybody else. They were selecting -- you know, they were selecting it just for one company for themselves, and they would have targeted an effective date in consideration of the time it would go to a hearing, is my understanding.

I would always ask them what effective date do you think would be reasonable to include given your expectation of when these rates would go into effect under the understanding that there would be a rate hearing.

Q Given the bureau's experience with what it alleges are regulatory delays as laid out in Mr. Anderson's exhibit, have you ever had that conversation with the bureau, what do you expect should be the effective date given your past experience with alleged regulatory delays?

A No, I don't think I had that explicit conversation with them.

Q Has the bureau ever talked to you about -- or done -- anybody there done anything to indicate that they were setting their effective date based on their past experience with alleged regulatory delays?

A They didn't. But in what I've learned during this hearing, I think this is a good suggestion for me to bring up with them at their next refiling.

Q I'm sorry. I didn't catch that.

A No, what I'm saying is I have not -- well, there's two issues. My recollection is that they selected an effective date. So -- Mr. Anderson has shown the historically -- the actual effective date, the implementation date has -- was later than the assumed effective dates in prior filings. And that was one of the components that he had identified as a contributing factor to a contingency provision.

In my situation for my client -- and you could -- this issue could apply to any company in any state. For an individual company, they will select an effective date that they reasonably believe would be the implementation date. The Massachusetts FAIR Plan or any clients -- so this is not specific to them -- should consider when they believe they would be able to implement the rates.

In the case of the bureau, not every filing always goes to a hearing. Some do. And as can be seen -- well, I don't need to restate Mr. Anderson's testimony, but history has been that there has been delays.

Q So Mr. Anderson's chart, if you recall -- and I can turn to it if you like -- included the delays in between a filing and settlement too, not just ones that actually went to the hearing; is that correct?

A That's correct.

Q Okay. So was it your understanding that they are considering the time lag between a filing and a settlement also to be an alleged regulatory delay?

A He was simply looking at the delay. Whether that delay was caused by settlement or through a hearing or for any reason, he was simply looking at that delay.

Q Okay. And has the bureau, to your knowledge, ever taken this -- according to him -- significant experience with alleged regulatory delays into account when setting the effective date?

A I don't think Mr. Anderson was necessarily involved in selecting that proposed effective date as part of a filing. That would have been selected by -- ultimately, I suppose by the committees of the bureau.

Q Okay. And has anybody at the bureau ever indicated to you that they took into account this -- these alleged regulatory delays in setting the effective date?

A See, it's a tricky issue because in reality you don't know when something will get filed. You submit the filing. It could get settled right away. It could take two years before it's implemented. If we went in -- if the bureau went in and said, Okay. Well, we think it could take two years, let's put an effective date two years out. Well -- and then what if it gets approved tomorrow? Are they now on the hook to have to wait two years to implement it because that's what they requested? And the insurance commissioner could hold them to that, I suppose.

So it wouldn't be a good business practice to simply say, oh, well, it could take two years. Let's put a two-year wait period and then -- and now we're stuck with it.

I think the approach is -- and what was testified earlier is an effective date that would give ample time for review of the filing and then production of release of the rates, allow companies to program into their systems. I think it's still oftentimes an effective date of a year down the road from when a filing is actually submitted which should be ample time to then say, Oh, well, we're not going to make the filing, we should then tack on another year on top of it, would -- it would constrict them at the time of actually implementing it, if it got approved sooner.

So I think it's perfectly reasonable to establish an effective date of when you think it should be approved by and implemented. The contingency provision is then saying -- or that one justification for the contingency provision is saying, well, even when selecting a sufficiently long period of time, it takes even longer, that's where the contingency provision builds in the effect of that additional inflationary effect.

Q Has anybody at the building -- excuse me -- at the bureau ever indicated to you that in setting the effective date they took into account their past -- the bureau's past experience with regulatory delay?

MR. SPIVEY: Objection --

(Overlapping speakers.)

MR. FRIEDMAN: I'm sorry.

MR. SPIVEY: I understood that to be the last question he asked.

