NORTH CAROLINA DEPARTMENT OF INSURANCE

RALEIGH, NORTH CAROLINA

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

COPY

BEFORE: AMY FUNDERBURK, HEARING OFFICER

TRANSCRIPT

OF

HEARING

VOLUME II - P.M. SESSION

Raleigh, North Carolina

Tuesday, October 8, 2024

1:32 p.m.

A P P E A R A N C E S

On behalf of the North Carolina Rate Bureau:

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Hearing in the matter of the filing dated January 3, 2024, by the North Carolina Rate Bureau for revised homeowners' insurance rates, at North Carolina Department of Insurance, 3200 Beechleaf Court, Raleigh, North Carolina, on the 8th day of October, 2024, at 1:32 p.m., before Wendy Sawyer, Court Reporter and Notary Public.

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(No exhibits offered.)

P R O C E E D I N G S

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HEARING OFFICER FUNDERBURK: Good afternoon. We're back on the record. It is 1:32 p.m., Tuesday afternoon, October 8th. I'll remind the witness that you are still under oath.

Mr. Friedman, are you prepared to continue?

MR. FRIEDMAN: I am, Your Honor.

HEARING OFFICER FUNDERBURK: Please do so.

MR. FRIEDMAN: Can everybody hear me now?

CONTINUED CROSS EXAMINATION

BY MR. FRIEDMAN:

Q. All right. Mr. Anderson, if you could turn to -- those are the ASOPs. Excuse me. When you were retained and began work on this filing, did you see some version of the work of Dr. Zanjani, ISO, and/or Dr. -- or Ms. Mao before you signed your opinion?

A. Yes.

Q. Okay. About how long before you worked on your opinion did you see their findings?

A. The rate review process, I may be getting the exact dates a little bit off, but I believe the rate review process began in April or May of 2023. And one of the first components would be reviewing some data from ISO, which is used then as an input for Aon's work. So the work that Ms. Mao oversees. There's additional review of -- hold on, I'm going to answer your question.

There's additional review of work completed by ISO, review of work completed by Aon, and then towards the end of the process, there's review of the work completed by Dr. Zanjani. That would have occurred really throughout the summer. And if memory serves me right, I completed my testimony, roughly, in October of 2023.

Q. Okay. And sir, did you actually begin on it at the same time that ISO began working on the filing or sometime after that?

A. I'll distinguish between the rate review process and the rate filing. The rate filing is the culmination of the rate review process. So ISO would have been working on, actually, the rate review process even before they brought information to the Rate Bureau. I believe Ms. Biliouris talked yesterday about the aggregation of the data and things like that.

So they would have had work going on for several months. They would have done a majority of the analysis in the work during the rate review process. And then at the -- again, towards the end, they would be preparing filing exhibits in preparation of the filing.

And at that point, I would begin drafting my -- or I did begin drafting my testimony and kind of wrap up the draft really as the final filing exhibits are also prepared so that I could kind of check my testimony against the final filing exhibits. Does that make sense?

Q. It does --

A. Okay.

Q. -- but I guess I'm still unclear on a couple of things. One, when ISO first -- here's the simplest, easy way to ask it. Yesterday, you may have heard Ms. Biliouris testify about that it took approximately 12 months to finish the filing. Do you recall that 12 to 13, I think was her estimate?

A. Yes, I remember that.

Q. At what point in those 13 months did you first come on and begin working on your part of the filing?

A. Are you asking when I began interacting with the Bureau and reviewing components of the filing

or actually working on my testimony?
Q. Working -- interacting with either the Bureau or any of the other experts who were working on it, as well, including ISO.
A. That would have been about six months into the process. So if the data aggregation began in roughly November of 2022, my involvement, I believe, would have kind of ramped up or began in roughly May of 2023.
Q. And how early on, whether they were the final results or preliminary results of their work, how -- how early on did you see some results from Dr. Zanjani or Dr. Mao -- or Ms. Mao, excuse me?
A. I'm estimating a little bit on the specific time frames, but the work completed by Ms. Mao would have been roughly in July, maybe early August, and that would also be about the time that I would have reviewed and seen Dr. Zanjani's work. It was probably roughly in late July or in August.
Q. Okay. And between that initial work you reviewed and the ultimate written opinion by Ms. Mao for her report, had there been any changes in her analysis, in her data?
A. Can you repeat that just to make sure that I'm answering?

Q. Sure. Did the initial data analysis by Ms. Mao change at any time after you first saw it?

A. Not that I recall.

Q. Okay. What about Dr. Zanjani?

A. I don't believe so. Not that I recall. I'm not remembering anything.

Q. So I'm going to be going through your testimony largely now. So that is in Book 1 at Exhibit RB-19. During the time you've worked at Milliman, did you -- was Dr. Appel also employed by Milliman at any time?

A. Yes, he was.

Q. Okay. Did you work with him on North Carolina Rate Bureau filings?

A. Yes. I did.

Q. With regard to what aspects of the filings?

A. The main -- my main role was to assist with the compensation for assessment risk.

Q. Okay. Did you assist him with the cost -- with the profits?

A. No.

Q. Were you familiar with what he did with the profits?

A. At a high level.

Q. Did you work with him on the net? The net -- by net, I'm meaning to refer to the net cost of reinsurance.

A. Again, I was familiar with that work at a high level.

Q. So when you worked with him, did you work with him on the contingency, as well, or was that your work from the get-go?

A. I did not work with him on the contingency, and that's a new component of the filing just in the last two or three years. So an exhibit resembling RB-21 would not have been included in any of the filings that David -- that Dr. Appel would have been involved in.

Q. When you said a new aspect of the filings, does that mean it's a new thing that Milliman, in particular, is working on?

A. Yes. The new thing is the exhibit that's documented in RB-21, which was an exhibit that Milliman put together that we developed prior to two or three years ago. There was not any quantitative support to support the contingency provision.

Q. But you have worked on the contingency provision before developing RB-21 along with Dr. Appel?

A. Again, I was familiar with it at a high level, but I did not work on anything specific related to the contingency provision.

Q. Okay. Do you know whether Dr. Appel's contingency provision was rejected in the 2014 homeowners' order?

MR. BEVERLY: Objection. Can you tell me what you mean by rejected?

BY MR. FRIEDMAN:

Q. Whether the Commissioner disapproved of it and gave 0 percent.

A. I would clarify that it wasn't Dr. Appel's contingency provision. It was the Rate Bureau's. And I'm not certain that Dr. Appel provided support for that or whose testimony would have --

Q. Okay.

A. -- would have supported that provision in the filing.

Q. Are you aware of whether Milliman's work, whomever was testifying for Milliman on the -- on the contingency was disapproved of in any part?

A. I don't recall who worked on the contingency provision. My recollection is that Dr. Appel's focus was on profits and the net cost of reinsurance.

Q. Okay. But do you know whether Milliman's analysis of the contingency provision was rejected? And it was Milliman's analysis. Am I correct?

A. No. My understanding is, again, prior to two or three years ago that there was not a standalone analysis to support a contingency provision, that there was not quantitative support or an exhibit included in the filing to support a 1 percent or whatever the selected contingency provision would be in those previous filings.

Q. Are you -- do you know whether there was a 1 percent contingency provision calculated by whomever in the 2014 homeowners' filing?

A. I don't know for certain. I would anticipate that there probably was. Many times a contingency provision is selected judgmentally. If you recall my earlier comments about the reasons for using a contingency provision, those are very difficult to quantify, if not impossible, what future judicial decisions, what the impact would be.

So it's common for actuaries to just judgmentally select a relatively small provision for contingencies. 1 percent is very common. I have seen contingencies up to 2, 3, 4, 5 percent on occasion.

Q. Would you say that 1 percent is the norm?

A. Yes.

Q. So with regard to on page 4 of your testimony, at the bottom paragraph, the bottom answer, you state that the 2024 homeowners' filing is generally consistent with prior filings, but there is one component of this filing that relies on a different approach as compared to the 2020 homeowners' filing. Do you see that?

A. Yes.

Q. And you then state on page 5 that that different component has to do with the calculation of the CAR?

A. That's correct.

Q. Okay. You state that in 2020, Milliman did not have available data necessary to complete the CAR. Is that a fair paraphrase of your testimony?

A. Yes. That's -- that's reasonable.

Q. Okay. What data was that?

A. It was event level detail of modeled hurricane losses. That type of data comes directly from one of the hurricane models. Again, we're using AIR or RMS, and that information is really only available to entities that license the models.

So Milliman was relying on a third party who had access to that information and essentially the licensing contracts of the modelers changed that restricted that information to be shared with Milliman as an independent third party.

However, Aon licenses those -- yeah. Aon licenses those models, which is why they were able to then complete the analysis in 2024.

Q. All right. And so let me understand that. So Milliman doesn't license its own models?

A. Correct.

Q. And it had been relying on a third party to provide -- it had been relying on a third party to provide it with the losses. Was it also relying on that third party's run of the model to provide it with detail to calculate the net?

A. The net -- I assume you mean net cost of reinsurance?

Q. Net cost of reinsurance. I'm sorry.

A. For who?

Q. If I understand -- I may be mis-recalling your testimony a bit ago, but that Milliman worked on the net cost of reinsurance in, let's say, 2014.

A. That's correct. That's my --

Q. Did it continue doing the net cost of reinsurance up until 2020?

A. The work supporting the net cost of reinsurance transition from Milliman to Aon, I think it was a little bit before 2020.

Q. Okay. So in any case, then, at least for the CAR, the third party ceased having access and so Aon licensed its modeling software itself. And so it took over the work. Is that fair?

A. The third party had access to the data, but they could not share it with Milliman because we were -- we were then the third party to the modelers. You know, the modelers had the relationship with -- with the third party. We were not allowed to have access to that data.

So in the 2020 filing, the most recent data we had was one year prior to that. So we were able to make an adjustment, just kind of roll the data forward or project it forward a year, and that's what we used to support the 2020 filing.

But by the time we began work on subsequent filings, not just for homeowners but other residential property filings, that the data that Milliman had access to was -- it was too old, it was too stale that the projection method wouldn't be appropriate.

