

NORTH CAROLINA DEPARTMENT OF INSURANCE
RALEIGH, NORTH CAROLINA

STATE OF NORTH CAROLINA
COUNTY OF WAKE

COPY

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

DOCKET NO. 2157

BEFORE: AMY FUNDERBURK, HEARING OFFICER

TRANSCRIPT

OF

HEARING

VOLUME XII - A.M. SESSION

Raleigh, North Carolina

October 31, 2024

9:09 a.m.

Reported by: Audra Smith, RPR, CRR, FCRR

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Hearing in the matter of the filing dated January 3, 2024, by the North Carolina Rate Bureau for Revised Homeowners Insurance Rates, at the North Carolina Department of Insurance, 3200 Beechleaf Court, Raleigh, North Carolina, on the 31st day of October, 2024, at 9:09 a.m., before Audra Smith, RPR, CRR, FCRR and Notary Public.

I N D E X

PAGE

ALLAN SCHWARTZ

Additional Direct Examination by Mr. Friedman 1851

Cross Examination (Cont'd) by Mr. Spivey 1853

P R O C E E D I N G S

1
2 MS. FUNDERBURK: All right. Good
3 morning, everyone. We -- thank you. We are
4 back on the record this morning, and we have
5 our technology kinks worked out.

6 Before we resume testimony this
7 morning, is there anything we need to address
8 administratively?

9 MR. FRIEDMAN: Yes, Your Honor, if we
10 could have a short bench conference, I'd
11 appreciate it.

12 MS. FUNDERBURK: Please approach.

13 (A bench conference was had.)

14 MS. FUNDERBURK: We're back on the
15 record. Mr. Schwartz, please retake the
16 stand, and I'll remind you, you do continue
17 to be under oath. Thank you.

18 When we recessed yesterday, the Rate
19 Bureau was conducting some cross of
20 Mr. Schwartz. There's been some information
21 that's come to light that we need to conduct
22 some direct on with Mr. Schwartz, so that's
23 the Rate Bureau, in the most efficient way
24 possible has the opportunity to cross on that
25 information.

1 Mr. Friedman, please proceed with your
2 additional direct examination of
3 Mr. Schwartz.

4 ALLAN SCHWARTZ,
5 having been previously duly sworn, examination and testimony
6 continued as follows:

7 ADDITIONAL DIRECT EXAMINATION

8 BY MR. FRIEDMAN:

9 Q Mr. Schwartz, last night did you have
10 the opportunity to review your written prefiled
11 testimony?

12 A Yeah. I checked over portions of my
13 prefiled testimony last night.

14 Q Is there something in that prefiled
15 testimony that you would like to amend?

16 A Yes. I'd like to make a change.

17 Q Okay. So if you could explain to us
18 what that is.

19 A Sure. On Schedule AIS-14, sheet 1, in
20 line B2, in figuring out how much of the premium is
21 available in terms of losses and loss adjustment
22 expenses, when I did the calculation, I only
23 accounted for variable-type expenses, like
24 commissions and premium taxes and reinsurance. I
25 didn't take into account fixed expenses.

1 You see that on schedule -- in fixed
2 expenses of what's referred to as General and Other
3 Acquisition Expenses. So that's shown on Schedule
4 AIS-9 of 5.9 percent for Other Acquisition, and 3.9
5 for General Expenses. And so that .664 needs to be
6 brought down by those two numbers, and I don't have
7 it memorized, but I could do the calculation.

8 So let me just check. That would
9 change the .664 to .566. And when you do the
10 remainder of the calculation, based on the
11 underwriting profit in line I, changes from 3.8 to
12 4.0, that changes the rate indication on Schedule 1,
13 the overall number from minus 3.3 to minus 3.1. But
14 you still have a combined recommended change of zero
15 because you can't have anything of a negative
16 number.

17 So what's going to happen is the number
18 from condominiums will go up slightly, but the
19 balance of the numbers for owners and tenants would
20 be slightly more negative to balance out the zero.

21 And, you know, looked at this last
22 night. I'm going to check it over, again, because
23 actually most of last night I spent trying to
24 respond to the numerous requests for information
25 that the Rate Bureau submitted at 9:00 o'clock the

1 night before. So I think these numbers are right,
2 but I'm going to check that. But that's the change.

3 MR. FRIEDMAN: I don't have any more
4 redirect [sic] of Mr. Schwartz at this time,
5 Your Honor.

6 MS. FUNDERBURK: Thank you, Counsel.

7 Mr. Spivey, are you prepared to
8 continue with your cross?

9 MR. SPIVEY: Just a moment, Your Honor.

10 MS. FUNDERBURK: Yes.

11 MR. SPIVEY: Your Honor, I'm ready to
12 proceed. I may come to other places where I
13 need a moment because this may impact other
14 things I was going to ask Mr. Schwartz. But
15 we can try to go ahead and move along now.

16 MS. FUNDERBURK: Thank you, please
17 proceed with it.

18 CROSS-EXAMINATION (CONTINUED)

19 BY MR. SPIVEY:

20 Q Mr. Schwartz, if you would, I want you
21 to walk me through the changes you just described.
22 I want you to go through them again to make sure I'm
23 getting them down correctly. I asked you a number
24 of questions yesterday regarding Schedule AIS-14,
25 sheet 1. Do you recall those -- do you recall that

1 I was asking you questions about that very exhibit?

2 A Yes.

3 Q And as I recall, I was asking you about
4 your source notes on that page. In the course of
5 those questions, you pointed us to, maybe,
6 sheet AIS-9 being a better documentation for line B2
7 on that exhibit.

8 Do I recall that to be your testimony
9 yesterday?

10 A Yes.

11 Q All right. Can you walk me through
12 what change you've just testified to on additional
13 direct to the value on line B2 of .664 such that it
14 is now, as I understand it, 0.556?

15 A Okay. So yesterday, I said you take
16 the .814, down at the bottom of the page, and
17 subtract out 15 percent for reinsurance, which gives
18 .664. And then when I was looking at it last night,
19 I realized that the .814, 81.4 percent, only took
20 into account variable expenses, not fixed expenses,
21 and I realized you need to take out fixed expenses
22 also.

23 So out of the .664, you would subtract
24 the value for Other Acquisition of 5.9 and subtract
25 the value for General Expenses of 3.9, and that

1 gives .566.

2 Q All right. So I'm understanding now
3 that line B2 becomes 0.566, and do I then understand
4 that those calculations on Schedule AIS-14, sheet 1
5 just flow through and then line I changes? I mean,
6 I guess a number of other lines change as well, but
7 the result at the bottom of the page on line I, as I
8 understood your additional direct testimony, becomes
9 4.0, correct?

10 A Right, uh-huh.

11 Q We may come back to that later when I
12 can figure out what I need there.

13 Mr. Schwartz, when we broke
14 yesterday -- well, strike that.

15 In your CV, Appendix AIS-A, we spoke
16 yesterday about the fact that you provided expert
17 witness testimony in a State Farm General Insurance
18 Homeowners Rate case in California in November 2015,
19 and in January 2016, right?

20 A Yes.

21 Q Did you actually present written
22 testimony in that case?

23 A Yes.

24 Q Along with those -- with that
25 California Homeowners case, we spoke yesterday about

1 the fact that there are a number of Workers' Comp
2 cases within that same most recent ten-year period
3 in Massachusetts and Delaware, did we not?

4 A Yes.

5 Q And did you actually present written
6 testimony in those cases as well?

7 A Yes. In Delaware, it's called a
8 report, not testimony, but there's reports that get
9 filed with the Hearing Officer.

10 Q Thank you.

11 In those cases -- and by "those cases,"
12 I'm referring to the California Homeowners case and
13 the Workers' Comp cases in Massachusetts and
14 Delaware, did you perform an analysis of
15 underwriting profit?

16 A Yes.

17 Q Did you determine the underwriting
18 profit provision in those cases in the same manner
19 that you determined the underwriting profit
20 provision that you recommend in this case?

21 A I just want to make sure I got the
22 right cases. Which cases did you talk -- did you
23 ask about?

24 Q In the Massachusetts and Delaware
25 Workers' Comp cases and the California Homeowners

1 case, which are set out in your CV as occurring
2 within the last ten years, did you determine the
3 underwriting profit provision that you recommended
4 in those cases in the same manner that you
5 determined the underwriting profit provision that
6 you recommend in this case?

7 MR. FRIEDMAN: Objection, Your Honor.

8 Obviously, those are all listed out by exact
9 case name and date on his résumé. And
10 Mr. Schwartz has already indicated that -- I
11 mean, he's posing a broad array of questions
12 about -- a broad question about very specific
13 calculations in individual filings. I think
14 it's only fair that if he wants to go into
15 this, he refers to the specific filing he's
16 asking about instead of saying "all them
17 cases through ten years in California,
18 Maryland, and Delaware."

19 MS. FUNDERBURK: Any response,

20 Mr. Spivey?

21 MR. SPIVEY: Your Honor, my question
22 is, in my view, a -- appropriately a general
23 one that I feel fairly confident the witness
24 can respond to. If he needs to refer to a
25 specific case, we can certainly ask about

1 each specific case. I don't know that that
2 speeds things along here at all.