MR. FRIEDMAN: Right. And I haven't gotten an answer whether somebody has ever indicated that to him. I -- it's a very simple yes or no.

MS. FUNDERBURK: I'll allow you to ask the question this time.

If you can provide an answer -- to the extent you can provide the answer or you feel like -- you can also state you responded with

all that you have available. If that is accurate in the case.
A I haven't had an explicit discussion with the bureau as to all the considerations they took into account when selecting the effective date.
In reality, when we look at that chart, there were times when it was a very short period of -- relatively short a period of time; other times, it was a very long period of time. I think they would typically include an effective date that provides ample time for review of the filing.
BY MR. FRIEDMAN:
Q But you don't know whether or not they're doing that? You just would suspect it?
A I answered everything I can on that.
(Overlapping speakers.)
MS. FUNDERBURK: -- what the question was, Mr. Friedman.
MR. FRIEDMAN: I believe he testified that he would -- he would suspect that the bureau is taking into account the alleged regulatory delays when it's setting its effective dates, and I asked him whether that's simply something that he suspects but doesn't know.

MS. FUNDERBURK: I believe you previously testified that you had given your opinion?

THE WITNESS: Actually, I'm giving my opinion on this. I wasn't involved in the actual selection of the effective dates.

BY MR. FRIEDMAN:

Q You testified that it was -- there would be reasons not to base it on the regulatory delay you would understand that, right?

A What I was trying to say is that the actual time it would take between submitting the filing and when it ultimately gets implemented, we've seen that there's a fairly wide range of what that time could be. It wouldn't necessarily be prudent to each and every filing. Always assume it's going to go to a hearing and assume it's always going to take two and a half years or whatever the case is.

So you have to make a selection. And at the same time, I mean I think once -- the idea is, once the decision from the commissioner is made, you implement it. Whatever that is.

So usually an insurance company will not select an effective date that is two years down the road. They'll pick something closer, and then, if need be, extend the effective -- extend the proposed effective date. I've seen that many times with insurance companies. They'll file with an assumed effective date. If it takes longer to settle, you know -- and I'm not talking a year or two years, I'm talking, like, a month, you know. They'll just amend the effective date.

Q Do you know if the bureau has ever done that?

A I think it does it regularly, right. I mean, every time the effective date is later, the implementation date is later than what they assumed. So, yeah, they do it every time.

Q Okay. But they're seeking a contingency -- excuse me. The CAR, based on that period of time in this case, correct? Or contingency, my mistake?

MS. FUNDERBURK: Counsel, could you approach, please?

(A bench conference was had off the stenographic record.)

MS. FUNDERBURK: Thank you. We're back on the record.

BY MR. FRIEDMAN:

Q In the most recent Massachusetts case that you testified in, did you testify in support of the use of a hurricane model in that case?

A Yes.

Q Okay. And did you testify in support of a calculation of the net using a hurricane model?

A Yes.

Q Okay. What was the outcome of that case?

A There's been multiple cases. Oh, gosh, I don't recall -- I don't recall the details. Like I said, it was several years ago. If you have documentation I could read, we can direct towards it. Some have been successful, some not as successful.

Q Do you recall whether in the most recent one the Commissioner of Massachusetts rejected the numbers that the hurricane model generated?

A I don't remember the details. But I believe that that was the case in at least one of the hearings.

Q Okay. And do you recall whether in at least one of the hearings the Massachusetts Commissioner of Insurance rejected the calculation of the net that ISO had testified in support of?

A I remember one of the filings, the initial order had an issue with it, and then there was a compliance filing to comply with her direction and then she allowed it.

But I will admit that hurricane modeling and reinsurance work were some of the more contentious issues in that filing.

Q And the ISO's numbers were rejected?

A I'm not sure if they were ISO's numbers. The hurricane modeling was performed by the modelers. We didn't run the model. It was done by a third party and the reinsurance cost also -- I'm trying to recall here. It was mostly done by the modeling firm. We did the numerical calculations which were relatively simple using the output from the models. So I wouldn't want to give myself too much credit in the grand scheme of things for the reinsurance calculation, but I certainly oversaw the arithmetic that was done.