Q. On page 5 of your testimony, you -- I believe you say that you -- Aon replicated the methodology used for the CAR by Milliman in the 2018 homeowners' filing. That is -- do you see that where

you state that?
A. Yes.
Q. Okay. When, in the past, Milliman calculated the CAR, did you use any consideration of the actual surplus of the Beach Plan or the FAIR Plan?
A. Yes. I did. Or we did.
Q. Do you know whether Aon continued to do that after they began modeling the CAR?
A. Yes. They do.
Q. Okay. And do they -- did you all use the actual assessment history?
A. Can you clarify who you all is?
Q. I'm sorry. Did Milliman use the actual assessment history of the FAIR Plan and the Beach Plan in calculating the CAR?
A. No. That wasn't really applicable to this methodology.
Q. Why is that?
A. The -- the -- the purpose of the methodology here is to simulate. It's to project the likelihood of an assessment, but it also -- we identify -- this could get technical here. We -- we apply the Beach and FAIR Plans reinsurance contracts to the modeled losses, we reflect the surplus of the Beach and FAIR Plan to identify in which events or in which

scenarios would the Beach or FAIR Plan essentially exhaust their resources and need to issue assessments.

We actually take those that the losses that result in assessments, and we put them into layers that reflect the likelihood of them occurring. You may hear about, like, a 1 in 100 hurricane event or a 1 in 20 event.

There's different severities or different probabilities of events that could trigger these assessments. And as you look at the exhibits supporting the compensation for assessment risk, depending on the -- the layer of where those losses fall, so the lower the probability, the more severe the event, there is a -- the multiplier that gets -- that gets applied in that methodology increases as you as the event becomes more severe or as the layers become less likely. So I mean, lower probability.

That complexity of an analysis, you can't glean that from historical assessment information. You need the thousands of iterations of modeled hurricane data to be able to apply the reinsurance contracts, to be able to put the losses into layers, and then apply these adjustment factors.

Q. Okay. So different subject, though also still on page 5, bottom of the first paragraph. Do I understand your testimony there to be, well, first of all, that there are insurance companies now that have provisions in their reinsurance treaties that would cover Beach and FAIR Plan assessments?

A. I'm sorry. Are you pulling that out of my testimony?

Q. Well, I'm looking at the last sentence of the first paragraph. To reflect that some insurance companies no longer retain exposure to assessments from the Beach and FAIR Plan pursuant to the companies' respective reinsurance agreements, Aon then modified the calculated compensation for assessment risk provision by multiplying it by 50 percent.

So is that -- so that's saying that just that, that some insurance companies are now -- have reinsurance against assessments?

A. Yes. That was information that the Rate Bureau and myself learned from Aon. As reinsurance brokers, they see reinsurance contracts. And we learned, again, within the last few years that many reinsurance contracts cover assessments from entities like the Beach and FAIR Plan.

Q. And is my understanding by multiplying it by 50 percent, that's an assumption that approximately half of the North Carolina homeowners' carriers do have coverage under their reinsurance for assessments?

A. Yes. I would just clarify that instead of 50 percent of the companies, it would be 50 percent of the exposures in the state.

Q. Okay.

A. That may be represented by that --

Q. Do know where that -- I mean, how you came to the 50 percent or how, I guess, more particularly, Aon did?

A. That was -- that was judgment. That type of information is difficult to obtain. Aon has access to reinsurance contracts but certainly not for the entire industry. So that was an informed judgment decision or selection.

Q. Did you ever see any data from Aon about actual reinsurance costs in North Carolina?

A. Whose costs?

Q. Costs borne by North Carolina homeowners' carriers that are members of the Bureau.

A. I have not seen that information or that data.

Q. Have you calculated reinsurance costs for other clients?

A. Do you mean a net cost of reinsurance?

Q. The net cost? Yes. I'll refer to it as net -- the net.

A. Okay. Yes. I have. I have calculated that.

Q. Okay.

A. In order to do that, again, the appropriate inputs or information need to be provided to me. I don't have access to the models like Ms. Mao would have at Aon.

So I would need to -- we need to have the right information and the right data available to me. That may include the total reinsurance premiums and the expected hurricane losses that coincide with those reinsurance premiums. And then subsequent to that, I could calculate a net cost to reinsurance.

Q. So when you have calculated it, you have actually seen historical data actually paid by carriers for their net.

A. Yes.

Q. But you didn't see any of that here?

A. No.

Q. Okay. Have you ever seen a reinsurance cost -- or excuse me -- a net calculation without some apparent actual prices included in it, other than this filing?

A. In any other state, a rate filing that would include the net cost of reinsurance would be for an individual company. And the corresponding losses and expenses and components of that filing would be company-specific. So in order to support their net cost of reinsurance in the filing, they would need to provide that specific information.

So, yes, this information is readily available in a state like Florida, where reinsurance information needs to be provided as part of the rate filing process. Because the Rate Bureau is submitting a filing on behalf of the industry, those assumptions, those processes, and method, they're different because the Rate Bureau is presenting information as a hypothetical one company.

There is not a single reinsurance contract that applies to the entire state of North Carolina or to the entire industry. So some of what we observe in other states simply doesn't apply in North Carolina.

Q. But the Rate Bureau's submissions, where there is relevant North Carolina data, are based, as I understand it, on the data they receive from the individual members through their data calls. Is that correct?

A. That's correct.

Q. Okay. Have you ever seen any actual data requested by the Bureau of its members regarding the costs of the net?

A. I have not seen that data.

Q. If you did see that data, would it give you a better insight into the actual costs that North Carolina carriers have for the net?

A. If the data was the actual reinsurance costs, yes, that would give me insights into the actual reinsurance costs.

Q. Would it give you insights and/or make you more comfortable with, if you were -- if you were the person calculating the net for the Bureau, would you find it helpful to have the actual costs, the net costs of the members?

A. It would be helpful, but that -- that specific component of rate indication or the rate making process is one item that companies keep confidential and proprietary. It's oftentimes only included in filings when a state such as Florida might require it.

So companies are typically reluctant to share that information. My understanding is that the Rate Bureau has asked for that information. It's just exceptionally difficult to obtain that.

As a result, the approach that's being used, relying on leading expert in the reinsurance market and Aon to use their experience to identify a reasonable layer of reinsurance and to quantify it that way is -- is a very reasonable alternative.

Q. Do you know whether homeowners' carriers that are members of the Bureau in North Carolina file annual financial statements with the Department of Insurance?

A. You mean with the North Carolina Department of Insurance?

Q. Yes.

A. I'm not 100 percent certain what the filing requirements are. If it's only their state of domicile or if they need to also submit financials in other states in which they're licensed, I'm not 100 percent certain of that.

Q. Okay. So you've -- have you ever seen any annual financial statement of a North Carolina homeowners' carrier?

MR. BEVERLY: Objection. You mean a carrier that writes in North Carolina?

MR. FRIEDMAN: I guess I better -- better specify. Yes. It would be a member of the Bureau that writes homeowners.

HEARING OFFICER FUNDERBURK: Can you

fully -- could you fully rephrase the question for
the witness?

MR. FRIEDMAN: Absolutely.

BY MR. FRIEDMAN:

Q. Have you ever seen an annual filing of a homeowners' carrier, an annual North Carolina filing of a homeowners' carrier that is a member of the Bureau?

A. A rate filing?

Q. No. Annual financial filing. Annual statement.

A. I have seen annual statements of companies that are members of the North Carolina Rate Bureau. Those annual statements would reflect the entire organization, and it would not be North Carolina specific, the -- the information that's contained in that.

Q. Do those annual filings -- for national companies you're talking about? Is that fair?

A. Yes. Yeah.

Q. For national companies, do those filings reflect their overall cost of reinsurance?

A. Indirectly. There are data elements in an annual statement such as direct written premium and net written premium that you can then imply the difference of those would be the ceded premium.

I actually tried doing some of these calculations recently, and the right information isn't there to obtain what I would consider a reasonable calculation or estimate of a net cost of reinsurance. So there are -- there's some direct losses and some net losses, but the pieces don't all fit together based on the information in the annual statement.

Q. For what purpose were you recently trying to discern that?

A. To see if I could determine the net cost of reinsurance out of an annual statement.

Q. The -- is your understanding that for other expenses in the -- for North Carolina homeowners' Bureau members that respond to the data calls, some of those are national carriers as well. Is that correct?

A. That's correct.

Q. And have you seen those carriers apportion their national expenses to North Carolina?

A. Which expenses are you specifically referring to?

Q. Their G&OA.

A. My understanding is that some of the expenses such as the G and OA, the General and Other AC (phonetic), are typically countrywide expenses. Obviously, well, expenses that might get, I want to say allocated or can be attributed to individual states would be something like premium taxes, which are unique by state. So it depends on the expense component as to whether it's a countrywide estimate or a state-specific estimate.

Q. Okay. So what is a component? I use the term apportion just because it's a tax term, but what is the allocate -- how -- are there some expenses, G&OA expenses, that are allocated by those national companies to North Carolina in order to respond to the data calls?

A. Yes. In fact, the ones you just mentioned, the General and Other AC, I believe, are allocated to the state because there are, as I think about it, there are state pages within the annual statement where the General and Other AC and commissions and taxes license fees can be found.

Q. Other than the companies' proprietary concerns about revealing what they pay for net, is there anything prohibiting them if they have a national reinsurance treaty from allocating some part of that to North Carolina?

A. The process of allocating a countrywide reinsurance contract to individual states is -- is not straightforward. It's complex. There isn't really a consistent methodology to do. There are several methodologies that are considered or used. That's a difficult process to do.

Q. But it is possible?

MR. BEVERLY: Objection; calls for speculation.

MR. FRIEDMAN: Your Honor, why don't we go to -- we're going to turn back to the Actuarial Standards of Practice that is at Book 3, Exhibit 12.

HEARING OFFICER FUNDERBURK: Is this in regard to arguments regarding Mr. Beverly's motion or objection, I'm sorry?

MR. FRIEDMAN: It is. It is absolutely related to that.

HEARING OFFICER FUNDERBURK: Proceed.