3 MS. FUNDERBURK: Overruled.

4 Mr. Schwartz, do you need the question
5 restated?

6 THE WITNESS: No.

7 MS. FUNDERBURK: Please answer the
8 question.

9 A So in the Delaware cases, I don't
10 believe I calculated an underwriting profit. It was
11 just accepted, what was in the Rate Bureau filing.
12 So I didn't do a separate calculation of the
13 underwriting profit.

14 In the California or State Farm case,
15 the insurance department has a specific regulation
16 about how profit should be calculated, and so I
17 followed the regulatory requirements in California.
18 And that's different than what I did in this case.

19 The Massachusetts case, I can't recall
20 off the top of my head what I did. I think we made
21 corrections to the internal rate of return
22 calculation that I believe Mr. Zanjani did
23 incorrectly. So Mr. Zanjani in that Massachusetts
24 case -- I'll say Dr. Zanjani in that Massachusetts
25 case used a different method than what he's doing in

1 the current case.

2 And I think the people I was working
3 with in that case -- in consultation with them, my
4 recollection is, we said that Dr. Zanjani's
5 calculation was incorrect, and this is how you
6 should correct for it.

7 So that would have been different
8 because he was starting with the calculation that
9 Dr. Zanjani did in Massachusetts, which is different
10 than what he's doing in North Carolina.

11 BY MR. SPIVEY:

12 Q All right. I asked you a moment ago
13 whether you performed an analysis of underwriting
14 profit in those cases. So let me -- let's go into
15 them separately. In the Delaware cases, did you
16 perform an analysis of underwriting profit, the
17 result of which was an underwriting profit provision
18 that you recommended?

19 A I did not evaluate the underwriting
20 profit in the Delaware cases. We accepted, for the
21 purpose of calculation, the underwriting profit
22 proposed by the rating bureau, but I believe we made
23 clear that anything we didn't object to or take a
24 different position on didn't mean we necessarily
25 agreed with the procedure used by the Rate Bureau.

1 Q And just hopefully to make the record
2 clear, when you refer to "the Rate Bureau" in these
3 last few questions, am I understanding you correctly
4 you're talking about, in that case, the Delaware
5 Rate Bureau?

6 A Yes. If you asked me a question about
7 Delaware --

8 Q But "Rate Bureau," in your response, is
9 referring to an entity in Delaware, and not the Rate
10 Bureau in this case?

11 A Right. Delaware as a rating bureau for
12 Workers' Compensation.

13 Q So if I'm understanding you correctly,
14 in the Delaware cases on page 8 of Appendix AIS-A,
15 your testimony is that you did not recommend an
16 underwriting profit provision but essentially
17 accepted what the Delaware Rate Bureau had proposed
18 in its filing?

19 A We used that number for the purpose of
20 doing a rate calculation, and also stating that that
21 didn't mean that we were offering any opinion on
22 whether that number was calculated appropriately.

23 Q But you did not recommend a different
24 profit factor?

25 MR. FRIEDMAN: Your Honor, I think this

1 is -- objection, been asked and answered now
2 about four times.

3 MS. FUNDERBURK: Restate the question,
4 Mr. Spivey.

5 BY MR. SPIVEY:

6 Q Mr. Schwartz, in an effort to make sure
7 that I'm understanding your testimony, you're
8 testifying that in those Delaware cases I just
9 identified, you did not recommend a different
10 underwriting profit provision than what had been
11 filed by the Delaware Rate Bureau?

12 A Just to make it clear, I wasn't making
13 any recommendation with regard to the underwriting
14 profit factor. I accepted, for the purpose of doing
15 a numerical calculation, the number included in the
16 Delaware Rating Bureau filing.

17 I just feel -- when you say I didn't
18 recommend a different number, it makes it sound like
19 I was agreeing with their number, and I just want to
20 make it clear that I used their number for the
21 purpose of calculation, but that doesn't mean I
22 believed that their number, the Delaware rating
23 bureau's number, was calculated appropriately.

24 Q Did you calculate an underwriting
25 profit provision in those Delaware cases?

1 A No.

2 Q I believe you testified you don't
3 really recall what may have been done in the
4 Massachusetts case. Let's speak specifically to the
5 case that's identified first on your list on page 8
6 of Appendix AIS-A as one in which you submitted
7 expert testimony in May of this year.

8 Did you perform an analysis of
9 underwriting profit?

10 A I think I've already answered this, but
11 I guess it wasn't clear to you.

12 What we did was we started with the
13 formula used by Dr. Zanjani in Massachusetts, which
14 is different than the formula procedure that is used
15 here in North Carolina, and we said -- in sort of to
16 the best of my recollection -- I want to make that
17 clear -- that the way he implemented that formula
18 was inappropriate. And if he used the formula
19 Dr. Zanjani used in Massachusetts, here's how you
20 should implement it and here's the answer you would
21 get from it. And in that, we derived an
22 underwriting profit provision different than the one
23 that Dr. Zanjani recommended.

24 Q So you performed calculations of what
25 you believed the underwriting profit should be under

1 that particular formula, correct?

2 A Yes. I mean, it's a formula -- in a
3 generic sense -- that had been used previously by
4 the Department of Insurance. So in a way, it was a
5 guideline of the Department of Insurance in
6 Massachusetts that these were formulas to be used in
7 calculating underwriting profit.

8 So we didn't think it was worthwhile to
9 say, "It was a wrong formula." We followed the
10 guidelines given by the Massachusetts Department of
11 Insurance in previous decisions. And then we said,
12 "If you're going to use that formula, here's the
13 inputs that should go into that formula."

14 Q You described a few moments ago in
15 response to my questions about cases generally --
16 you spoke to the California Homeowners case, and I
17 believe you testified -- and I'm trying to
18 summarize. If I get it incorrect, please tell me.
19 But you performed an analysis of underwriting profit
20 and presented a provision there, and you followed,
21 essentially, guidelines or a formula that California
22 requires you to follow there.

23 A Right. There's a specific regulation
24 saying how you should do it. I think it's set forth
25 in 10 CCR §2644, although that might not be exactly

1 right. But there is a specific regulation saying,
2 "Here's a formula you should use," and the
3 California Department of Insurance actually
4 publishes on its website the parameters that you
5 should put into that formula.

6 Q Do Delaware or Massachusetts or
7 California, to your knowledge, have any specific law
8 regarding the consideration to be given investment
9 income on capital and surplus when determining an
10 underwriting profit provision?

11 A I don't believe there's a statute that
12 references those words or that concept.

13 Q Is there, to your knowledge, any case
14 law that addresses that concept?

15 A No. Well, I assume you mean case law
16 in those states?

17 Q Correct. Thank you.

18 A No, not to the best of my knowledge.

19 Q Is it correct that in the cases in
20 Delaware, Massachusetts, and California, the
21 development of underwriting profit involves the
22 estimation of the cost of capital, and then the
23 translation of that into an underwriting profit
24 provision?

25 MR. FRIEDMAN: Your Honor, objection.

1 It's a compound question, and I, at least
2 from my own conception, almost need those
3 broken out.

4 MS. FUNDERBURK: I couldn't hear your
5 objection.

6 MR. FRIEDMAN: Compound question, Your
7 Honor, and I'm not clear if I got it. The
8 witness may very well have, but I would just,
9 for the purposes of the record, request that
10 that be broken up.

11 MS. FUNDERBURK: Do you need the
12 question clarified, Mr. Schwartz?

13 THE WITNESS: I have an understanding
14 of the question, how I would answer it.

15 MS. FUNDERBURK: Please proceed.

16 THE WITNESS: Just to make sure I have
17 it right, could I have the question read
18 back?

19 MS. FUNDERBURK: Yes. Well,
20 Mr. Spivey, can you reask the question?

21 MR. SPIVEY: Yeah.

22 BY MR. SPIVEY:

23 Q In the cases that we've been discussing
24 in Delaware, Massachusetts, and California, is it
25 the case that the determination of underwriting

1 profit involves an estimation of the cost of
2 capital, and then essentially a translation of that
3 into -- or a determination from there of
4 underwriting profit provision?

5 A So I just want to be clear that, as far
6 as I know, there's no statutory or legal requirement
7 that the cost of capital be used in those states.
8 But it is true that in Delaware and Massachusetts,
9 the two rating bureaus in those states use a
10 cost-of-capital analysis.

11 In California, the Department of
12 Insurance gives what they call a maximum rate of
13 return and a minimum rate of return that could be
14 used in the rate calculation. Someone may believe
15 those are cost-of-capital approaches.

16 I'm pretty sure that in California, the
17 way they calculate the maximum rate of return is by
18 adding an increment to a risk-free rate of return,
19 which my understanding is that there was a court
20 decision in North Carolina, I think in the late '60s
21 or sometime in the '70s, that said that type of
22 procedure is not legally allowed in North Carolina.

23 Q Does all of that, particularly about
24 the California case, Mr. Schwartz, mean that in
25 California, a determination of an underwriting

1 profit provision includes -- or is derived from a
2 process that includes an estimation of the cost of
3 capital?

4 A I just want to make clear that that is
5 not what the California Department of Insurance
6 calls it. I've described what I believe they've
7 done, which is add an increment to the risk-free
8 rate of return. I mean, that's one of the
9 procedures that Dr. Zanjani has said in this
10 proceeding is a cost-of-capital method. And I
11 believe -- and I think he acknowledged -- that that
12 type of method is not allowable in North Carolina.