Q Okay. And as to the demand surge function in one of those Massachusetts cases that ISO worked on, do you recall it being rejected as well or at least the numbers, your numbers generated from the model?

A I just don't recall -- I just don't recall. Like I say, it's been several years. It could have been, and I won't say it wasn't. I just don't recall.

There are -- the hurricane models and reinsurance were contentious issues during all of those hearings.

Q I'm going to move on to the issue of the CAR. Do you recall Mr. Anderson's testimony that he wasn't aware of any provision in Article 36 that allowed specifically --

A Excuse me, I'm sorry. I've been drinking a lot of soda.

Q If it were me, I'd be spitting up my soft drink all the time.

A Of course, I'm going to choke when I'm here. Right?

Q Do you recall his testimony that he wasn't aware of a provision in Article 36 allowing the commissioner to take into account an assessment by the FAIR Plan?

A I remember that being discussed.

Q Okay. Are you aware of one?

A No. I don't have -- no. My understanding -- so let's take a step back.

My understanding is from an actuarial perspective -- so I would approach it as from an actuarial perspective, the cost associated with the compensation for assessment risk that is specifically due to the FAIR Plan, separate from the Beach Plan. But both of those are actuarial costs and from an actuarial perspective it is appropriate to include -- my recollection is that the statute affirmatively permits and states with regards to one of those two entities and is completely silent -- doesn't say you can, doesn't say you can't -- with regards to the other.

So my approach as an actuary -- and I'll refer to legal people, legal advisors to advise differently, but from an actuarial perspective, I would approach it as both are appropriate from an actuarial perspective. The statute permits one. It doesn't say anything about the other. So I would say the actuarial standard of including it would be appropriate.

Q And the one that is included, that is allowed to be, is the Beach Plan, correct?

A That is my recollection.

Q You represent the Beach Plan?

A On other matters.

Q On other matters. Yes. Okay.

And when you say you reviewed the 2014 order from the commissioner, do you recall reviewing what his opinion was about even being able to consider an assessment risk for the FAIR Plan?

A No, I do not recall.

MS. FUNDERBURK: Do you need a break or are you okay?

THE WITNESS: No.

MS. FUNDERBURK: Okay.

BY MR. FRIEDMAN:

Q In those Massachusetts proceedings, who was -- what firm was doing the modeling?

A It might have changed over time. My recollection was in one of their earlier filings they were using RMS and AIR and giving equal weight to both. My recollection was that in maybe the later filing, they were using just the AIR model.

Q Okay. And so who's the "they"?

A It would have been the Massachusetts FAIR Plan that would have made those decisions.

Q But who is the person running the model?

A So in one of the earlier fillings that went to a hearing, they -- the Massachusetts FAIR

Plan contracted separately with RMS and AIR, and RMS and AIR specifically ran the models for the bureau -- for the FAIR Plan.

Likewise, when they use just the AIR model, they also contracted with AIR. I think the most recent filing I was involved with, which was several years ago, they contracted with AIR. And AIR ran the models.

Q So either -- at least the FAIR Plan in Massachusetts at one time contracted with both AIR and RMS to run their respective models?

A Correct.

Q And then later it contracted only with AIR, otherwise known as Verisk, to run the AIR model?

A That's my recollection. And there might have been other filings -- I've done more than two filings, there could have been other situations, too. But I remember those two situations occurring.

Q I'm going to go to the issue of dividends and deviations.

And I'm going to first ask you to look at your report on page 24.

A I'm there.

Q Sorry. I'm finding where in this

paragraph the sentence is.

All right. This is actually the first sentence in the second paragraph at the top, I'll read it into the record: As in past homeowners filings, bureau committees reviewed the latest available policyholder dividends payment data as well as the multiyear history of companies consistently paying dividends to policyholders. The bureau's subcommittee concluded that factor for expected dividends is appropriate to include in this filing.

Do you recall how many out of the 110 or so homeowners carriers there are in North Carolina, or at least bureau members there are, were actually paying dividends over the five-year period you looked at?

A I think we might disclose that in one of the exhibits maybe. My recollection it's a very -- it's a relatively small number of companies, single digits, I would say.