MR. FRIEDMAN: Sorry, one second, Your Honor.

HEARING OFFICER FUNDERBURK: And while you're doing that, Mr. Beverly, could you elaborate on why that would be speculative, not able to be done?

MR. BEVERLY: Anything is possible, Your Honor. I was looking for more context to the question.

HEARING OFFICER FUNDERBURK: Okay.

MR. BEVERLY: That's all.

HEARING OFFICER FUNDERBURK: Thank you.

MR. FRIEDMAN: Sorry, Your Honor. There is a specific provision on speculation by actuaries, and I'm looking for it. I'll move on in 30 seconds, Your Honor, if I can't.

If you could turn -- we're going to be going to ASOP 17, and that is at page 18 in Exhibit 12 and going to Rule 3.8 that is on page 21. I'll read it into the record.

The actuary may be asked to answer hypothetical questions. Hypothetical questions may fairly reflect facts and evidence, may include only a part of the facts and evidence, or may include actuarial assumptions the actuary believes to be unreasonable.

If permitted by the rules of evidence and procedure and any other rules applicable in the forum, and by the rulings of a judge or other official charged with overseeing the forum, the actuary may refuse to answer hypothetical questions based on what he believes, in good faith, to be unreasonable actuarial assumptions.

So my response to Mr. Beverly would be

that it -- this is -- I mean, actuaries are employed to hypothesize. They term it estimate, but still, that's what they're -- that's the nature of what they do is look at different possibilities and outcomes and consider if X fact were to change, what would that outcome be.

So that is -- I'm asking him simply whether it is possible that for a national insurer that is a member of the Bureau and writing homeowners insurance in North Carolina to allocate some portion of its national net reinsurance costs to North Carolina. He's answered so far that it's cumbersome, but I'm asking him whether it's possible.

HEARING OFFICER FUNDERBURK: And I think that the first question is, is it possible? I wouldn't necessarily consider that to be speculative because it's yes or no. Is it possible? Now, we may be in different territory when and if he's asked to speculate.

So, Mr. Beverly, I'm going to overrule your objection and ask the witness do you understand the question that is pending, Mr. Anderson? Would you like it restated?

MR. DIETDERICH: Can you repeat the

question, please?

MR. FRIEDMAN: Sure.

BY MR. FRIEDMAN:

Q. Is it possible for a national homeowners' carrier that is a member of the Bureau writing homeowners insurance in North Carolina to allocate some percentage of its national net costs of reinsurance to North Carolina?

HEARING OFFICER FUNDERBURK: And, Mr. Friedman, please adjust your microphone. Bring that closer so the court reporter can hear you. Thank you.

THE WITNESS: Yes. That would be possible.

BY MR. FRIEDMAN:

Q. Did you review the CAR calculation that Milliman did in 2014?

A. Yes.

Q. Okay. Is it correct that that was based on the AIR WSST?

A. I reviewed it at the time, which was ten years ago.

Q. Okay.

A. I would rely on whatever is documented with the 2014 filing if it identifies what version of

the AIR model was used, then that's what was used.
Q. Do you recall whether or not the output that was used to calculate -- the AIR output that was used to calculate the CAR was event level?
A. Yes. The output from the AIR model that would have been used in the CAR analysis would have been event level.
Q. Okay. For the CAR analysis or CAR analysis in the current filing, is the model output at event level?
A. My understanding is that Aon intended to replicate Milliman's methodology from the 2020 filing. And if they did that then that would have also used event level data.
Q. Okay. Going back to your testify -- testimony. On page 5 of your testimony, in the last paragraph before the first full question, beginning with this approach.
A. Yes.
Q. Okay. You state, this approach, though it changed from the 2020 homeowners' filing, was used by the Rate Bureau and its dwelling insurance rate filing submitted in July 2023. And the change is reasonable, actuarially sound, and has minimal impact on the rate level indications.

By that, are you in addition to talking about that change, are you also saying that Aon's calculation of the CAR is actuarially sound?

A. I'm just checking to see if I specifically comment on the compensation for assessment risk later in my testimony.

Q. Where else do you -- page 13 is where you address it further. If you look at --

HEARING OFFICER FUNDERBURK: Well, Mr. Anderson, you can have the time you need and just let us know when you're ready to proceed.

THE WITNESS: As I say, so in on page 13, I say I reviewed Aon's methodology and results to ensure that the compensation for assessment risk provision in this filing is consistent with those previous filings. So given that it was consistent, I would say that it was reasonable.

BY MR. FRIEDMAN:

Q. Thank you. Now, with regard to the CAR, you testified that the calculation includes both the potential for FAIR Plan assessments and the potential for Beach Plan assessments. Is that right?

A. Yes. That's correct.

Q. Do you know if there's a statutory provision allowing for the Commissioner to take into

account as part of a rate assessment by the FAIR Plan?
A. Can you explain your question?
Q. Sure. Are you aware that there is a North Carolina statute allowing the Commissioner to take into account, for the purposes of rate making, the potential for an assessment by the Beach Plan?
A. Yes.
Q. Are you aware of whether there's a similar plan for a similar permission for the Commissioner with regard to FAIR Plan assessments?
A. I believe the statutes are silent on one of the entities. It's where it's not mentioned. So it explicitly identifies one and is silent on the other.
Q. Are you aware that in the 2014 order by the then Commissioner, he found that the CAR did not provide for consideration of an assessment as to FAIR Plan's assessments by the FAIR Plan, if I may rephrase?
A. I am -- I am familiar with the order as it relates to the compensation for assessment risk.
Q. So you do recall that part of his 2014 order?
A. Yes.
Q. Okay. Did notwithstanding that order and notwithstanding the fact that you don't know whether -- you're not aware of any statute permitting the

Commissioner to consider FAIR Plan assessments, did for as long after that, 2014, as Milliman calculated the CAR, did it continue calculating it with FAIR Plan assessments?

A. Yes. The compensation for assessment risk reflects FAIR Plan assessment, but it is not a provision for assessment.

Q. I understand it's not a provision for assessment. It's the CAR. Correct?

A. Right.

Q. But you're aware that the Commissioner's order in 2014 said that the CAR cannot be calculated to reflect FAIR Plan data.

A. Is that also reflected in the statutes?

Q. No. There's -- as you said, there's nothing in the statutes about FAIR Plan data allowing the Commissioner to consider it at all.

A. Is there a question?

Q. Yeah. The question was -- back that up then. So when did Milliman stop doing the CAR calculation? Remind me.

A. After the 2020 filing.

Q. Okay. And since then, has --

HEARING OFFICER FUNDERBURK: Mr. Friedman, please speak up or get closer to the mic.

BY MR. FRIEDMAN:
Q. Since then, has Aon continued including FAIR Plan data in its calculation of the CAR?
A. Yes. They have.
Q. Okay. Since you are aware of the absence of any statutory provision allowing that and since you are aware of the Commissioner in 2014 saying it's not allowable, the FAIR Plan data, did you have any concerns about the law on that issue that such that you'd raise them in your personal opinion or such that you'd raise them to Ms. Mao or such that you'd raise them for to the attention of the Commissioner's actuaries?
A. No.
Q. Why not?
A. My understanding is that the Commissioner's order misunderstands the intention of the compensation for assessment risk. This does not relate to expected assessments.
Q. The Commissioner's order was upheld on appeal. Was it not?
A. Yes.
Q. To your understanding, does that establish the law in North Carolina, an appellate decision?
A. My under --

MR. BEVERLY: Objection.

HEARING OFFICER FUNDERBURK: Grounds, just put a statement for the record, and then I'll allow Mr. Friedman to respond.

MR. BEVERLY: I mean, there's -- there's a question asking him whether he understands what the Court of Appeals was thinking in -- in ruling on a Commissioner's order.

HEARING OFFICER FUNDERBURK: Any arguments, Mr. Friedman?

MR. FRIEDMAN: Yes. I'm not asking that question. I'm asking whether he understands that a Court of Appeals decision, whatever it may say, is law.

HEARING OFFICER FUNDERBURK: I'm going to sustain as to the way that I heard the question and ask you to restate and rephrase your question.

BY MR. FRIEDMAN:

Q. Do you understand that the Commissioner -- excuse me, that the Court of Appeals decision affirming the Commissioner's 2014 order is law?

A. I'm not a legal expert in a situation like that. I would rely on the Rate Bureau's counsel.

Q. Do you know the history of assessments currently for the FAIR Plan versus the Beach Plan? In the last ten years, do you know whether the Beach Plan's assessed more than once?

A. Not off the top of my head. I would know where to find that information, though.

Q. Do you know how often over the past ten years the FAIR Plan has assessed?

A. I believe the FAIR Plan has issued assessments a couple of times in the last few years, if I'm remembering right. I know one of the entities has. I thought it was the FAIR Plan. I may be misremembering that.

Q. Hypothetical. If the FAIR Plan is assessing more often than the Beach Plan, and if you're including the FAIR Plan data on those assessments in your CAR, would that not drive up the CAR as opposed to just including the Beach Plan assessments?

A. The compensation for assessment risk is not a provision for assessment?

Q. They're -- they're including it as the data. If the Beach -- if the FAIR Plan is assessing more often and you include that data, then the Beach Plan is assessing, and you include that data in calculating the CAR, would that drive up the number, the mere fact that the FAIR Plan is assessing more often?

HEARING OFFICER FUNDERBURK: Would -- would you like the question restated, Mr. Anderson?

THE WITNESS: I can answer -- I can answer the question.

Not based on the current methodology because we're using modeled hurricane data. The recent history of assessments doesn't impact the analysis because it's based on modeled data.

BY MR. FRIEDMAN:

Q. But it is also based on the surplus in but the calculation is at least based on the surplus, the actual surplus of the FAIR Plan versus the Beach Plan. Is that correct?

A. That's correct.

Q. Do you know whether, in the case of the FAIR Plan, the surplus has been exhausted so that it has assessed?

A. I haven't looked at financials recently, but I believe that they have had to assess in the last several years.

Q. And wouldn't the fact that the calculation is taking into account the surplus and the FAIR Plan is assessing more often than the Beach Plan, wouldn't that lead to the CAR being higher than if you were to include only the Beach Plan data?