13 Q So the law in California is different
14 from the law in North Carolina?

15 A Well, there is no specific law in North
16 Carolina -- there is no specific law in North
17 Carolina. There is no specific law in California
18 dealing with the issue of capital and surplus
19 investment income. All court decisions, as far as I
20 know. The only provision in California law that I
21 know of -- and I may not get the exact words
22 right -- dealing with investment income is something
23 to the effect that the rate has to explicitly
24 reflect investment income. I don't think they make
25 any distinguishing -- they don't distinguish in

1 California between investment income on reserves and
2 investment income on capital and surplus. It just
3 says investment income needs to be taken into
4 account in establishing the rate.

5 Q Mr. Schwartz, I want to ask you a
6 question about ASOP 30.

7 A Sure.

8 Q I believe it's in book 3, tab number
9 12.

10 A Do you know what page?

11 Q Yes, I'm going to ask you -- well,
12 ASOP 30 appears to start on what's Bates-stamped
13 number 50. I assume that's the number within tab
14 12.

15 A Yes, I have it.

16 Q And please turn to Section 3.1 that's
17 on Bates-stamped number 52.

18 A Okay.

19 Q ASOP 30 deals with actuaries' treatment
20 of profit and contingency's provision and the cost
21 of capital, does it not?

22 A It says -- the title is "Treatment of
23 Profit and Contingency Provisions and the Cost of
24 Capital in Property/Casualty Insurance Ratemaking."

25 Q In looking at Section 3.1 for which the

1 underlying heading, I guess you would say, is
2 "Estimating the Cost of Capital and the Underwriting
3 Profit Provision."

4 Is it correct that the first sentence
5 thereafter says: Property/casualty insurance rates
6 should provide for all expected costs, including an
7 appropriate cost of capital associated with the
8 specific risk transfer?

9 A I believe you read that correctly.

10 Q Thank you.

11 Is it correct that the ASOP goes on to
12 provide that the appropriate cost of capital can be
13 provided for by estimating it and translating it
14 into an underwriting profit provision after taking
15 leverage and investment income into account or by
16 developing an underwriting profit provision and
17 testing that provision for consistency with the cost
18 of capital?

19 A Yeah. I wasn't sure where you started,
20 so it says whatever it says. If you want to ask me
21 a question about it.

22 Q With the provision of ASOP 31 in
23 section -- I'm sorry, ASOP 30, Section 3.1 in mind,
24 did the profit provisions in the Massachusetts
25 Workers' Comp case comply with ASOP 30?

1 A The actual calculations done by the
2 Massachusetts Rate Bureau, I don't believe complied
3 with ASOP 30 because he calculated the incorrect
4 underwriting profit. So the value he arrived at
5 wasn't actuarially sound.

6 Well, when I say "he," I should say
7 Dr. Zanjani and the Massachusetts Rating Bureau.

8 Q Mr. Schwartz, is it your testimony if
9 you disagreed with a calculation by, in that matter,
10 the Rate Bureau in Massachusetts regarding the
11 manner in which they calculated underwriting profit,
12 that they failed to comply with ASOP 30?

13 A It's my testimony that if you come up
14 with an actuarially unsound number, you're not
15 complying with Actuarial Standards of Practice.
16 People could have different opinions about what's
17 actuarially sound and actuarially unsound.

18 That's why we're all in this room, and
19 Dr. Zanjani may believe that what he did was
20 consistent with ASOP 30. I believe it wasn't. And
21 actually I also think Dr. Zanjani admitted that --
22 well, Dr. Zanjani alleged that even though he has an
23 actuarial designation, he doesn't need to comply
24 with Actuarial Standards of Practice because what
25 he's doing isn't actuarial work.

1 Q Whether you agree with the particular
2 inputs that were used in determining an underwriting
3 profit provision in Massachusetts, did the process
4 in which that was undertaken purport to provide for
5 all expected costs, including an appropriate cost of
6 capital associated with the risk transfer?

7 A I believe that is what the
8 Massachusetts rating bureau purports their
9 calculation to have done.

10 Q In the Delaware cases, were the
11 profit -- underwriting profit provisions that were
12 presented, in which I generally understand your
13 testimony to be that you accepted, were those
14 derived using a process that provided for all
15 expected costs, including an appropriate cost of
16 capital associated with the specified -- or specific
17 risk transfer?

18 A Well, I disagree with your
19 characterization of my testimony, so why don't we
20 not have to deal with that. I'll just say I
21 disagree with your characterization of my testimony.

22 Delaware, to the best of my
23 recollection -- and I would say because I did not
24 evaluate the underwriting profit provision in
25 Delaware, I don't have a really good recollection of

1 what was in the Delaware rating bureau filing.
2 Because I believe they used the cost-of-capital
3 approach, I didn't try and evaluate it in terms of
4 whether what they did was actuarially sound.

5 Q In the California Homeowners case that
6 we discussed that's listed on page 8 of
7 Appendix AIS-A in your testimony, is the profit
8 provision under the process that is essentially
9 required by the State of California one that
10 provides for all expected cost, including an
11 appropriate cost of capital associated with the
12 specific risk transfer?

13 A What the California Department of
14 Insurance does, is they promulgate a maximum rate of
15 return, and the way they do that is when using one
16 of the procedures that Dr. Zanjani, in this case,
17 says determines a cost-of-capital estimate.

18 Q In this case, is it your testimony that
19 you did not develop an estimate of the cost of
20 capital as part of your underwriting profit
21 analysis?

22 A I did not do a cost-of-capital
23 analysis.

24 Q It's your testimony that you did not
25 develop your underwriting profit provision from an

1 estimate of cost of capital, correct?

2 A I didn't use the cost of capital at
3 all, so none of my calculations are based on a
4 cost-of-capital calculation.

5 Q Is it also your testimony here you have
6 not tested your underwriting profit provision for
7 consistency with the cost of capital?

8 A I didn't do such a test because I
9 didn't calculate cost of capital.

10 Q Does the underwriting profit provision
11 that you recommend in this case comply with your
12 obligations under ASOP 30, Section 3.1?

13 A It complies with the standard of
14 practice taken as a whole.

15 Q Thank you, Mr. Schwartz.

16 Does it comply with ASOP 30,
17 Section 3.1?

18 A I believe these have to be taken as a
19 whole, and I would say the actuary -- well, the last
20 sentence, "The actuary may use any appropriate
21 method as long as such method is consistent with the
22 considerations in this standard."

23 So 3.1 talks about the entire standard.

24 Q Does the underwriting profit provision
25 that -- strike that.

1 Do the rates that you propose being
2 used in -- from your testimony, do they provide for
3 all expected costs, including an appropriate cost of
4 capital associated with the specific risk transfer?

5 A I haven't calculated a cost of capital,
6 so I haven't done a calculation that major.

7 Q Mr. Schwartz, do you believe that the
8 law in North Carolina regarding the consideration
9 that is to be given to investment income on capital
10 and surplus in determining an underwriting profit
11 provision -- do you believe that conflicts with the
12 provisions of AIS -- I mean of ASOP 30 Section 3.1?

13 A To the extent that 3.1 would appear to
14 say you must do a profit calculation using a cost of
15 capital, I would say that that conflicts with my
16 understanding of North Carolina law.

17 Q And have you developed your
18 underwriting profit provision in this case in
19 accordance with what you believe or have been
20 advised that the law in North Carolina requires?

21 A I believe my underwriting profit
22 calculation is consistent with the law in North
23 Carolina. Not every aspect of my calculation is set
24 forth in statutes or court decisions. And so not
25 every part of it could be referenced to a particular

1 statutory provision. But in terms of the applicable
2 statutory provisions and court decisions, I've made
3 my calculation consistent with those.

4 Q Have you disclosed to your client in
5 this case any material difference between the
6 underwriting profit you developed in this case and
7 the underwriting profit provision that would be
8 determined in accordance with the provisions of
9 ASOP 30, 3.1?

10 MR. FRIEDMAN: Objection, Your Honor.
11 Mr. Schwartz works directly with me on this
12 entire filing, and his communications come in
13 to me first or somebody's cc'd, but I'm
14 always on them. So that is, I believe,
15 attorney-client privileged. It's calling for
16 privileged information.

17 MR. SPIVEY: Your Honor, I'm not asking
18 him the contents of his discussions with
19 counsel. I don't think what I'm asking is --
20 is in any way asking for something that's
21 privileged information.

22 MR. FRIEDMAN: Your Honor, I disagree
23 because when asking whether -- he said, "You
24 discussed this method with your attorney."
25 That's directly calling for the content. And

1 that very question reveals whether or not he
2 discussed -- in this case, Mr. Spivey's going
3 after some alternative cost of calculation,
4 cost-of-capital calculation that Mr. Schwartz
5 has already testified ten times over he did
6 not engage in.

7 MR. SPIVEY: He did not what? Sorry.

8 MR. FRIEDMAN: Engage in.

9 MR. SPIVEY: Your Honor, my question
10 was: Has Mr. Schwartz disclosed to his
11 client any material difference between the
12 profit he determined and the profit he would
13 have determined in compliance with this ASOP?

14 MR. FRIEDMAN: That's calling for
15 confidential --

16 MR. SPIVEY: That's not asking for
17 privileged information.

18 MR. FRIEDMAN: I disagree. That's
19 actually asking for the content of what he
20 has disclosed.

21 MS. FUNDERBURK: You see that as
22 privileged and not part of the expert opinion
23 that he's giving testimony to?

24 MR. FRIEDMAN: His testimony as to
25 whether he even ran his own calculation is

1 clear. He's said over and over he never
2 engaged in the exercise of running it.