Q Why don't we just look very quickly at that page in the filing?

A Sure.

Q And so that will be in Book 1. And the page -- well, it's actually Exhibit 1HI. So finding that is another matter.

We're going to display that on the display so you don't have to worry to look for it. I can't find it myself.

There we go.

A Yes, that was what I remember seeing.

Q Perfect.

MR. FRIEDMAN: Could you make that a little smaller, Shannon, so we can see it all on one page? Perfect. Thank you so much.

BY MR. FRIEDMAN:

Q So in the five-year period that you examined dividends, it looks to me that for three years only three out of the 110 carriers or so actually paid dividends and then for two years, only two out of those three paid dividends.

Would you agree?

A Yes, I agree with that, yep.

Q And also on page 24.

A Is that in my testimony? Yeah, okay.

Q Yes, I'm moving off of that exhibit.

Last sentence in that second paragraph: If dividends were not reflected in the bureau's rates, the profit level in the filing would not be achieved because of dividends paid to policy levels.

My question is, in that sentence, whose profit level out of the 110 carriers?

A So to answer that question for this filing, we are viewing -- we're viewing this filing for the composite industry for -- as if all of the business -- homeowners business in North Carolina were written by one composite insurer. So it will be that composite insurer, their profit level.

Q Do you recall your testimony yesterday that -- leaving aside the issue of -- that the Beach Plan is not a member of the bureau yet its losses are included in the bureau's losses. Putting that issue aside, you also stated that the Beach Plan being only one company would -- whatever it's paying for -- in premiums for its reinsurance, would not be reflective of the full market. Do you recall that?

A I don't remember exactly what I said, but that sounds like a fair --

Q Summary of --

A Yeah.

Q And here, do you think that three companies experience with paying dividends is reflective of the experience of all 110 companies?

A So our position -- my position -- is that we're treating this as a composite of the entire industry. We're developing indicated rates for the composite industry, and those two or three companies are part of that composite industry -- composite single company. The framework, as I understand it, to assess this filing is we view the entire composite industry as if it was being written by a single company -- single member company of the bureau. In that sense, those two or three companies would be part of that experience of that composite company.

Q So you testified earlier today that if you even had numbers for all -- if I'm paraphrasing you right -- and please correct me if I'm wrong. That if you even had the actual numbers for the premium dollars paid for insurance for all 110 companies, it still might not be reflective of the combined experience; is that fair?

A Well, that was a different issue. I think with that issue we were -- with the premium level, we were trying -- we were talking about -- or what I was talking about was that we're trying to measure the rate adequacy of the bureau's rates so we wouldn't want to use reported premiums reported by individual companies because they could be at a different level than the bureau so it would be inappropriate to use the actual premium level. But that was because we were talking about a different issue.

Q In this testimony -- from your witness that we just read, you're also, though, talking about the profit level for the hypothetical line?

A Okay.

Q Am I correct, the last sentence of the second paragraph?

A Yes, I would agree.

Q Okay. And so as I understood what you just said, the actual net premium dollars would not necessarily reflect the profit level that the industry needs to achieve, and yet three companies' dividend experience does reflect the profit level that the whole hypothetical one needs to achieve?

A I think there's multiple issues going on in here. Given the terminology, you're talking about net premiums and I don't think that's accurate. So maybe you can just restate the question, again.

Q Sure. I'm just figuring out -- trying to figure out when you think that everybody's -- all the members' actual experience isn't relevant to the necessary profit level versus when you think only three companies' experience is reflective of the hypothetical -- all of the company's necessary profit level.

A I'm trying to think about how to phrase this.

From the purpose of setting the aggregate rate level, for the purposes -- doing -- preparing the rate analysis, we aggregate the experience across all companies. It could be very large companies, it could be very small companies.

In that regard, if we're looking at -- if we're compiling, whether it's total losses, total dividends, total general expenses, we would simply aggregate it for all the member companies. If it so happened that it was being dominated by one company or another, I don't think that that is necessarily -- as long as it's accurate data -- I mean if it is inaccurate data, it should be corrected through the data quality procedure. But if we are dealing with accurate data, I don't think it's an issue if it's coming from one company or if it's coming from multiple companies.