A. Including FAIR Plan model losses and their contribution to assessments to the industry creates a larger compensation for assessment risk than only including the Beach Plan.

Q. Thank you. Turning to page 6 of your report, about middle of the page, do you see beginning with "in my opinion", do you see where it states, in my opinion, the selections and methodologies referenced above, including the excess factor, the loss adjustment expense factors, the loss trend factors, and the premium trend factors are reasonable and actuarially sound?

A. Yes. I see that.

Q. And other than the hurricane loss adjustment expenses, the rest of those were calculated by ISO?

A. Yes. They were.

Q. Is it your understanding that in this case, with regard to the historical losses, the ISO used what's called a two-step formula to diverge between the historical losses and then the prospective ones.

A. Did you say a two-step formula?

Q. Yes.

A. Yes. I'm familiar with that.

Q. Okay. Could you explain what that is?

A. In the process of trending losses, maybe by contrast, a one-step process would be to select a single loss trend factor and determine how many years to trend or to project each of the historical accent (phonetic) periods into the future. So you select a trend rate and you apply that to all the years.

To add precision and responsiveness, many companies, including the Rate Bureau, use a two-step approach where they make one selection for the historical time period and a separate selection for what they call the projection period.

So typically, the end of the historical period is either the midpoint or the end of the most recent accent year in the experience period. A separate trend selection is made for that because you can observe history and identify what the trend is over that time.

And it's typically a narrower range of trend selections to make. It's a little bit more of a, if you want to say, a straightforward process. Obviously, to project things into the future, it's a wider range of potential selections there because that's unknown.

And so it's a little bit more straightforward or easy to pick the historical loss trend for the projected trend. Actuaries would also maybe look at the last several years to see are those trends changing.

If the trend is significantly increasing or decreasing in the most recent year or two, you can reflect that in the projection period. It may not be appropriate to apply that if you only use the one-step approach over the historical and the projection.

So the two-step breaks it up into historical and projection to allow for really reflecting the historical data separately from where you think the future experience will be.

Q. And you said many companies use that in addition to the Rate Bureau?

A. Yes.

Q. Okay. Have you ever used it?

A. Yes.

Q. Now, where you have calculated historical and prospective losses, have you ever become aware of subsequent data? For example, a subsequent data on a subsequent year's losses that caused you to change your calculation?

A. No. That's typically not the way a rate filing process works. When a rate indication or a rate indication supporting a rate filing is submitted, that historical experience, that analysis, that rate indication is what is being evaluated in the filing. To introduce new data as a separate filing.

I, in my earlier comments, I talked about the delay in reviewing and approving filings. Typically, there's no need to update the data if the filing is reviewed within 30 or 60 days.

North Carolina is unique, especially with Rate Bureau filings, where it has been over ten months since this filing has been submitted. The analysis was done well before that. We talked about the timeframe for that.

I can't think of any other insurance company, individual insurance company, that would be in a situation like this where the -- it would even be feasible to introduce new data. So the -- the delay in the regulatory process here is what provides even the opportunity to consider this.

It's not what actuaries do. We don't -- we don't introduce new data into a filing that's already been submitted. That's a whole separate analysis. It's a whole separate filing.

Q. Are you familiar with what the 2014 Commissioner's order, how it addressed the -- respect the -- the loss trend, in particular, the data that was available for analysis?

A. I believe I have a high level understanding of that.

Q. Okay. Do you recall that the Commissioner said that, for his purposes, he can take notice of subsequent data that has revealed itself after the data period that you were looking at?

A. I didn't recall that detail. I do not recall that detail.

Q. So let's see. On page 7 of your report -- actually, one second, Your Honor.

On page 8, first full answer about midway down. When you state, I'm also familiar with the assumptions selected as inputs to each model, and it is my opinion that the assumptions were applied consistently in both the AIR and RMS models, such that the resulting output of both models is comparable. Do you see that?

A. Yes.

Q. Okay. Are you familiar with the term black box to describe models?

A. Yes.

Q. Is that a common term for -- among actuaries to describe particularly catastrophe models?

A. No. I wouldn't say that actuaries consider catastrophe models to be black boxes. I hear that term more in reference to statistical models, generalized linear models, things that are some of the -- the more complex versions of those you get into -- this is going to go down a statistical road there, but neural networks and GBMs and different types of modeling like that where it's not easily explainable.

For actuaries, catastrophe models are explainable. There are different components to it from the meteorological aspect, the damaging aspect of it, the exposure aspect of it. When the industry refers to black boxes, that implies that there's just uncertainty and a lack of information and a lack of disclosure. And that's not the case with catastrophe models.

The -- the modelers disclose as much information as they're able to, to explain it, to allow regulators to be comfortable with it, and to approve it. There's proprietary information that cannot be shared. You know, the -- the proprietary information around the meteorological data or how the engineers are -- are assessing the damage to structures.

But the actual just the way the kind of general overview of how the model works, enough information has been shared that my opinion is actuaries would not consider that to be a true black box, that there's enough understanding to be comfortable with the modeling process and to be comfortable with the results.

Q. Okay. You just spoke about engineering. For lack of a better term, I'll call it inputs, to the models that can't be shared.

A. By engineering, I meant, like, engineers that are building and constructing buildings.

Q. Right.

A. Okay.

Q. I -- for instance, with regard to homes, the durability of --

A. Right. Right.

Q. -- homes. Okay.

A. Sorry. Some people use engineering in talking about even modeling, engineering the data, engineering.

Q. I've represented the North Carolina Building Code Council for four years. I got some understanding about the broad array of engineers there.

So you say that that -- the modelers can't -- is that -- the model, the companies that create the software can't reveal how they're in -- what their assumptions are as far as engineering?

A. I suppose they can. I would say maybe they choose not to. I mean, that's -- that's what would make one model different than the next. I mean, that's what makes the AIR different than RMS is all the components that they would use to build that model. So --

Q. I'm sorry. I misunderstood your testimony. You were explaining the difference between RMS versus --

A. You asked if engineers can or can't disclose information.

Q. I guess I should better say the software makers who create the models. Can that -- you said that they can't -- I understand is that when you're talking -- you're not talking about whether or not Ms. Mao, for example, can disclose the engineering assumptions that have gone into RMS. Are you?

A. No. I'm talking about AIR and RMS.

HEARING OFFICER FUNDERBURK: Mr. Friedman, can you restate the question so we're clear where we are?

BY MR. FRIEDMAN:

Q. So, I'm distinguishing between the user of the model, which would be, in this case, Ms. Mao, and the creator of the model. I referred to them as the software maker. But -- and in this case, when you say that the engineering standards that have been programmed in as assumptions to the model cannot be shared, they won't -- that is they won't be shared by AIR and RMS, correct?

A. This is getting beyond my expertise. So I wouldn't say the engineering standards, but maybe the way those are applied in the modeling or the way, again, the weather patterns are simulated. It's how these different components are being simulated or estimated. That's the proprietary information of each model that would not be shared with the public.

Q. Okay. When a person is using the model, such as Ms. Mao, reports its results, do those results contain some part of -- let's just put it this way -- are the losses in the results based on some part of the model that does address the durability of a house? The engineering of house?

Is it your understanding that the model you may not know what engineering assumptions are built into the models, but is it your understanding that when you use the models and get the results, the model is taking into account, for example, that all the homes on the coast in North Carolina may be made of Styrofoam?

A. I understand your question. Yes. The output or the results of the model would reflect the components that go into that model, which would include, among other things, the engineering component

of that, the damageability function. Did I answer your question?
Q. It does.
A. Okay.
Q. It does. So is -- the user of the model, how can the user cross check whether those damageability assumptions are at all accurate?
A. I can't speak for what Aon does to validate the models. I'll resort back a little bit to when I worked at Allstate. So this is -- this occurred a number of years ago, 20 or so years ago. But when Allstate -- so this isn't even directly applicable to Allstate today.
But when Allstate might evaluate the use of different modelers, different vendors, we would evaluate -- we would rely on kind of the validation of those models so that the modelers may -- may simulate historical events that actually occurred.
So in 1995, they could have re-simulated Hurricane Andrew, and they can -- they could compare their actual modeled losses to what actually happened during the actual event. So you can -- you can rerun old events on the models today and compare an actual to predicted. That's a very common approach.
They can do other validation techniques and can

even adjust some of the different assumptions in the models and show companies how that affects the results so they can assess is option A reasonable or is option B reasonable.

So the assessment of the components and of the assumptions and of the proprietary information is really done through, I want to say, kind of scenario testing or these validation exercises where they can see the results that are generated in different scenarios and determine is this reasonable.

Q. So is my understanding correct that those validation methods you can engage in for a model would test the overall losses against the overall model losses?

A. Overall for what?

Q. Let's use hurricanes as an example. When you -- you were talking about validation methods for hurricane losses that are modeled.

A. In a state, in a country, in a year? I mean, what -- what -- what model or what losses are being compared?

Q. North Carolina.

A. So what would you like to compare?

Q. If you -- are you able to validate -- well, first of all, you don't -- the user of the model does not know what portion of the model losses are specifically attributable to the quality of home construction in North Carolina. Is that right?

A. Right. Right.

Q. And when you go back and validate, do you happen to have that data?

A. No.

Q. Okay. As to meteorological assumptions in the models, I understood your testimony to also be that the model makers -- RMS, Aon has its own models, AIR -- don't reveal the proprietary data regarding what climatological assumptions they built into the model.

A. That's my understanding.

Q. AIR is owned by Verisk, isn't it?

A. Yes.

Q. And it, in fact, does business under the name Verisk nowadays?

A. That's my understanding.

Q. ISO is owned by Verisk and does business as Verisk nowadays.

A. That's correct.

Q. Okay. And Aon owns its own type of or has its own type of modeling that at least is not reflected in the Aon data here. Is that correct?

A. I'm not aware of that. I'm not certain.

Q. Did the Bureau request that Aon specifically combine the results for hurricane losses, not the CAR, not the net. But for hurricane losses, did Aon -- did the Bureau request that Aon combine the results from the AIR standard model and the RMS historical model?