3 Now, Mr. Spivey is asking a follow-up
4 question to say, "Well, did you even" -- as I
5 understand it, "Did you even discuss this
6 alternative matter allegedly required by ASOP
7 30, 3.1 with your client?" Did you reveal --
8 whether you call it "reveal" or not, that's a
9 communication.

10 MS. FUNDERBURK: But it's not the
11 content of the communication. Would you
12 agree?

13 Here's what I'm having difficulty
14 parsing out. He has to evaluate your expert
15 for what your expert actually did and where
16 your expert stands on things. And I think
17 that question is getting more to that than
18 the content of a privileged communication.

19 MR. FRIEDMAN: All right, then,
20 Your Honor, I'll withdraw the objection.

21 MS. FUNDERBURK: Note certainly if it
22 goes further into discussions that could
23 indicate privileged information, please
24 object. But I think Mr. Spivey, at this
25 point, is still on safe grounds. Now if he

1 goes further, he may not be, but I think at
2 this point he's on safe grounds.

3 Please restate your question.

4 BY MR. SPIVEY:

5 Q Mr. Schwartz, have you disclosed to
6 your client in this case any material difference
7 between the underwriting profit provision you
8 developed in this case and the underwriting profit
9 provision that would comply with the provisions of
10 ASOP 30, Section 3.1?

11 A Well, again, 3.1 references a whole
12 standard. But if your question is, did I tell my
13 client here's the number you would get if you did a
14 cost-of-capital calculation, and how does that vary
15 from the number I'm putting in the filing, I did not
16 have a discussion with the client regarding that.
17 Because I did not do a cost-of-capital calculation.

18 MR. SPIVEY: Your Honor, would this be
19 an appropriate time to take a break this
20 morning?

21 MS. FUNDERBURK: You were reading my
22 mind. We were both looking at the clock.
23 Yes, I think this would be an appropriate
24 time for a break.

25 Do you need to do any consultation that

1 would take more than 10 minutes? Do you need
2 15?

3 MR. SPIVEY: Ten.

4 MS. FUNDERBURK: We are in recess for
5 10 minutes. It's currently 10:30. We'll see
6 you back at 10:40.

7 Mr. Schwartz, when you return to the
8 stand, you'll continue to be under oath.

9 Thank you. We're in recess.

10 (A recess was taken from 10:30 to
11 10:40 a.m.)

12 MS. FUNDERBURK: We are back on the
13 record.

14 Mr. Schwartz, you remain under oath.

15 Please resume your questioning.

16 Well, do we need to address anything
17 before we resume?

18 MR. FRIEDMAN: Actually, if I could
19 briefly, Your Honor, I have contacted the
20 counsel for the Beach Plan.

21 MS. FUNDERBURK: I think we can address
22 that after -- do we need to address that
23 before his testimony?

24 MR. FRIEDMAN: No, ma'am.

25 MS. FUNDERBURK: We want to get through

1 as much testimony as we can and hopefully get
2 people out of here. That may be something we
3 can address after people are off the stand.

4 MR. FRIEDMAN: Okay.

5 MS. FUNDERBURK: Okay. Mr. Spivey,
6 please proceed.

7 MR. SPIVEY: Thank you.

8 BY MR. SPIVEY:

9 Q Mr. Schwartz, let's turn to your
10 Schedule AIS-15. Are you there?

11 A Yes.

12 Q And we discussed this some yesterday,
13 and we talked about the fact that the 36-year
14 average for all lines shown on this exhibit is
15 4.9 percent, correct?

16 A Yes.

17 Q And we talked about the fact that the
18 36-year average, as you're showing it here for
19 homeowners on a countrywide basis is negative
20 2.7 percent, correct?

21 A Yes.

22 Q And at the bottom of this schedule in
23 sort of the line that has a box around it, you show
24 your selected target run on operations as a percent
25 of premium as 8.0 percent, correct?

1 A Yes.

2 Q So where are the data or calculations
3 that show how you got to 8.0 from the numbers you
4 show here or from any other numbers, for that
5 matter?

6 A There's not a specific calculation. It
7 was my judgment, looking at the numbers on this page
8 and taking into account what I believed should be a
9 higher return for North Carolina homeowners
10 insurance because of the risk involved.

11 Q Your testimony is that all the numbers
12 shown on AIS-15 for the various returns shown there
13 are operating returns, correct?

14 A Yes.

15 Q Now, for every year that you show on
16 Schedule AIS-15, and those start with 1988 and
17 continue through 2023, do they not?

18 A Yes.

19 Q So for every one of those years, the
20 insurance company -- companies writing these various
21 lines of business had investment income from capital
22 and surplus funds, did they not?

23 A Insurance companies would have
24 investment income on capital and surplus.

25 Q In each and every one of those years?

1 A Yes.

2 Q And we talked yesterday about a
3 definition that you had set out on page 31 of your
4 testimony of total return as being the sum of
5 operating profit and investment income on capital
6 and surplus, correct?

7 A You want me to go to it and read it?
8 Why don't I just go through and read it. It's your
9 question, you know, so we'll take as much time as
10 you want.

11 So on page 31, on lines 4 and 5, the
12 definition of total return taken from ASOP Number
13 30, it says: Total return: The sum of operating
14 profit and investment income on capital, usually
15 after income taxes, often expressed in percentage
16 terms.

17 Q And your footnote 42 to that sentence,
18 as shown at the bottom of the page, states that:
19 Capital as used in this definition encompasses what
20 is sometimes referred to as capital and surplus.

21 Correct?

22 A Yes.

23 Q So in general terms, then, is it
24 correct that total return can be described as the
25 sum of operating profit and investment income on

1 capital and surplus?

2 A Yes.

3 Q Given that general definition of "total
4 return," one could create a table that looks like
5 Schedule AIS-15 that incorporated investment income
6 on capital and surplus and then label the exhibit
7 "derivation of total return," could they not?

8 A I suppose someone could if they wanted
9 to.

10 Q Given your definition, or the general
11 definition, of "total return," as we've just
12 discussed it, as being equal to operating return
13 plus investment income on capital and surplus, one
14 could start with total return and subtract
15 investment income on capital and surplus to derive
16 the operating return or the operating profit,
17 correct?

18 A Calculation can be done different ways.
19 You'd have to see what someone did to see if you
20 agreed with it.

21 Q But the calculation I just described
22 is, in simple terms, is basic math, correct?

23 A Well, there's always a lot of -- what's
24 the expression? "The devil is in the details." So
25 you could say something generic, and then when you

1 try and implement it, you find out that it doesn't
2 work the way you thought.

3 Q So just a moment ago when I asked you
4 about how you calculated or where the data were that
5 you used in getting your 8.0 percent target return
6 on operations, I understood your testimony to be
7 that you selected that number. Am I understanding
8 you correctly?

9 A I selected it based on the various
10 considerations set forth in my testimony.

11 Q So as I understand your testimony, from
12 your selected 8 percent target return on operations,
13 you subtracted investment income on reserves and
14 installment fee income to arrive at your
15 underwriting profit provision; is that correct?

16 A Yes.

17 Q Did you just select your value for
18 investment income on reserves or is that a
19 calculated number?

20 A That's a calculated number.

21 Q Did you just select your statement fee
22 income number or is that a calculated number?

23 A That's a number that was calculated by
24 the Rate Bureau, and I used it.

25 Q Mr. Schwartz, when you're calculating

1 or when one is calculating investment income on
2 policyholder-supplied funds or investment income on
3 reserves, is it typical to make adjustments for
4 agent's balances and prepaid expenses?

5 A Those are things that the last
6 commissioner's order said should be taken into
7 account, along with other considerations.

8 MS. FUNDERBURK: If you could speak a
9 little closer to the microphone.

10 THE WITNESS: I'm sorry.

11 MS. FUNDERBURK: Thank you.

12 THE WITNESS: Did the court reporter
13 get my last sentence?

14 MS. FUNDERBURK: She'll let us know if
15 she did not.

16 THE WITNESS: Okay.

17 BY MR. SPIVEY:

18 Q When calculating investment income on
19 reserves and making adjustments in that calculation
20 for agent's balances and prepaid expenses, those
21 adjustments are done to reflect the fact that the
22 agent's balances and prepaid expenses are not
23 available for the insurance company to invest; is
24 that correct?

25 A That part of the adjustment on unearned

1 premium reserves is appropriate and it needs to be
2 taken into account with other appropriate
3 adjustments.

4 Q In your calculations, how do you
5 account for agent's balances and prepaid expenses?

6 A Well, I compared the amount of assets
7 available for investment for the unearned premium
8 reserve, the value of the unearned premium reserve,
9 and the amount of invested assets available for the
10 unearned premium reserve was larger than the
11 unearned premium reserve. So whatever the impact of
12 agent's balances are in terms of the impact on
13 invested assets would be taken into account when you
14 look at the total invested assets.

15 Q So bottom line is you assume that
16 100 percent of the unearned premium reserve is
17 investable, do you not, in this case?

18 A I did the calculation. It's on
19 Schedule 14, sheet 2.

20 Q You just referenced AIS-14, sheet 2 in
21 response to my question about whether you assumed
22 that 100 percent of the unearned premium reserve is
23 invested, correct?