In the end, we're looking at the composite experience for the industry and that is what we're assessing.

Q Have you ever, outside of North Carolina, done work on homeowners' filing where the insurer did not treat dividends and deviations as an expense but rather as a substraction from the profit?

A So I'll treat these -- deviations and dividends are two separate issues.

Do you want to address both of those or just --

Q Why don't we just address dividends.

A Okay. So then restate the question.

Q Okay. Have you ever represented a company in a filing outside of North Carolina that treated dividends not as expenses but instead took them out of the profits?

A So with regards to policyholder dividends, I don't recall actually working on a consulting project where my client was paying policyholder dividends that I had to reflect in the analysis. As we see here, you know, in North Carolina, only maybe three companies.

So the subset of companies I've done work for in other states, I don't think policyholder dividends has come up in my personal experience.

Q Have you ever reviewed a filing or, for that matter, an annual statement by an insurer that has not treated dividend as an expense but rather subtracted them from the profit?

A I'd have to review the statutory income page just to qualify where exactly policyholder dividends are being subtracted out. My understanding is it's an expense item that would flow into the underwriting gain or loss.

Q So you haven't ever seen an instance where it was being treated as something subtracted from the profit? Where dividends were being treated as something subtracted from the profit?

A I think it's -- depending upon the purpose of the analysis, maybe there could be different approaches. I would probably -- if someone asked, I would probably focus on -- from a statutory financial accounting perspective, there's a -- there are a number of steps that you would go through to calculate the underwriting gain, different levels of profit, net income.

I don't have that page in front of me. I've worked with it many, many times. But I would probably direct myself to where specifically that policyholder dividend is being taken into account. My recollection is it's in the underwriting expense category. But I would have to refer to the page from the financial statement since I haven't worked with that for a while.

Q In terms of deviations, have you ever seen an instance, whether in filings you've worked on, whether in filings by other companies, whether in an annual insure financial statements where the deviations have not been treated as an expense?

A So deviations in the connection here is specific to North Carolina, wouldn't apply outside of North Carolina. Right? So it's not something I've had to -- it's not something I've had to address.

Q Okay. So outside of North Carolina, companies don't seek reimbursement for the alleged expense of a deviation?

A A deviation, I believe, right? In the connection of North Carolina, an individual insurance company can submit a filing to deviate typically downwards from the bureau rate. So by definition, as we're using it here, that deviation is really defined specific to North Carolina. So if we're talking about a state outside of North Carolina, there isn't this corresponding bureau, there isn't a corresponding deviation. Right? So this is very North Carolina specific. So, no, I have not -- this issue, as it pertains here, wouldn't apply outside of North Carolina.

Q What does deviations mean to an actuary outside of North Carolina?

A Well, I think we're defining -- again, we are defining a deviation as a deviation from an -- North Carolina Rate Bureau's promulgated rates. The bureau doesn't have rates outside of North Carolina, so deviations from the bureau rates don't apply outside of North Carolina.

Q Outside of North Carolina, do actuaries speak in terms of discounts given to policyholders as deviations?

A Well, let me ask -- from my own understanding, to answer the question, deviations from what?

Q From the standard rate. Whatever the approved rate is by that respective commissioner of insurance?

A What would be the approved rate in a state outside -- I'm asking you so I can answer the question, but what would be the approved rate --

Q In a filing --

A -- in a nonbureau state?

Q In a file-and-use state where the company filed for 5 percent increase and the commissioner didn't challenge it so it went into effect. Discounts from that 5 percent increase, would the -- have you ever seen -- do actuaries refer to those discounts as deviations?

A So my experience -- and maybe there's differences here. But my experience in personal lines, I guess, for nonadmitted business, it could be different or surplus lines business, it could be different.

But in traditional homeowners business, even outside of North Carolina, insurers typically still need to file their rates. It could be a file and use or use and file. But once they file those rates and those rates are deemed acceptable for use, they have to use those rates. You can't -- for personal lines, you generally don't have the ability to subjectively go in and deviate upwards or downward. That is the approved rate until you submit a new filing.