A. Actually, the statute requires the Rate Bureau to consider two models.

Q. I'm speaking, though, as to those two particular models. Do you know whether the Rate Bureau asked Aon to use those two particular models?

A. I don't know that specific discussion as to if direction was provided, if a recommendation was made by Aon. So I don't know that exact interaction there.

AIR and RMS are certainly the two most well-known, I would say, the kind of the longest tenured CAT model vendors as far as, again, just being widely known and used throughout the industry. So those two certainly come to mind frequently when hurricane models or CAT models are discussed.

Q. Are you aware that it was not the AIR standard or the RMS historical, but rather the AIR WSST and the RMS medium term that were specifically used for the calculation of the net cost of reinsurance as well as the CAR?

A. Yes.

Q. Okay. Do you know whether the Bureau instructed Aon to use those models for that limited purpose or whether Aon chose to?

A. I believe the Rate Bureau would have directed, given that direction, based on input and guidance from Aon about what is used and done in the industry. When pricing and -- and Ms. Mao is -- is more of an expert in this area, but when reinsurance contracts are priced, they consistently rely upon the warm sea surface temperature model and the medium term model. That's the way reinsurance is priced, and therefore that's what was used as the basis of the Rate Bureau's analysis.

Q. Did you review the modeled loss results from -- that Aon provided from, on one hand, RMS historical and AIR standard, versus, on the other hand, Air WSST and RMS medium term?

A. I don't recall if I had -- if I was -- if I received data that showed the two models separate from each other, I believe the information that I was provided to review the output was the blended version of the models. So AIR and RMS were already combined at that point.

Q. But -- okay. Better said this then. Did you see on one hand the combined model losses of AIR standard and RMS historical combined?

A. Can you repeat that again?

Q. Sure. Did you see on one hand the model loss results from AIR standard and RMS historical combined?

A. Yes.

Q. Did you see, on the other hand, the modeled loss results from AIR WSST and RMS medium term combined?

A. I'm trying to recall from the reinsurance, the net cost of reinsurance analysis. The starting point of that calculation is the calculated reinsurance premium. And the Rate Bureau then subtracts the modeled losses corresponding to those layers related to the standard and the long term model.

The ratepayer would not need the modeled losses from the warm sea surface temperature medium term to do that calculation. So I'm not sure if they were available in that analysis file or not.

Q. So you don't recall seeing them?

A. I don't recall seeing them.

Q. Do you recall seeing any data in the results from the hurricane models, any of the four that made a distinction between the hurricanes that made landfall in North Carolina versus those that didn't? The models hurricanes, I should say.

A. Yeah. The only time I saw that distinction was when the filing was put together, and I believe it's Exhibit F in the filing that has all the detailed hurricane data. That's the only time where that level of detail is provided to see where the events made landfall.

Q. So Exhibit F in your recollection shows which modeled hurricanes made landfall outside of North Carolina versus which modeled hurricanes land fell in North Carolina?

A. That's correct.

Q. For those modeled hurricanes that had landfall outside of North Carolina, do you recall any data in Aon's data that distinguished among the strength of the winds once that non-landfall hurricane reached North Carolina?

A. In Exhibit F that has that level of detail, there was a category of the storm, but the standard industry practices of that is measured at the time of landfall. That's -- that's the way the modelers identify the category of the event is at the time of landfall or maybe a small distance off of shore. It's very near to the time of landfall.

And I believe if you go to the NOAA website, National Oceanic, they're -- again, they're the government entity that is the expert on hurricanes. They also identify the category of the storm based on when it made landfall.

There are historical storm tracks that may identify a higher category throughout the storm track, but when a category of a hurricane is identified, it relates to the time of landfall.

Q. Is it possible that if there is a Category 5 -- well, let's just, regardless of the category, if there is a modeled hurricane based on that simply is a hurricane based on, I think, the 75-miles-per-hour standard that hits South Carolina that by the time it actually comes to North Carolina, will not any longer be a hurricane because it's no longer has wind speeds of 75 miles an hour?

A. What's the question in that?

Q. Is it possible that if something -- if an actual hurricane hits South Carolina, it's a hurricane because it's winds are over 75 miles. By the time it hits North Carolina, it is no longer classifiable as a hurricane?

A. Yes. That's -- that's possible.

Q. Okay. To your knowledge, do -- in modeling North Carolina losses, do AIR or RMS take that into account? The fact that it's modeled hurricanes may no longer technically be hurricanes once they hit North Carolina.

A. What do you mean by take into account? What would they do with that to take --

Q. Would their losses in North Carolina for a non-North Carolina landfall event be based -- their calculation of North Carolina losses -- be based on the strength of the modeled hurricane in whatever other state it made landfall? Or would it be based on the actual wind speed by the time it reached North Carolina?

A. There are modeled hurricane losses in North Carolina attributable to an event. Some kind of a named hurricane or named storm. The category of that storm is based on when it makes landfall. So whether it makes landfall in North Carolina or South Carolina or Florida as a Category 4, regardless of what it is when it gets to North Carolina, it's categorized as a Category 4 based on the time of landfall. And if it generates modeled losses in North Carolina, it will be in the dataset.

Q. So the modeled losses, as for example, there's a model hurricane that hits Florida, Category 4. Are the model losses for North Carolina, once it reaches here, based on the damage that a Category 4 hurricane can inflict even though that may no longer even be a hurricane when it hits North Carolina?

A. Are you asking if the losses in North Carolina would represent or reflect a Category 4 hurricane?

Q. Yes.

A. No. That -- the path of the hurricane is part of the modeling process. It's simulated, and that includes a weakening of the winds. It would include the corresponding rainfall and the wind speeds and things like that. So I'm sure there are others tens of thousands of rows of data there.

But if we went through, we could find a Category 4 storm that made landfall in Florida that only had $50,000 of losses in North Carolina because that simulated storm died down so much that there were barely any winds, therefore, barely any losses in North Carolina.

So through the modeling process, the modeled losses in North Carolina represent the state or the condition of that storm when it's affecting North Carolina.

Q. Okay. Thank you for clarifying that. Does -- do the RMS and AIR models only measure hurricane strength events?

A. I'm not 100 percent certain. That might include some tropical depressions. If it's -- it may include named storms, which includes tropical depression sometimes, so there would be a lower threshold for that. Again, that would be something that Ms. Mao would be able to articulate.

HEARING OFFICER FUNDERBURK: And Mr. Anderson, I'll note we're -- we're planning to go till 4:00 today. You've been on the stand about an hour and a half. Are you fine to proceed, or do you need a break?

THE WITNESS: I'm okay.

HEARING OFFICER FUNDERBURK: Thank you. Please proceed. I'm sorry to interrupt you.

MR. FRIEDMAN: No problem.

BY MR. FRIEDMAN:

Q. For a tropical depression, what's the wind speed necessary for it to qualify as one?

A. I'm not sure. They don't get nearly as much attention as hurricanes.

Q. Right. So those -- would that -- those be better questions posed to Ms. Mao?

A. Yes. Yeah. I would suspect it somewhere, I don't know, 50, 60 miles an hour. Obviously, something below that 75-mile-an-hour threshold.

Q. Could you go to page 9 in your testimony?

A. Okay.

Q. Top of the second full paragraph in -- on that page, where you're discussing the demand surge. Could you explain what a demand surge is?

A. When a major catastrophic event occurs impacting a single state or multiple states because of the widespread damage in a localized area, there's typically a noticeable increase in costs for labor and supplies because of the increased demand.

So this is the law of supply and demand. When the supply is low and the demand is up, the costs increase. So that's what this is intended to reflect is that it's measurable, it's noticeable. There have been enough historical events to observe the impact of this increased demand on labor and materials when a major event occurs.

So the model without demand surge would just reflect the damage done on the insured value of the home. So if it's a $100,000 home, it would it would reflect damage on a $100,000 home.

But if an event were to occur, it may cost X percentage more than that to actually rebuild or repair that home because of the increased demand and the lack of supply in the area.

Q. Is the demand surge in one state surrounding a hurricane the same as the demand surge in an adjoining state from the same hurricane entering it?

A. I guess I don't know that for certain, but I would imagine that it would differ. That's where damage is more widespread, and there's a greater increase in demand, the impact of that demand surge would be greater, again, maybe at the point of landfall as opposed to 500 miles inland.

Q. And by demand in that context, would that include simply how many people's homes were there that got affected?

A. Yes. Which then has a resulting demand on materials and rebuilding costs and things like that. But, yes, it's based on the number of homes or policies affected.

Q. You ever calculated demand surge or reviewed results from a hurricane model of demand surge?

A. I have not calculated, but I have reviewed results from a model that include demand surge.

Q. When they calculate demand surges, they place a percentage on it. Is that fair?

A. Yes.

Q. Have you ever seen a hurricane model whose demand surge calculation varied between states?

A. No. That adds a layer of complexity and uncertainty that it kind of goes beyond the purpose of the hurricane model. You know, the hurricane model is simulating tens of thousands or 100,000 years, and it is averaging all this information together.

Similarly, the additional costs for demand surge represents an average across all of the areas that might be impacted by an event. So, again, to try and measure and estimate the precision and granularity of localized demand surge would be exceptionally difficult.

Q. Would you agree that the demand surge, if you had a -- if you had a hurricane that first hit Florida and moved up to Alabama, the demand surge could be different simply because there are fewer people living in Alabama than Florida?

A. It could be different for a variety of reasons. That could certainly be one of them is the number of people or the population.

Q. Okay. And yet you've never seen a model that differentiated between what the percentage of demand surge there was in Florida -- this is just a hypothetical -- versus what it was in Alabama?

A. I have not seen that. No.

Q. Our demand surge functions in hurricane models based on actual past historical expenses for demand surge?

A. That's my understanding that the -- that that component of the model would be based on historical experience. They would look at the impact of past events and, yeah, and compare the impact that additional demand surge on each of those events.

Q. So the models, although they are modeling historical losses without necessarily any data on actual hurricane losses. First of all, is that your understanding that what was done here that the measurement of the hurricane losses was purely modeled?