24 A I used the value of 100 percent based
25 on the calculation that I did.

1 Q Based on the calculations you present
2 on Schedule AIS-14, sheet 2, your calculations
3 assume or reflect your position that 100 percent of
4 the unearned premium reserve is invested. Is that a
5 fair way to say it?

6 A A fair way to say it is that when you
7 look at the amount of invested assets that are
8 available, that the amount of those that are
9 available in relation to the unearned premium
10 reserve is more than the value of the unearned
11 premium reserve.

12 So I didn't make an assumption about it
13 being 100 percent. I did a calculation showing that
14 after you say how much of the invested assets go for
15 reserves, for losses, and loss adjustment expense,
16 and for policyholder surplus, what's left over, and
17 each year, it's more than the unearned premium
18 reserve.

19 Q What data underlie your calculations on
20 Schedule AIS-14, sheet 2?

21 A Well, the types of data are in the
22 heading. Do you want me to read them?

23 Q Are those data countrywide data for all
24 property/casualty insurance companies?

25 A Yes.

1 Q What lines of business?

2 A It's all the different lines of
3 property/casualty business.

4 Q This is not just homeowners insurance,
5 correct?

6 A Well, we could go through this, but as
7 we discussed at length yesterday, policyholder
8 surplus is not available by line of insurance or by
9 state. So you cannot do this calculation on a
10 by-line, by-state basis.

11 Q Thank you.

12 Is it correct that the data on this
13 exhibit are not solely homeowners insurance data?

14 A Well, since I answered before that they
15 include all lines of insurance, it follows logically
16 that it's not just homeowners.

17 Q So the answer --

18 (Overlapping speakers.)

19 A I said many times, which I guess you
20 want me to repeat over and over again, is that it's
21 not just homeowners insurance.

22 BY MR. SPIVEY:

23 Q And the data on Schedule AIS-14,
24 sheet 2 are not data solely for the state of North
25 Carolina?

1 MR. FRIEDMAN: Objection. Asked and
2 answered.

3 MR. SPIVEY: I'm sorry, I don't recall
4 asking that question.

5 MR. FRIEDMAN: I think you've -- Your
6 Honor, I think that counsel has asked
7 repeatedly, "Is this national data? Is this
8 National data?" And he has answered, "Yes,
9 this is national data."

10 MS. FUNDERBURK: Can you repeat your
11 current question?

12 BY MR. SPIVEY:

13 Q Is it correct that the data on Schedule
14 AIS-14, sheet 2 are not limited to the state of
15 North Carolina?

16 MS. FUNDERBURK: I'm going to allow the
17 question. We did have a couple very similar
18 questions yesterday about the -- what was
19 composed of the data, whether it was only
20 homeowners, although it was broken down. I
21 think you are asking things a little bit
22 differently. I'm going to allow it, but just
23 please be mindful.

24 Please answer the question,
25 Mr. Schwartz.

1 THE WITNESS: Sure.

2 A Since I've said before that it's
3 countrywide data, it follows logically it's not
4 North Carolina data. And as I've said, North
5 Carolina data is not available for this calculation.
6 And it's my understanding that the statutory
7 provisions allow for the use of countrywide data
8 when North Carolina data are not available and,
9 therefore, I believe my calculation is consistent
10 with the applicable statutory standards.

11 MR. SPIVEY: May I have just a moment,
12 Your Honor?

13 MS. FUNDERBURK: Yes, sir.

14 I'll note, I can't hear you, but your
15 microphone is on. Just FYI.

16 MR. SPIVEY: Thank you.

17 BY MR. SPIVEY:

18 Q Mr. Schwartz, the NAIC promulgates
19 rules regarding the allocation of investment income
20 to line of business, does it not?

21 A Yes. They have a formula that is used
22 for statutory reporting of allocating certain things
23 to line of business.

24 Q And is it correct that the data -- the
25 data in the annual statement that insurance

1 companies file with the Commissioners of Insurance
2 around the country, include investment income
3 allocated to line of business in accordance with
4 that direction or formula from the NAIC?

5 A Yes.

6 Q And those data are reflected in the
7 NAIC Report of Profitability by Line and by State,
8 that you utilized as the source of data on some of
9 your exhibits; isn't that correct?

10 A Well, the financial statements
11 allocate -- so the official required financial
12 statements that need to be reported to insurance
13 departments allocate investment income by line of
14 business. The NAIC Report on Profitability also
15 includes an allocation by state. But that's not a
16 required financial statement. Those are reports
17 that the NAIC puts out on its own.

18 Q And those reports include reports that
19 are included in the NAIC Report on Profitability by
20 Line and by State, do they not?

21 A Well, the report is the report. Is
22 that what you're asking when you say "those reports
23 are in the report"? Unless I misunderstood your
24 question.

25 Q Where in the annual statement is

1 investment income allocated to line of insurance?

2 A In the Insurance Expense Exhibit, which
3 is a supplement to the annual statement.

4 Q And the Insurance Expense Exhibit is
5 sometimes referred to as the "IEE." Is it not"?

6 A Yes.

7 Q And the data from the IEE are used in
8 the NAIC Report on Profitability by Line and by
9 State, correct?

10 A I believe so, yes.

11 Q And you used the NAIC Report on
12 Profitability by Line and by State as a source of
13 data for some of the information in some of your
14 exhibits, did you not?

15 A Yes.

16 MR. SPIVEY: May I approach the
17 witness?

18 MS. FUNDERBURK: Please approach.

19 MR. FRIEDMAN: Your Honor --

20 MR. SPIVEY: I'm going to ask the
21 witness to read a sentence --

22 MS. FUNDERBURK: Oh, sorry. We just
23 want to make sure the mic picks you up.

24 MR. SPIVEY: I'm going to ask the
25 witness to read a sentence from a document.

1 It's a document Mr. Friedman had provided
2 earlier in the proceedings and marked but
3 which he's thinking he's now not going to
4 introduce. I believe you have it, and I can
5 point you to it by referring to it the way he
6 had marked it. Maybe you don't have it.

7 MS. FUNDERBURK: Is that 30?

8 MR. SPIVEY: It was originally marked
9 DOI 40.

10 MS. FUNDERBURK: Forty. Was that the
11 one I had yesterday and gave back? Let me
12 check my documents and see if I have a copy.

13 MS. WHARRY: Your Honor, I don't
14 believe you have a copy. That was, I think,
15 one that we were going to give
16 electronically, 39 and 40, so we did not
17 provide that in hard copy.

18 MR. SPIVEY: It was a voluminous
19 electronic copy.

20 MS. FUNDERBURK: I do not have a copy.

21 MS. WHARRY: I have it. I can share it
22 electronically.

23 MS. FUNDERBURK: Please approach.

24 BY MR. SPIVEY:

25 Q I'm going to try to speak loud so they

1 pick up my voice, Mr. Schwartz.

2 I want to point you to a document which
3 is a copy -- and I'll show it to you while we're
4 talking. It's entitled "Report on Profitability by
5 Line and by State in 2022," dated March 2024.

6 A Okay.

7 MR. SPIVEY: And it was -- for
8 everyone's reference, it had been marked as
9 DOI 40. Just for the purpose of pointing you
10 to it, Your Honor.

11 BY MR. SPIVEY:

12 Q Mr. Schwartz, are you generally
13 familiar with the Report on Profitability by Line
14 and by State?

15 A Yes.

16 Q What I've done here is simply copied
17 the initial pages of what is a very long document,
18 and I want to just point you to a portion of the
19 introduction on page under a heading, Investment
20 Gain.

21 Do you see that?

22 A Yes.

23 Q Would you please read into -- read
24 aloud for us -- I think it's two sentences I have
25 put brackets around there as the first two sentences

1 of that section.

2 A "This report shows two investment gain
3 estimates. Column 8A includes only investment gain
4 attributable to 'insurance transactions' " --

5 "Insurance transactions" are in quotes.

6 -- "excludes investment gain capital
7 and surplus, investment gain on 'insurance
8 transactions' " --

9 And, again, "insurance transactions"
10 are in quotes.

11 -- "is estimated for each line, state
12 by multiplying an investment gain ratio, and that's
13 in quotes by the sum of loss reserves, loss
14 adjustment expense reserves, unearned premium
15 reserves and ceded reinsurance balances payable less
16 agent's balances and prepaid expenses for each
17 line/state."

18 Q Thank you, Mr. Schwartz.

19 If I heard you correctly, I believe you
20 said "ceded reinsurance balances"?

21 A Did I? Well, it says "ceded
22 reinsurance premiums payable."

23 Q Thank you.

24 With that statement from the
25 introduction of the NAIC's Report on Profitability

1 by Line and by State in 2022, it's correct, is it
2 not, that the NAIC directs that the determination of
3 investment income by line and by business -- by line
4 of business include a deduction for agent's balances
5 and prepaid expenses from the investable funds
6 attributable to reserves?

7 A Well, I just want to clarify so there's
8 no confusion, that I wouldn't use the word "directs"
9 because that implies that it's some kind of
10 directive saying that it has some legal force that
11 everyone has to use it.

12 I would say that the NAIC is stating
13 that's the way they did that calculation in that
14 report. And not everyone does it that way. We've
15 talked about the California regulations, and the
16 California regulations take into account the
17 entirety of invested assets, similar to the way that
18 I've done it.