Q Okay. So --

A Sometimes -- I'll just clarify. Sometimes for commercial lines, like general liability or commercial property, insurance companies can do something called schedule rating where they are permitted to deviate upwards or downwards, but that's not applied for personal lines in general.

Q Okay.

A It's a more regulated -- so once the rate is established, that's the rates. So you don't have that flexibility, typically.

Q So North Carolina is, in your experience, unique in allowing insurers out there discretion to discount from the established rate?

A Well, that's a little bit misleading. You know, in every state an insurance company files their rates and gets them approved. A deviation is simply the process that you would go through in North Carolina if you wanted to establish your own rates. In North Carolina, everything has to be tied to the approved bureau rates. So outside of North Carolina, I would just file for, oh, I want a -- to file for a 5 percent increase or a 2 percent decrease.

Well, in North Carolina, that process is done by way of a deviation. Right? Because there is that standard in North Carolina that doesn't exist anywhere else. So in North Carolina, you -- a company, if they want to have their own independent rates, you would file a deviation to the bureau rates. But that process wouldn't just apply in that -- in that way, right, outside of North Carolina.

Q Okay. I'm sorry. I really need to repeat this question. I'm just honestly unclear. Do companies outside of North Carolina offer unique discounts from the approved rate for homeowners, some of them?

A So I'll interpret that question the way I think -- discounts, right? Can mean different things than a deviation. So deviation, let's put that totally aside.

Discount, lots of rating plans that homeowners insurers will have, will have discounts for certain, let's say, loss savings elements that might be part of the insurers. So, for example, if a home has smoke alarms or a burglar alarm or central reporting burglar alarm, that might qualify for a discount, maybe it's a 5 percent discount. But that would still be something that's approved and part of the approved rate structure of the insurer. So it wouldn't be something that they would just apply on a discretionary basis.

Q Okay. Page 28 of your testimony.

MS. FUNDERBURK: Is that page 28 of RB-5?

BY MR. FRIEDMAN:

Q Yes.

Second paragraph, second sentence. You state: It would not be appropriate for North Carolina insurance to assume the reinsurance costs of exposures in other states and vice versa.

Do you recall Ms. Mao testifying that Aon, at least in part, considers the reinsurance costs on a regional level?

A So let me make sure I answer this precisely. And it's my interpretation, obviously, of my opinion.

So what she testified on -- my understanding of her testimony would be that she would -- Aon looked at regions that were homogeneous to develop certain parameters. In this case, maybe a rate online-type of an estimate that would be very consistent for a homogeneous set of states.

That is not the same as what I'm referring to in this paragraph here. So in this paragraph here, what I'm referring to is this should not be a cross-subsidization of the reinsurance costs from one state to the other.

As an example, let's just say I write in just two states. I write in North Carolina and I write in Florida. My total reinsurance premium might be $1 million, but Florida has a higher hurricane exposure than North Carolina so -- just making this up. Let's say 700,000 is Florida and 300,000 is in North Carolina.

This statement that I'm making would be it would be unfair if I charged both states 500,000 because then North Carolina would be cross-subsidizing Florida by a couple hundred thousand. Likewise, you know, if I only wrote in North Carolina and Colorado, it would be unfair for Colorado to assume some of that hurricane exposure from North Carolina. So that is the statement I was making.

What the analysis or the testimony that Minchong was providing was totally different. It was saying what would be the rates online or other parameters that were selected based upon looking at a homogeneous group of states that represent a similar exposure to hurricane...

So it's misconstruing the nature of, you know, North Carolina versus the Florida group in a very different way where those two sentences are not related.

Q Also on page 28. And I recognize, first of all, that in this case, the bureau, in this particular filing, has placed a zero value on deviations.

You write at the bottom of the page -- I'm going to read three sentences to you, all of them from that last big paragraph at the bottom of the page. The second sentence is: Deviations are a cost of doing business in North Carolina for the insurers that have them approved by the department.