A. Do you mean the measure of the hurricane losses in the filing?

Q. Yes.

A. And are you asking if the hurricane loss component is strictly based on model losses?

Q. For the AIR and the RMS that Ms. Mao used, was that strictly modeled?

A. If I'm understanding your question

correctly, the or the hurricane loss provision in the filing is based strictly on modeled losses.

Q. Okay. But it is your understanding, as I understand, from what I take from what you just said, that even though the hurricane losses are not based on actual historical hurricane data, the demand surge function of that same model is based on actual demand surge prices?

A. I believe so because of the ability to measure the impact of increased demand is -- is objective. It can be measured. It can even be monitored over time if that increases or decreases over time. It's not possible to measure hurricane exposure looking at a 5-year, 10-year, 20-year time period. I mean, modelers are simulating, as you probably know, 10,000 or 100,000 years.

In that sense, hurricane exposure can't be measured objectively by looking at historical experience. There isn't enough historical experience to measure that. There is enough experience to measure demand surge.

Q. I appreciate that. Thanks so much. Going on to going to page 10 of your report. About midway down, you are talking about the other acquisition expenses.

A. Yes.

Q. And the second paragraph in that answer distinguishes between the fixed expenses for homeowners versus the fixed expenses for tenants and condominium owners.

A. Yes.

Q. And the filing sets the fixed expenses for tenants and condominium unit owners at 50 percent of the expense to homeowners.

A. That's correct.

Q. What is that 50 percent calculation based on?

A. ISO would better be able to answer this question, but I believe it's based on judgment, informed judgment, knowing and understanding that the expenses that correspond to tenants and condo are lower than the expenses corresponding to owners. This were based on how the data is collected and aggregated. I'm not sure that the specific level of detail would be available to quantify this. So this was the Rate Bureau's best estimate to reflect the fact that the expenses are different and to develop a reasonable estimate to do that.

Q. Have you ever seen any actual data from the Rate Bureau reflecting the difference that their members reported or their fixed expenses for tenants and condos versus their fixed expenses for homeowners?

A. I have not seen that data. No.

Q. Do you know if they ever asked for it?

A. I don't know if they've asked for that.

Q. Have you -- you said inform that they have judgmentally selected 50 percent, and I believe you said on some informed basis?

A. Yes. That's correct.

Q. Do you know what that informed basis was?

A. Member companies are -- are participating on all the committees so they can, without disclosing proprietary information, they can certainly share their company experience with, again, the relative differences in things like other acquisition expenses between forms. They could confirm that there is a difference or whether there is not a difference between these.

So the Rate Bureau does have access or they have information from the member companies to assess whether this is a reasonable assumption. I'm not sure if there is other specific data that might be available, but certainly, the discussions at the committee level and getting assurance or affirmation from the committee members, from the member companies, is a -- is a good reasonability check on this selection.

Q. So you stated that the Bureau members may not be able, for proprietary reasons, to share the actual fixed expenses for tenants and condominiums with the other members of the -- of the Bureau?

A. Well, at -- at committee meetings, member companies can't talk about proprietary information. I mean, they have to be careful about, you know, antitrust laws and things like that.

Q. Do you know whether North Carolina homeowners' carriers that are members of the Bureau actually internally keep data on the actual fixed expense load for or the actual fixed expenses of tenants and condominiums policies?

A. I don't know that.

Q. Have you seen in other states' carriers where you're dealing with a single file or carrier that have kept that data?

MR. BEVERLY: I'm sorry. A single what?

BY MR. FRIEDMAN:

Q. Well, I guess, I should say for a company that is filing its own rate request, have you said that -- you said you've worked on homeowners' filings for individual companies in other states. Have you seen whether those individual companies internally keep the data on the fixed expense loads for tenants and condominium owners versus homeowners?

A. This level of detail in the data isn't commonly displayed in a rate filing. Oftentimes, the expense provisions would be reviewed, and they'd be summarized across all of homeowners, which is what this filing -- so owners, tenants, and condos would be combined.

So I haven't specifically looked for this information in other filings. I would suggest that that's probably a low probability to find it, just because most companies would keep it at the aggregated level, but it's -- it's possible that it would be available.

Q. Do you recall the conclusion in the 2014 order about the 50 percent load for fixed expenses that the Bureau assigned to tenants and condominiums?

A. I do not recall that. No.

Q. Do you know if there was a time in the past when the Bureau did not assign a 50 percent fixed expense load based on judgment but used a different formula to assign the expense load?

A. No. I'm not aware of that. I might clarify. All this is doing is allocating the expenses among the three policy forms. So there's like a fixed bucket of -- of other acquisition expenses, and this is just allocating it to the policy form.

So it's not removing expenses or costs out of the system or adding some in. It's just the allocation process. So --

Q. But it is affecting the premiums that a tenants and condo policy -- or policyholder will pay versus those that a homeowner's policyholder will pay?

A. Correct. So it would be reduced because that's a lower expense load. It would be reducing the premiums for tenants and condos, maybe possibly a modest amount, a moderate amount, because they are lower dollar premiums typically than homeowners.

So even a $10 savings might be more significant than it would be on a homeowner's policy. There's also a lot more homeowner's policy -- excuse me, a lot more owners' policies in the overall owners' book.

So the offsetting slightly higher premium for owners is, I would argue, negligible. So you have very few policies that are getting the benefit because tenants and condos are less represented, and the owners would only have to go up a little bit, so --

Q. You'd argue it's negligible, but you also said that you'd never seen the data split out at that level. Is that correct?

A. Well, in the rate filing, it's -- we can see the effect of this calculation. We could remove this adjustment and calculate it as a constant other acquisition expense applied to all of them and see the impact.

Q. What if you took the 50 percent judgmental call and cut it in half, would that be only a negligible impact on the premiums paid by tenants and condo owners?

A. What are you cutting in half?

Q. The 50 percent fixed expense load, if you cut that to 0.25.

A. So is the -- the relativity 0.25 or is the relativity back up to 0.75?

Q. For the tenants and condos, the -- the relativity is now 0.25.

A. Well, that would further reduce the expense component for those two policy forms.

Q. Right. Would the difference still be only negligible?

A. Well, it's not negligible on those two policy forms because those are smaller dollar premiums.

Q. Okay.

A. So again, only, you know, even a 10 or 15 or $20 reduction in their premiums could be a sizable percentage. If the offset is only a $2 increase on a homeowner's policy, if the average homeowner's premium is $1,000 that's two-tenths of a percent. So the -- the negligible impact is on the owners.

So this is an effective way to allocate the costs, giving a recognizable benefit to tenants and condos with a minimal impact on owners.

Q. Okay. Thank you. Turning to page 13 of your report. Actually, let's turn to page 17. You've already referred to these yourself. But there are two paragraphs there. I'll just read the questions.

Assuming that the provisions for profit, CAR and NCR or net are reasonable, do you have an opinion whether the proposed rates reasonably provide the expected cost for homeowners' insurance in North Carolina? And you said, yes, if I assume that they are reasonable.

Do you, in fact, consider the calculation of the profit provision by Dr. Zanjani to be reasonable?

A. Yes.

Q. Have you ever reviewed any past Commissioner's orders or North Carolina Courts of Appeals decisions on the calculation of profit for the Department's purposes?

A. I'm familiar with, again, that 2014 order at a -- at a high level. The profit.
Q. What do you recall from that 2014 order about the Court of Appeals finding on the profit provision calculations done by Dr. Vander Weide and Dr. Appel?
A. So the high level recollection is that the Rate Bureau's profit provision was rejected. I don't remember the specific arguments or details or points of contention that led to that conclusion.
Q. And opining that Dr. Zanjani's calculation is reasonable, did you go back and see whether it resembled the calculations done by Dr. Vander Weide and Dr. Appel?
A. I did not make that comparison.
Q. Okay. Did you rely on the advice of the Bureau's attorneys as to whether Dr. Zanjani's calculation was in keeping with North Carolina's law?
A. Yes.
Q. Turning to page 14 in your report.
A. Okay.
Q. At the bottom paragraph, you state, for this filing, the Rate Bureau engaged Aon, one of the world's largest reinsurance brokers, to develop the provision for the net cost of reinsurance.

It is my understanding that Aon was retained by the Rate Bureau based on their ability to access relevant data and experience from the reinsurance market, their expertise with catastrophe-related issues, and their prominence in the reinsurance industry. This is consistent with prior homeowners' rate filings submitted by the Rate Bureau.

Do you know whether Aon, in calculating the net, actually relied on any experience as in actual net costs from the reinsurance market?

A. My understanding is that that's not the way reinsurance is priced. The net cost of reinsurance is really the end result of the whole process of purchasing and applying reinsurance and building it into rates. My understanding is that in Aon's analysis, they evaluated the prices for reinsurance in the market.

So it's the reinsurance premium is -- was the starting point, and that was really the focal point was they identified what a reasonable reinsurance contract would look like, where would it attach, where would it exhaust. They have models or techniques that determine reinsurers split things up into layers.

The first layer is $500 million and then a billion dollars. They have methods to optimize that, where they will reduce costs as much as possible or make that process as efficient as possible. But the starting point is reinsurance premiums.

And then the modeled losses that are subtracted out of that came from a different component of the filing that came from the modeled hurricane losses. And the net result then is the net cost of reinsurance.

So my understanding is that Aon's focus in doing their analysis is not on the net cost of reinsurance. It's on reinsurance premiums and the cost of purchasing reinsurance in the market.

Q. In Aon's data, did you see anything reflecting the actual price of -- of historical price of reinsurance premiums?

A. No. I did not.

Q. Okay. You stated that when you have calculated re -- or the net costs for, in other states, for single insurance companies, you have typically considered that data?

A. Yes.

Q. And you testified that it is possible for national homeowners' carriers that are also members of the Bureau and write homeowners in North Carolina to allocate their national costs, their national net cost for reinsurance to North Carolina?

A. Could you repeat the beginning portion?

Q. Do you recall your testimony an hour ago that it is possible for a national carrier that also does business writing home policies in North Carolina, homeowners' policies, to allocate its national net costs for reinsurance to North Carolina?