19 I know in Massachusetts I've raised
20 this issue also, and the Massachusetts insurance
21 department decisions have indicated that it's
22 appropriate to take into account the other assets of
23 companies, other invested assets of companies in
24 determining how much of the unearned premium reserve
25 is invested, not just agent's balances and prepaid

1 expenses. That would be an incomplete picture.

2 And my recollection of the 2014 Order
3 in North Carolina indicated that the commissioner
4 was changing his position from previously in that
5 agent's balances of prepaid expenses needed to be
6 taken into account. But I believe that order also
7 had some discussion in it about the issue needed to
8 be studied further.

9 And so as part of that studying
10 further, I think the result of that is an indication
11 that insurance companies have a lot of invested
12 assets related to insurance operations, which also
13 need to be taken into account in determining the
14 amount of unearned premium reserves that could be
15 invested.

16 Q The sentence that -- the two sentences
17 that you read from the NAIC profitability report
18 just a few moments ago state that investment gain on
19 insurance transactions is estimated in a manner
20 which reflects deductions for agent's balances and
21 prepaid expenses, do they not?

22 A I mean, the sentence says what it says,
23 and it's explaining what the NAIC did for its
24 calculation in that report. There's no indication
25 in that report that the NAIC is saying that for any

1 other purpose, other entities have to follow that
2 same formula.

3 Q When the NAIC presents, in its Report
4 on Profitability by Line by State, the investment
5 gain on insurance transactions reflected in its
6 report reflect that there have been deductions made
7 for agent's balances and prepaid expenses, do they
8 not?

9 A The NAIC is saying what they've done,
10 which includes those deductions.

11 Q You did not make any adjustments for
12 prepaid expenses in agent's balances in your
13 calculation of the investment income on reserves,
14 did you?

15 A I disagree with that.

16 Q Did you make deductions in your
17 calculation of investment income on reserves for
18 agent's balances and prepaid expenses?

19 A Any such deductions are taken into
20 account in the determination of the invested assets.
21 And, therefore, to the extent there are deductions,
22 related to prepaid expenses and agent's balances,
23 looking at the actual data shows that there are
24 additions to the assets insurance companies have
25 available to invest, which more than offset those

1 deducti ons.

2 So there's enough invested assets for
3 100 percent of the unearned premium reserves to be
4 invested.

5 Q Mr. Schwartz, is it your testimony that
6 you did include adjustments for agent's balances and
7 prepaid expenses in your calculations?

8 A Yes. It's not an explicit line. The
9 impact of those are reflected in the invested
10 assets. If a company has additional prepaid
11 expenses for agent's balances that will lower the
12 invested assets they have. So to the extent that
13 agent's balances and prepaid expenses are lowering
14 the amount of invested assets, that's taken into
15 account in my calculation.

16 MR. SPIVEY: May I have just a moment,
17 Your Honor?

18 MS. FUNDERBURK: Yes.

19 MR. SPIVEY: Thank you, Your Honor.

20 BY MR. SPIVEY:

21 Q Mr. Schwartz, I'd like to ask you to
22 consider a hypothetical. Let's consider a
23 homeowners insurance company that does not purchase
24 reinsurance, and then let's consider an otherwise
25 identical company that does purchase reinsurance.

1 In general, which of those companies would have more
2 funds available to invest?

3 A I mean how much policyholder surplus
4 did they have, what other lines of business did they
5 write, where are they writing, are they writing
6 long-tail lines of business or short-tail lines of
7 business?

8 Are you saying everything about these
9 two companies is exactly the same, but one buys
10 reinsurance and one doesn't?

11 Q Yes.

12 A Okay. I think it depends on the
13 reinsurance agreements. You know, do they have to
14 pay the reinsurance upfront? Do they get to hold
15 the balances before they pay the reinsurer? It
16 depends on a whole variety of things.

17 Q Well, let's add a further assumption, I
18 guess, that when the company that purchases
19 reinsurance -- purchases reinsurance, it pays the
20 reinsurance premium to the reinsurance company.

21 A Okay. So it's a -- you're saying one
22 company keeps all its assets and another company
23 gives some of its assets away? And the company that
24 gives some of its assets away will have less assets
25 to invest.

1 Q In making rates for a company that buys
2 reinsurance, versus an identical one that does not
3 buy reinsurance, under the assumed facts that -- or
4 hypothetical I just described, it would be
5 appropriate for us to account for the fact that the
6 company that buys reinsurance has less funds
7 available to invest, would it not?

8 A You should take into account a
9 particular circumstance of each company.

10 Q Are you familiar with the term
11 "reinsurance recoverable"?

12 A Yes.

13 Q Are reinsurance recoverables investable
14 assets?

15 A No.

16 MS. FUNDERBURK: Mr. Schwartz, could
17 you be sure to speak into the microphone?

18 THE WITNESS: I'm sorry. There's such
19 a long delay between the questions, I lean
20 back and rest for a while.

21 BY MR. SPIVEY:

22 Q Let's look, again, at your Schedule
23 AIS-14, sheet 2. And on that exhibit, it's correct,
24 is it not, that you calculate the percentage of the
25 unearned premium reserve that is invested?

1 A Yes.

2 Q And when you do that on this exhibit,
3 you're using an industry composite balance sheet,
4 are you not?

5 A Yes.

6 Q The loss reserves and unearned premium
7 reserves that you're using on that particular
8 balance sheet are on a net-of-reinsurance basis,
9 correct?

10 A Yes.

11 Q And your conclusion, as presented there
12 on this -- on your Schedule AIS-14, sheet 2, is that
13 100 percent of this net unearned premium reserve is
14 invested, correct?

15 A Yes. That's the value I selected based
16 on the numerical values above it.

17 Q And your selected 100 percent that you
18 show at the bottom of column 5 on Schedule AIS-14,
19 sheet 2, you then utilize on your Schedule AIS-14,
20 sheet 1 in line A3, do you not?

21 A Yes.

22 Q And you applied that 100 percent factor
23 to the amount you show or the value you show in line
24 A2 of \$528,500, which is the way it's presented on
25 this sheet. I assume there's zeros omitted. But

1 that's the number you apply it to, correct?

2 A Right. That's the way it's presented
3 in the Rate Bureau report. So if you go above it,
4 it's just assuming a million dollars of earned
5 premium. And so that million dollars up at the
6 top -- I don't know why it's being cut off on the
7 screen. Does anyone see a million dollars here or
8 is it just my screen where line 1 is cut off?

9 MS. FUNDERBURK: It's just because of
10 how the document is -- is pulled up. I'm
11 sure it's there. It's just the current
12 display of the document.

13 A Anyway, pretty much everything on this
14 page in terms of dollars is a percentage of the
15 million dollars in line 1. So, you know, it's just
16 of an index value. Whatever the value you put in
17 line -- in line A, I should say, the million. Line
18 A1. Everything would proportionately change.

19 So it's an index-type thing, as opposed
20 to the actual numbers for homeowners insurance in
21 North Carolina, which is the way it's presented in
22 the Rate Bureau filing.

23 BY MR. SPIVEY:

24 Q And as you're saying, that ratio or
25 that number for the mean unearned premium reserve of

1 0.5285, you obtained from the bureau filing,
2 correct?

3 A Yes.

4 Q And is that number a direct or a net
5 unearned premium reserve?

6 A I don't recall specifically which
7 number the bureau used.

8 Q Well, do you know what -- your
9 understanding of your exhibit, or Schedule AIS-14,
10 sheet 1 is, as whether the mean unearned premium
11 reserve that you post there is on a direct or a net
12 basis?

13 A I didn't look at that particularly. I
14 accepted the Rate Bureau number. It really wouldn't
15 make a difference of any significance on a net or
16 direct basis.

17 Q Mr. Schwartz, if in the Rate Bureau
18 exhibit that you obtained that number from includes
19 the cost of reinsurance as an expense item, is it
20 correct that the mean unearned premium reserve there
21 is on a direct basis?

22 MR. FRIEDMAN: Objection, Your Honor.

23 I think at this point the -- you know, it
24 seems very clear to me that opposing
25 counsel --

1 MS. FUNDERBURK: I can't understand
2 what you're saying.

3 MR. FRIEDMAN: I'm sorry. It seems
4 very clear to me that opposing counsel knows
5 where this number in the filing is, and yet
6 he's continuing to ask questions that
7 Mr. Schwartz has already said would require
8 him to speculate. I do think it's just fair
9 for Mr. Schwartz to be pointed to this page
10 in the filing so that he can see how the
11 bureau described whether the unearned
12 premiums were calculated on net or direct.

13 MS. FUNDERBURK: Mr. Spivey.

14 MR. SPIVEY: Your Honor, I'm happy for
15 the witness to turn to the exhibit in the
16 filing. We're talking about an exhibit
17 Mr. Schwartz included in his testimony. But
18 you appear to be suggesting that his witness
19 doesn't understand what kind of calculation
20 he made. But we can point him to what he
21 says he relied on and find out.

22 MR. FRIEDMAN: Okay. I appreciate
23 that.

24 BY MR. SPIVEY:

25 Q Mr. Schwartz, would you turn to

1 Exhibit RB-24 in --

2 A You mean the --

3 (Overlapping speakers.)

4 A On line A2, the note there? I already
5 know where it is in the filing. I just didn't have
6 it memorized. I can know where to find it.