Then the last two sentences are: The bureau and ISO believe it actuarially appropriate for filings made by rating bureaus to contain a factor to reflect expected deviations and other variations from manual rate that would result in the filed profit level not being achieved. The bureau also recognizes that the reflection of expedited -- expected -- excuse me -- deviations has been a contentious issue in previous rate fillings. In this filing, the bureau elected to include a provision of zero for deviations.

What were you referring to when you stated it has been a contentious issue?

A So my understanding is it's been an issue that's been debated in the past. People have different opinions on the matter.

Q When you use specifically that language, did you understand that various courts of appeals in North Carolina have ruled that deviations are not an expense for the bureau members?

MR. SPIVEY: Objection.

MS. FUNDERBURK: Mr. Ericksen, if I could get you to -- well, I'll get you to hold off on responding until we rule on the objection. But if and when you do, just make sure you're speaking into the microphone.

Mr. Spivey, grounds for your objection.

MR. SPIVEY: Objection. Characterization of what the courts have held deviations.

I'd also note this is all very interesting, but I'm curious if the department -- if -- I'm curious if deviations is an issue in this case. We're spending a lot of time talking about them, but it was not my understanding that they were an issue.

MS. FUNDERBURK: Sounds like we have two objections. One concerns about this relevancy related to the deviations and then also characterization of the legal standing, or legal surroundings of what the court of appeals decided in 2014 regarding the issue.

Mr. Friedman, would you care to respond?

MR. FRIEDMAN: Sure. As to the first issue, it wasn't 2014, but the court also reiterated that this issue of dividends and deviations being, for the bureau's purposes, not an expense they repeated I think two other decisions in that 2014 decision that had previously decided that.

But regardless, I'm just trying to figure out what he meant when he said "contentious issue in previous rate filings," and whether he was aware that there were court opinions that had disapproved deviations being counted as --

MS. FUNDERBURK: That's two separate things. Let's take them separately.

I'm going to allow you to rephrase your question, but if you're asking about separate issues, they should be phrased as separate issues, so I'm going to allow you to rephrase.

And, again, doesn't rule out Mr. Spivey objecting, again. But let's start from there. You're addressing two separate issues. Let's address them separately, and I'll note that we have ten minutes left in the court day.

BY MR. FRIEDMAN:

Q When you used the term "contentious issue" in that paragraph regarding deviations, were you referring to any court decisions that you were aware of?

A No. I was referring to -- there were -- it was a disputed topic between the bureau and the insurance department. It could have been in orders and such, but it was simply a matter of being a disputed issue.

My recollection was it was also not overly material to the answer. So I think it was just one of those things where it's not overly material, it's being contentious, let's select zero, and move on type of thing.

Q You did include a full paragraph talking about why deviations would be justifiable, but then assign a zero to it, correct?

A That's correct.

MR. FRIEDMAN: Okay. That's all I have for the witness, Your Honor.

MS. FUNDERBURK: Thank you. Mr. Friedman.

Mr. Spivey, would you like to begin your redirect in the morning? I'm going to assume it's going to take more than ten minutes or so. What do you expect your timeline to be?

MR. SPIVEY: Yes, Your Honor, I do anticipate we will have redirect questions, and I anticipate it will take more than ten minutes.

MS. FUNDERBURK: Do you have an estimate on your timeline? I'm just trying to -- I'm trying to determine if we could finish today. It doesn't sound like that would really be feasible to finish your redirect today.

MR. SPIVEY: I do not think we could finish today.

MS. FUNDERBURK: Okay. All right. Then what I'm going to plan for is that when we resume tomorrow, Mr. Spivey, you will begin your redirect of Mr. Ericksen.

And, again, you'll remain under oath when you retake the stand in the morning at 9:00 a.m.

Are there any administrative or housekeeping matters we need to address before we recess for the day?

MR. FRIEDMAN: Not that I'm aware of, Your Honor.

MR. SPIVEY: Same here.

MS. FUNDERBURK: All right. Then we are at recess at 3:53 p.m. We will reconvene at 9:00 a.m. tomorrow morning. Thank you.

(The hearing adjourned at 3:53 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.

____

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