A. Yes.

Q. And you didn't see any of that data in Aon's calculation of the net?

A. What do you mean by that data?

Q. Yeah. The actual allocations -- the actual allocations of the actual premium price.

A. So I mean, that data would be proprietary, confidential data between Aon and their clients that can't be disclosed with third parties. That's a -- that's part of the client relationship between Aon and the companies that they do business with, similar to Milliman with our clients. That's not my data to share. It's the client's data. I can't share that.

So Aon, legally, as far as the contracts with their clients, they're obligated, they can't share that information. If I have access to that information in reviewing an individual company's reinsurance, it's because that company has given me that data to use for an analysis. It's not for me to share. It's for me to do an analysis for them, maybe submit a rate filing for them, but it's their data and it's their proprietary information. So these are two very different scenarios. That's not Aon's data to share.

Q. Assuming there were no proprietary concerns of the insurance companies in sharing their actual premium experience for the net cost of reinsurance, would that be helpful information to know in calculating the net costs for North Carolina?

A. That's a very big assumption. But if there were no proprietary issues, yes. I mean, additional data would be helpful.

Q. Okay. And to be clear, it is the insurance companies that have deemed it proprietary.

A. That would depend on the contracts between Aon and their -- their clients.

Q. Okay. But I think you did testify that -- have you entered into contracts with carriers that say the -- where the carriers are the ones who define what is proprietary and what you can't share other than with them?

A. Yes. Yes.

MR. FRIEDMAN: So, Your Honor, can I address the Court briefly?

HEARING OFFICER FUNDERBURK: On what?

MR. FRIEDMAN: On just the schedule.

HEARING OFFICER FUNDERBURK: Proceed.

MR. FRIEDMAN: So I'm going to go on now to the one calculation that Mr. -- not just ones he opined on, but the actual calculation he conducted, that is with regard to the contingency cost or contingency provision. I do not anticipate that my direct of him will necessarily be done by 4:00, but I will try to put in as much of it as possible unless the Court has other concerns.

HEARING OFFICER FUNDERBURK: Do you have any response, Mr. Beverly?

MR. BEVERLY: No. Your Honor. Onward.

HEARING OFFICER FUNDERBURK: Let's move forward. When we get to 4:00, we'll reevaluate exactly how much additional time we may need to take. As we discussed earlier, I am concerned about timeliness, and making sure that we're proceeding forward. So please -- please go ahead and continue.

MR. FRIEDMAN: Could I address that briefly, Your Honor?

HEARING OFFICER FUNDERBURK: I think we need to -- I think we need to finish your witness testimony.

MR. FRIEDMAN: Okay.

HEARING OFFICER FUNDERBURK: And then counsel can discuss the overall schedule, and we'll get back to that. But if -- I would like you to go ahead and proceed.

MR. FRIEDMAN: Absolutely.

BY MR. FRIEDMAN:

Q. Could you go to page 12 of your exhibit? Or, excuse me, your report.

A. Okay.

Q. So are you basing your calculation of the contingency provision only on the regulatory or supposed regulatory delays that you calculated? Or are you also basing it on the potential for adverse court decisions, extension of coverage for unforeseen or unintended exposures, or reduction in filed rate changes, and unexpected large losses?

A. Just to clarify, what's the beginning of that? Did I base my calculation, or did I base the contingency provision?

Q. Your -- your opinion about a 1 percent contingency provision being actuarially reasonable?

A. My opinion about the 1 percent provision being reasonable is based on all of those reasons, all those components.

Q. Okay. Can you tell me about any adverse court decisions in the past ten years that would have affected the homeowners' carriers in North Carolina?

A. No, I cannot.

Q. Do you know about any pending lawsuits that would contribute to a contingency provision?

A. No. I cannot.

Q. So with regard to reduction in filed rate changes, are you referring to -- does that include where the Commissioner has ordered a reduction in the recommended rate or by -- the recommended rate of the Bureau?

A. Yes. I believe that's wording that comes out of the ASOP, Actuarial Standard of Practice Number 30. That would be my interpretation of that language would be similar to yours where the company has requested a certain rate change and whether it's the Commissioner or just through the review and approval process a lower amount is approved or is agreed upon.

Q. So the reduction could be due to a Commissioner's order or a settlement for less than the requested rate.

A. Right. Yes.

Q. If it's due to a Commissioner's order, is the order that the rate that he adopts the legal rate, regardless of whether the -- the Bureau sought a higher rate?

A. So this ASOP, this terminology applies to more than just North Carolina. I understand we're applying it in this instance to North Carolina, but the concept of reductions and filed rate changes certainly applies universally across the state. So Commissioner decisions may or may not even be involved as to a contributing factor here.

Q. But in North Carolina, specifically, is it your understanding that if the Commissioner orders a rate that is less than the requested rate of the Bureau, then that is the legal rate?

A. I would defer to the lawyers to assign a legal label on that -- on that decision, whether it's the legal rate or what other label might be attached to that.

Q. But that is the maximum that a member of the Bureau can charge in North Carolina.

A. No.

Q. Well, without regard to --

A. A rate loss.

Q. Yes.

A. Yeah.

Q. Let's just say that whatever the variance in the manual rate, that is the maximum manual rate that a homeowners' carrier that's a member of the Bureau can charge in North Carolina.

A. That's correct.

Q. And if the Bureau enters into a settlement for less than its requested rate, that is -- that establishes the maximum manual rate that the members can charge?

A. That's correct.

Q. And if the Bureau decides on what the effective period for that rate will be in its settlement, that is the effective period that they have to abide by for the manual rate?

A. I believe the effective date in settlements isn't decided by the Rate Bureau. That would either be collaborated or the Department of Insurance would certainly contribute to the settlement date.

Q. Certainly. But what I'm asking is once it's been entered into, the settlement, that establishes what the effective period will be for the manual rates that the Rate Bureau members can charge?

A. Yes.

Q. And where the Commissioner orders that the -- there be a particular effective period, that order establishes what the effective period will be for the manual rates that the members can charge?

A. Kind of. I guess I don't consider an effective period. There's an effective date of the rate change, and at the time that's decided, we don't know how long that rate will be in effect for because we don't know when the next rate change will occur.

Q. We don't know when the Bureau will come back and ask for it.

A. Right.

Q. Okay. But at the very least then it establishes the effective date at the front end.

A. Yes. So these Commissioner orders and settlements certainly represent reductions in filed rates, which are actually added reasons for a contingency provision because the contingency, again, is the difference between the estimated cost and the actual cost.

And this reduction in rates, whether it's by Commissioner's order or settlement that you just asked about, is exasperating that. It's increasing the difference between the estimated rate and the actual cost -- the estimated cost and the actual cost. So that's actually more of a justification for a contingency provision.

Q. Okay. If the Bureau has entered into a settlement that establishes the rate, the manual rates, and the effective date, they sign off on that, why should they get to come back and ask for more afterward based on what they didn't get in the settlement?

MR. BEVERLY: Objection. There are any number of reasons, Your Honor, why a settlement might be reached. I suggest that's an improper question.

MR. FRIEDMAN: He's testified that the -- that's what is -- that policy or, excuse me, that factor reflects, and I'm just asking him whether or not once they've signed off on the settlement, why should they get to come back and say, oh, we really wanted more?

HEARING OFFICER FUNDERBURK: And can you explain, Mr. Friedman, how that's in the purview of an actuary giving an expert opinion on how to set rates?

MR. FRIEDMAN: Well, his testimony is that the contingency provision allows for the company to try to recover rates that it didn't agree to in the settlement or rates above what they agreed to in the settlement.

And what I'm asking him is whether or

not they -- once they've agreed in the settlement that those are the legal rates, why, as a policy matter or as from an actuarial perspective, they should be entitled to come back and try to get what they bargained away?

MR. BEVERLY: I'd argue, Your Honor, that the -- the entire premise mischaracterizes the testimony. That to suggest that the -- somehow the Rate Bureau has now agreed that the settled or the rate agreed upon in settlement is the adequate rate or the needed rate, that's just wrong.

HEARING OFFICER FUNDERBURK: The objection is sustained, Mr. Friedman.

BY MR. FRIEDMAN:

Q. Can you tell me if any -- any unexpected large losses other than hurricanes that occurred in North Carolina -- for North Carolina homeowners' carriers in the past five years?

A. Not off the top of my head. I would have to go back and look at actual experience or even news reports or things like that.

Q. So going on to RB-21. This is your calculation of the purported impact of regulatory delay on the contingency provision that's requested in this filing?

A. It's my calculation of the estimated impact on rates. It provides support for one of the reasons as to why a contingency provision is needed.

Q. And in order to arrive at this, you compared so-called regulatory delays among four types of residential policies. Is that correct?

A. That's correct.

Q. Those four types are Dwelling, manufactured home or Mobile Home F, Mobile Home C, and then Homeowners.

A. That's correct.

Q. Okay. Why are the alleged regulatory delays in Mobile Home C, Mobile Home F, or Dwelling relevant to the alleged regulatory delays in Homeowners?

A. Because the general rate review process and approval process is consistent. It's the same entity the Rate Bureau that is submitting the filing. The analyses are very similar between those four products. So the way the filing is presented to the Department is very similar. The components of each of those rate filings are very similar to each other. The people reviewing the filings are the same.

So all of the facets of the analysis are very, very similar. It's just a different line of business.

So the review process, the questions that might be raised, they're consistent across all four of the products. So that's the primary reason that this -- the rate review and approval process is very, very similar across all these -- all these products.

The other is that it increases the sample size. To make decisions off of one or two observations, again, as an actuary, the larger the sample size, the more credible it is, the more confident we are in being able to make reliable decisions.

I didn't -- I'd have to count the homeowners. If there's only three or four homeowners' filings here, it's hard to know if that's a trend or just an anomaly or if it's -- if it's reliable. Here we have 21 observations that we can -- we can make more reliable estimates or observations than if it's just three or four filings.