7 And so --

8 BY MR. SPIVEY:

9 Q I'm sorry. Could you say that, again?
10 I didn't hear what you said.

11 A I said I know where to find it, and I'm
12 already there.

13 Q And you showed it as a source on your
14 exhibit, did you not?

15 MR. FRIEDMAN: Your Honor, could I
16 learn where he already is and where
17 Mr. Spivey --

18 MR. SPIVEY: Well, I'm referring to his
19 source note at the bottom of his exhibit,
20 Schedule AIS-14, sheet 1.

21 THE WITNESS: Sure.

22 MS. FUNDERBURK: Mr. Schwartz, we don't
23 need any commentary.

24 THE WITNESS: Okay. I'm just
25 exhausted.

1 MS. FUNDERBURK: We'll be breaking for
2 lunch soon.

3 A So --

4 MS. FUNDERBURK: I believe it's around
5 page 113 out of 128. Is that correct,
6 Mr. Spivey?

7 I'm sorry, I may not have scrolled down
8 enough yet. I may be on a prior page.

9 MR. FRIEDMAN: So page 7 is what's
10 showing. There's not 118 pages of Exhibit
11 24.

12 MS. FUNDERBURK: I'm looking at the
13 full document on my laptop.

14 MR. SPIVEY: Your Honor, in the upper
15 right corner, it should say Exhibit RB-24,
16 page 7.

17 MS. FUNDERBURK: It does. I have a
18 stamp covering my section on that.

19 Mr. Friedman, can you find that, RB-24,
20 page 7?

21 MR. FRIEDMAN: Yes, ma'am.

22 MS. FUNDERBURK: Are you there?

23 MR. FRIEDMAN: Yes, ma'am.

24 MS. FUNDERBURK: Mr. Spivey, please
25 proceed.

1 BY MR. SPIVEY:

2 Q Mr. Schwartz, are you looking at
3 Exhibit RB-24, page 7?

4 A Yes, I am.

5 Q And that is one of the sheets you cite
6 as a source for your exhibit, correct?

7 A Yes.

8 Q Does it show there the mean unearned
9 premium reserve, 52.85 percent, and then translated
10 to a dollar amount of \$528,538?

11 MS. FUNDERBURK: If you could please be
12 sure you speak into the microphone. Thank
13 you.

14 A Yes.

15 BY MR. SPIVEY:

16 Q And on your exhibit, you have posted
17 that factor in line A2 of 0.5285, have you not?

18 A Yes.

19 Q Now, does looking at Exhibit RB-24,
20 page 7 refresh your recollection as to whether the
21 mean unearned premium reserve you use in your
22 exhibit is on a direct or net basis?

23 A RB-24, page 7 does not indicate whether
24 the mean unearned premium reserve is net or direct.
25 For that you would need to turn the page -- to

1 Exhibit RB-24, page 8, which shows the derivation of
2 the 52.85 percent. And it indicates, under line A2,
3 that the source is a statutory page 14 of the annual
4 statement, which is on a direct basis.

5 So RB-24, page 7 doesn't say whether
6 it's net or direct. You would need to turn to the
7 next page to see where the Rate Bureau says they got
8 the information.

9 Q Is the number presented on a direct or
10 net basis?

11 A As I've said, just minutes ago, it says
12 it's from statutory page 14 of the annual statement,
13 which is on a direct basis.

14 Q Mr. Schwartz, I'm going to change
15 topics. We may have to come back to this later.

16 On pages 50 to 52 of your testimony,
17 you discuss modeled losses, do you not?

18 A Yes.

19 Q Mr. Schwartz, there's a chart on
20 page 52 in your testimony there.

21 A Yes.

22 Q I'll ask you to take the whole page.
23 Do you see that?

24 A Yes.

25 Q What is the source of the actual

1 hurricane losses in the first column?

2 A That would be from Rate Bureau filings.

3 Q And that's indicated at the bottom of
4 your exhibit where it says "Source: NCRB HO
5 Filings," correct?

6 A Yes.

7 Q Which Rate Bureau homeowners filings
8 did you obtain those numbers from?

9 A The various filings made by the Rate
10 Bureau over time.

11 Do you want me to go through and just
12 list the dates of all the filings?

13 Q Mr. Schwartz, you made reference
14 earlier in your testimony today to a request we made
15 a couple of nights ago for some source information.

16 Do you recall making that comment
17 earlier?

18 A I wouldn't say it was a couple of
19 nights ago. It was Tuesday night at 9:00 o'clock.

20 Q Okay. As I understand, a couple of
21 nights ago would be Tuesday night, and, yes, it was
22 about 9:00 o'clock.

23 As I recall, this question was among
24 the questions that we posed. We were wondering if
25 we could get additional information about what

1 homeowners filings this information came from.

2 A And I'll be happy to supply it. I
3 believe that you were provided with some of the
4 information for some of the other questions you had.
5 I believe there are about ten different items that
6 you had questions on, of a document that you got, I
7 think on September 14th, and you waited until
8 October 29th to ask for information about it.

9 MR. FRIEDMAN: Your Honor, could I be
10 heard briefly on this?

11 MS. FUNDERBURK: Please.

12 MR. FRIEDMAN: Yes. As Mr. Schwartz
13 has stated, this was in his report, which was
14 originally filed on September 14th. And as
15 Mr. -- as Mr. Spivey explained, this was sent
16 to us on Tuesday evening at 9:00.

17 We have worked -- Mr. Schwartz did
18 yesterday -- on finding the specific page
19 cites, and we can do so this evening, but we
20 were unable to find -- I mean, Mr. Schwartz
21 and I had to get some sleep, and so we were
22 unable to find the specific cites for every
23 one of the ten or so questions they had for
24 us at that time.

25 So this apparently is one of them that

1 we were unable to get to last night and we
2 certainly intend to get to today or this
3 evening.

4 MS. FUNDERBURK: I presume Mr. Schwartz
5 will be available through tomorrow, if
6 necessary?

7 MR. FRIEDMAN: Yes, ma'am.

8 MS. FUNDERBURK: Mr. Spivey, any
9 comment?

10 MR. SPIVEY: Your Honor, we're simply
11 trying to ascertain where various information
12 comes from, and posed that request, yes. We
13 can continue for now. And if we can get that
14 information at whatever time it works, that
15 would be helpful.

16 MR. FRIEDMAN: With regard to the
17 timing, just one thing I am having to
18 consider, I think we're definitely going to
19 need some redirect, and part of me is, you
20 know, wondering whether I need to go cram for
21 that redirect over lunch or this evening.

22 So I guess my ability to go look for
23 that data with Mr. Schwartz is going to be
24 affected by whether y'all think you will be
25 finishing with his cross today. And what

1 that, in turn, means whether I'm going to
2 have to do my --

3 MS. FUNDERBURK: I cannot imagine you
4 are going to be getting cross [sic] before
5 lunch.

6 MR. FRIEDMAN: I meant by 4:00 o'clock.
7 Excuse me, ma'am.

8 MR. SPIVEY: And at this point, I'm
9 sorry, I can't give you a good answer to
10 that. It's hard to say how far along we will
11 get. I'm hopeful we will finish, but that
12 remains to be seen.

13 MR. FRIEDMAN: Okay. So I guess the
14 best I can say, then, is that for my own
15 client's protection, I need to focus on
16 redirect over lunch in the possibility that
17 that will take place, which means that I
18 don't think I'll have time to focus on --

19 MS. FUNDERBURK: Okay. We may be
20 getting a little far afield and into too many
21 administrative matters when we've got
22 Mr. Schwartz on the stand and we need to get
23 through his testimony and get to the lunch
24 break, where then the parties can have some
25 discussion about timelines.

1 MR. FRIEDMAN: Thank you.

2 MS. FUNDERBURK: Unless those are
3 something that I need to address, that's
4 something the parties can talk about at
5 lunch.

6 Mr. Spivey, if you can continue, and
7 I'm sure you will note where you need
8 additional data and what you're waiting for,
9 as far as -- I guess I shouldn't say "data,"
10 you're looking for the sources for the data,
11 not the data itself necessarily. But I'm
12 sure you will make note of that and have
13 requested that, and, if necessary, we'll come
14 back to it.

15 MR. SPIVEY: Thank you.

16 MS. FUNDERBURK: Okay. Thank you.

17 Please proceed with your questioning.

18 BY MR. SPIVEY:

19 Q Mr. Schwartz, it is correct, is it not,
20 that there were not Rate Bureau homeowners filings
21 in each of the years you've displayed on page 52 of
22 your testimony?

23 A That's correct.

24 Q In that same chart, there's a column
25 labeled "NCRB Modeled Hurricane Losses," correct?

1 A Yes.

2 Q You note in that chart, in the footnote
3 for that column, that those values include actual
4 values from filing and AIS-estimated values, do you
5 not?

6 A Yes.

7 Q Do I understand that to mean that you
8 obtained modeled NCRB values from -- some of those
9 numbers from bureau filings, and other of the
10 numbers you posted in that column, are numbers that
11 you estimated?

12 A Yes.

13 Q Do you know, as you sit there right
14 now, which values in that column are actual values
15 from bureau filings and which are numbers you
16 estimated?

17 A Not exactly. I know -- or my
18 recollection is that in earlier filings I believe
19 the bureau gave values for each of the five years in
20 the filing. I think at some point they stopped
21 doing that, and just gave a projected value for the
22 future rate period. And what I did was I took that
23 future value for that rate period and I adjusted it
24 to earlier periods for trend and changes in
25 exposure. But I don't know which years are which as

1 I sit here.

2 I mean, this exhibit is an extension of
3 an exhibit from the 2014 Filing, so probably a lot
4 of this has been discussed previously.

5 Q Previously in this case?

6 A No, previously in the 2014 Filing of
7 the Rate Bureau.

8 Q You didn't present this table in the
9 2014 case, did you?

10 A This table was presented for the years
11 that were available at that point in time.

12 Q So it was a different table?

13 A I don't want to get into a semantic
14 argument with you. It was a table that included
15 these values for the years that were available at
16 that point in time, and now I've added additional
17 years to it.

18 MR. SPIVEY: Your Honor, and
19 Mr. Friedman, this is another one of the
20 items that we were asking which of these
21 values were estimated. So it's just on that
22 list.

23 THE WITNESS: Is that a new request?
24 Because I don't think that was --

25 MR. SPIVEY: That was not a question --

1 (Overl appi ng speakers.)

2 THE WITNESS: -- I said.

3 MR. SPIVEY: That was not a questi on,
4 that was --

5 THE WITNESS: Well, but I'm going to
6 have to do it, and I just want to make sure I
7 didn' t mi s understand.

8 MS. FUNDERBURK: It's something that
9 the attorneys will address outside.

10 THE WITNESS: Okay.

11 MS. FUNDERBURK: And Mr. Friedman will
12 coordi nate wi th you on that.

13 THE WITNESS: Okay. Thank you.

14 BY MR. SPIVEY:

15 Q All right. And just to be clear, my
16 questi on to you was, which of the values are
17 li terally posted from a bureau filing and which are
18 ones that you estimated.

19 A Right. But I thought you said that was
20 in your request that you previously submi tted, and
21 that's not my recolle cti on.

22 But whatever it is, we'll get it worked
23 out.

24 MR. FRIEDMAN: Your Honor, we
25 certainly -- if it was or wasn't in the

1 request they sent at 9:00 p.m. on Tuesday,
2 we'll, you know, try today or this evening,
3 if they want to make clear what request that
4 is, to get the answers.

5 MS. FUNDERBURK: That's something that
6 I need the -- I need counsel to address at
7 lunch. If I need to deal with anything when
8 we come back from lunch, I will. But the two
9 of you need to get together and address
10 exactly what's being requested and what the
11 timeline is and when that's going to be
12 produced and whether or not Mr. Schwartz is
13 going to have to be recalled to discuss
14 things if that information does not come in
15 while he's here this week on the stand.

16 BY MR. SPIVEY:

17 Q Mr. Schwartz, for the values in the
18 column we're currently discussing, which is the
19 column labeled "NCRB Model ed Hurri cane Losses," and
20 understanding that some of those values were drawn
21 directly from bureau filings and some were values
22 that you estimated, for those values that you pulled
23 from bureau filings, did you make any adjustments to
24 any of those values, or do you recall?

25 A I mean, if there was a value there for

1 the modeled losses, I used a value from the filing.

2 Q On that same chart, in the third
3 column, that's titled "Actual Losses Less NCRB
4 Value," how are the values in that column
5 determined?

6 A By subtracting the NCRB modeled
7 hurricane losses in the column immediately to the
8 left from the actual hurricane losses immediately to
9 the column to the left of that.

10 So for 2021, it's -- and the 205 is 23
11 minus 227.

12 There's a -- so if you just do it from
13 the numbers on this page, it comes out to a minus
14 204, I'm rounding because the actual calculation is
15 done in decimal places. So 223 minus 227 is 204,
16 but with rounding from the additional decimal
17 places, the actual calculation rounds to 205.

18 Q So your testimony is that the values in
19 that third column are a result of starting with
20 column 1 and subtracting the values in column 2?

21 A Yeah. Column 1 being actual and column
22 2 being modeled.

23 Q Well, the fourth column, which is
24 titled "Actual as a percent NCRB value," how are
25 those values determined?

1 A So that would be column 1, actual ,
2 divided by column 2, modeled. So, again for 2021,
3 if you take 23 and divide it by 227, that's .1 or
4 10 percent.

5 Q Is the same true for the value
6 72 percent shown for the line labeled "Combined,"
7 near the bottom of the chart?

8 A Yes. So, I mean, I'll just do the
9 calculation so -- to make sure. But if you take
10 4150 and divide it by 5730, that comes out to
11 72 percent.

12 Q How is the value 90 percent shown just
13 beneath the 72 percent, how is that value
14 determined?

15 A That's taking all the values in
16 column 4, all those ratios, excluding the combined
17 value ratio, and just taking a straight average --
18 adding them all up and dividing it by the number.

19 BY MR. SPIVEY:

20 Q Mr. Schwartz, is it your view that
21 there's sufficient documentation on this exhibit to
22 satisfy any ASOP requirements about documenting your
23 work?

24 A I believe it's consistent with ASOPs.

25 Q Mr. Schwartz, turn to page 67 in your

1 testimony. Toward the bottom of the page there, you
2 have a heading "Compensation for Assessment Risk,"
3 do you not?

4 A Yes.

5 Q This is a section where you discuss
6 that particular issue, correct?

7 A Yes.

8 Q At line 37, you state: Insurance
9 companies in North Carolina that write property
10 insurance are required to participate in the
11 residual market. Do you not?

12 A I believe that's what is written there.

13 Q Am I correct in understanding that by
14 that statement, you mean that the companies writing
15 property insurance in North Carolina are required to
16 participate in paying losses incurred in the
17 residual market, that the residual market lacks the
18 resources to pay?

19 A What I mean is what I wrote, is that
20 insurance companies are subject to assessments. And
21 those assessments would come, presumably, from the
22 residual markets not having sufficient funds to pay
23 claims as they come due.

24 Q And the residual market we're referring
25 to here and that you're referring to here is the

1 Beach Plan, or what we are referring to as the Beach
2 Plan, correct?

3 A Well, it's the Beach Plan and the FAIR
4 Plan. I mean, I have a footnote down at the bottom
5 from the first sentence where I said, "Residual
6 market to reference the North Carolina General
7 Statutes."

8 Q All right. Thank you for clarifying.
9 We're talking about both the Beach Plan and the FAIR
10 Plan.

11 A Right. Because the Rate Bureau put in
12 assessments for both of those in its filing.

13 Q So stated another way, if the Beach
14 Plan's or the FAIR Plan's losses exceed the amount
15 of money they have to pay those losses, then the
16 insurance companies writing property insurance in
17 North Carolina have to step in and pay those losses,
18 correct?

19 A Right. I mean, there's all the
20 resources. So, you know, I know they have
21 reinsurance also, the Beach Plan and the FAIR Plan.
22 So if that -- depending on what point in time money
23 runs out, so to speak, the reinsurers may pay a
24 portion of it before or in conjunction with what
25 insurance companies pay as assessments.

1 Q And those assessments are in the form
2 of nonrecuperable assessments, are they not?

3 A Yes. In the sense of saying they can't
4 be charged back -- the policyholders -- directly.

5 Q So by choosing to write homeowners
6 insurance in North Carolina, companies expose
7 themselves to the cost associated with those
8 potential nonrecuperable assessments, do they not?

9 A They expose -- well, expose themselves.
10 They could potentially be assessed money, and that
11 would be a cost.

12 MR. SPIVEY: I'm not sure, Your Honor,
13 when you were thinking about lunch today, but
14 this is a natural break for me.

15 MS. FUNDERBURK: Yes, if it's a natural
16 break, then that works for me for lunch.

17 Sounds like when we come back from
18 lunch, there will be at least a few things to
19 address. Well, "potentially" address. We
20 can address the document we discussed this
21 morning when we return from lunch, and if
22 there's any need to discuss requests for
23 information, requests for sources for data,
24 we can address that when we come back from
25 lunch.

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MR. FRIEDMAN: I'm sorry, of the document -- yes.

MS. FUNDERBURK: Yes. We'll address that when we come back from lunch.

Thank you, Counsel. We are in recess.

Mr. Schwartz, I'll remind you, you do continue to be under oath.

Thank you, I will see you all in an hour and a half.

(A recess was taken from 12:03 p.m. to 1:33 p.m.)

1 STATE OF NORTH CAROLINA)

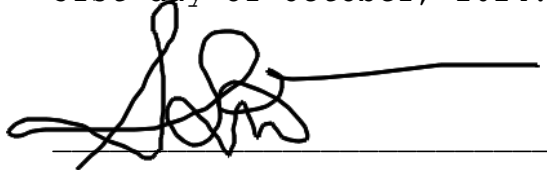
2 COUNTY OF FORSYTH)

3 REPORTER'S CERTIFICATE

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

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

14 IN WITNESS WHEREOF, I have hereto set my hand this
15 31st day of October, 2024.

16 
17 _____

18 Audra Smith, RPR, CRR, FCRR

19 Notary Number: 201329000033

20 Commission Expires: June 26, 2025

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E R R A T A S H E E T

PAGE LINE CORRECTION

I, _____, after having
read the foregoing transcript of the hearing In the
Matter of: The Filing Dated January 3, 2024, by North
Carolina Rate Bureau for the Revision of Homeowners
Insurance Rates wish to make the above corrections.

SIGNATURE_____

AS

DATE_____