Q. So would you agree that the exposures for MHC are far fewer than those for homeowners?

A. By exposures, do you mean, like, residential properties?

Q. I guess I should say policies. Maybe that's a better term.

A. Yes. Mobile home would have fewer policies than homeowners.

Q. Both Mobile Home C and Mobile Home F forms?

A. Yes.

Q. It's the same for dwelling?

A. Yes.

Q. Okay. And the Rate Bureau, in your -- does it, in your experience, ask for different requested rates for Dwelling, Mobile Home C and Mobile Home F than it does for Homeowners?

A. Did you ask if there's different rates?

Q. Different requested rates. When it does an MHC filing, that requested rate is not necessarily going to be duplicative of what it requests when it does on homeowners filing.

A. That's correct. Yeah. These are standalone insurance products and standalone lines of business that have separate premium calculations, and the rate -- rate indications and the rate filings are separate.

Q. And in your experience, do the premiums among Mobile Home C, Mobile Home F, Dwelling, and Homeowners vary?

A. Yes.

Q. Significantly?

A. Premiums within each of those products vary significantly. I mean, the premiums for properties are -- depend on a lot of characteristics. The primary one is probably the value of that dwelling. I would -- well, it's not a stretch to say that the average value of a home is very different than the average value of a mobile home. So, yes, the premiums vary but as do the underlying characteristics.

Q. Are there fewer carriers in North Carolina writing mobile home policies than writing homeowners' policies?

A. Yes.

Q. Are there fewer carriers writing dwelling policies than are writing homeowners' policies?

A. I believe so. Yes.

Q. Okay. And are there some -- so by that token, there are some people, some carriers writing homeowners' policies that aren't writing mobile home policies. Is that fair?

A. That's correct.

Q. Likewise, there are some carriers writing homeowners' policies that are simply not writing dwelling policies.

A. That's correct.

Q. So in light of all those differences in numbers of policies among these four forms, in premiums charged among these four forms, and in the difference between what companies are homeowners' writers versus which ones are writing the other three forms, how can you say that the experience of mobile homes and dwelling are reflective of the alleged regulatory delay for homeowners' carriers?

A. Because the -- the review process, the analysis, the exhibits, the content of the filing is consistent, just because the numbers are bigger because it reflects more policies or more homes, the -- the review process is consistent across all four filings. It's still just one filing being submitted for each one.

So and with the consistent presentation of the data from one filing to the next, there should be consistency, or there could be consistency in the review process and understanding the way the data is presented and what have you.

So I'm not -- I'm not sure I understand why the number of policies or homes would affect the review process.

Q. Why should the homeowners' carriers get a contingency provision based on the regulatory delay for dwelling and mobile home carriers when those homeowners' carriers aren't even writing those policies?

A. The -- the contingency provision as implied by the name, it's -- it's a contingent provision for this difference between the expected and the actual costs. It's a provision to account for unknown things that may occur, large losses, judicial court -- judicial decisions, things that are unpredictable, they're difficult to quantify.

In prior settlements or rate filings or negotiations with the Rate Bureau and the Department, it's been mentioned that, you know, there was no support for the contingency provision. So this was an attempt to -- we identified that among the list of reasons that are included in the actuarial standard of practice, we identified this one can be quantified.

So here is the Rate Bureau's attempt to quantify, to respond to that question or objection that it's not supported. So we've -- we've done that. The Rate Bureau has done that. They're quantifying one of the reasons for the contingency provision to -- to adjust how we can actually put some numbers around something that in the past had been unknown. So this is actually addressing a concern of the Department in response to questions that they've raised in the past.

Q. So I recognize that this is an attempt by the Bureau to quantify some support for the contingency provision. But you understand the questions I've just gone through in the past 15 minutes are not about the fact that y'all tried to quantify it, but rather about the quality of that quantification. Do you understand that?

A. Yes.

Q. Thank you. Now --

A. I would note that just visually looking at this exhibit, if we pared it down to just homeowners, the indicated impact would increase. So if you would you know, if -- if there's a preference to focus on just homeowners, it's going to actually increase the contingency provision because there's greater uncertainty, greater delays on homeowners' filings than the other -- than the other filings. So that adds to the uncertainty, and it adds to the need for this provision in the filing.

Q. You testified earlier, as well, though, that you don't go back based on data that isn't included in your report and recalculate the report. Is that fair?

A. Yes. I'm not suggesting we did that. You asked about limiting the data to just homeowners.

Q. Now, when you say regulatory delay, what do you mean by that term? What are the types of things that can constitute, in your opinion, regulatory delay?

A. Yeah. As an actuary, when we use the term regulatory, it's really, I would say, almost anything related to kind of insurance department activities. So we'll talk about the regulatory environment or the regulatory requirements.

So the regulatory delay is, in this instance, I would say is any delay associated with once the filing is in the hands of the insurance department. You know, whether that is entirely due to the insurance department processes or whether it's simply the interaction of the two entities in the filing process.

It's -- this is simply the -- the result. We can observe what has happened in the past. I can't explain why there's a delay, but it's measurable, and it's consistent, and it's evident, and it exists. So we -- we quantified it.

Q. Is some of that delay attributable to the Bureau?

A. I don't believe so. The assumed effective dates, when rate filings are made, in my opinion, have a significant cushion built into them. They are projected well beyond an effective date that an individual company would use.

So from my perspective, there is sufficient cushion, sufficient time for that review and approval process with the assumed effective date. The fact that filings can't be resolved until beyond that, it represents, again, just the -- the North Carolina regulatory environment.

Q. Okay. So I understand better, when you are speaking of regulatory delay, you're speaking of the period between the filing and the resolution. Or you speak -- also including the time that the Bureau spends preparing for the filing?

A. It's just the former. It's the delay occurs once the filing is submitted. And we're not quantifying the length of time for the review process. That would be -- well, we're at ten months so far right now, so it'd be over 300 days right now.

This is just between -- the difference between the assumed effective date, which is well in the future when the filing is made, and the actual effective date by the time the filing is settled or approved or -- so it takes so long to get to that process that even this generous assumed effective date has to get pushed out further.

I believe the assumed effective date for this homeowner's filing was 10/1/2024. Well, that was last week.

Q. Would the effect of that regulatory delay be cut down if, say, the hearing officer in this case ordered that the new rates she were to adopt the Commissioner was to adopt be trended from the original requested effective date to the actual one?

A. Can you repeat that again?

Q. Would your estimates -- are you aware that in 2014, the Commissioner ordered that, although he had already -- the hearing was taking place after the effective date of the filing, in the filing, and although his order came down after the effective date in the filing, but nonetheless, the -- all of the provisions be trended forward until the effective date that he ordered?

A. I was not aware of that.

Q. Okay. Would that affect your contingency provision in term -- just in terms of the effect of regulatory delay?

MR. BEVERLY: I'm sorry. You mean if that were to be done in connection with this case when the order is issued?

BY MR. FRIEDMAN:

Q. In general, where you have a Bureau filing that has a requested effective date, but it isn't resolved until after that requested effective date. If the resolution allowed for trending from the requested effective date to the actual effective date, would that, at the very least, diminish the effect of regulatory delay that you've calculated here?

A. So that's unprecedented. Again, effective dates typically aren't changed once a filing is submitted. I guess what concerns me is if the filing is already resolved, there is a settled rate change or an approved rate change that has already been agreed to. Changing the effective date would change the indicated rate need. It would not change that resolved rate change.

So if the indication was 20 percent and they -- the Department and the Rate Bureau settled on a 5 percent rate increase, and now if -- if the Commissioner said we'll go back and change the effective date, that's going to take the 20 percent indication and maybe bump it up to 21 percent. Doesn't change the 5 percent settled rate change. It actually increases the gap between the required or the indicated rate need and what was settled.

I suppose if that marginal change, going from 20 to 21, that increase the indication by 1 percent, if that was then applied to the settled rate change, so 5 percent was taken up to 6 percent, that would eliminate this. But this would need to occur before a settlement or an approval, enters the equation because it changes the calculations of the rate indication.

Q. So assuming that --

HEARING OFFICER FUNDERBURK: Please speak louder or closer to the microphone.

BY MR. FRIEDMAN:

Q. Assuming that -- let's -- purely hypothetical, but the Commissioner adopted what he said was the maximum legal rate, manual rate, that the Bureau could charge. And he adopted that rate and set the effective date six months after the requested effective date, but then ordered that all of the data supporting the rate that he adopted be trended forward until his ordered effective date, would that not eliminate the regulatory delay? Whether or not the Bureau agreed with the ordered rate, but at least based on the Commissioner's reasoning, would that not eliminate the regulatory delay?

A. No. I mean, the ordered rate is what it is. The changing of effective date impacts the indicated rate need. So the indicated rate need could move up and down, and the ordered rate is what it is. So we could include a new year's worth of experience.

We could, I don't know, change covered provisions. We could do all kinds of things to adjust the numbers, which affects the indication. But if the ordered rate is a 5 percent increase, it is what it is.

So again, if the indication was 20 percent and Commissioner agrees to 5, the Rate Bureau would say there's still a 15 percent rate need left on the table. It would impact the remaining rate need.

So the Rate Bureau would theoretically want to turn around and say, hey, we still have -- we still need 15 percent more rate. If you add data or change effective dates, it will adjust that 15 percent that's left on the table. Maybe it goes up to 18, maybe it goes down to 12 or -- but it -- it doesn't change the 5 percent. So hopefully that makes sense. This --

Q. No, it does.

A. Yeah.

Q. So, I understand that the Bureau might not be satisfied with the rate that the Commissioner ordered. But assuming that that all plays out on appeal or that they don't appeal it -- let's just say they don't appeal it -- then at the least under the Commissioner's reading or holding on the maximum rate, if he trended it forward based on the data that he relied on --

HEARING OFFICER FUNDERBURK: Mr. Friedman, I'm not seeing a lot of -- it could just be me, but I'm not hearing a lot of difference in the last couple questions that you've asked. If you could be very careful to make sure that you are asking for additional information, I would be much appreciative.

BY MR. FRIEDMAN:

Q. One last question then on that. The reason that you say there would still be an impact from regulatory delay is because the -- if assuming, again, that the Commissioner trended it based on his findings, is that the Bureau didn't get what it wants. Is that correct?

A. No. That's not how I would categorize it.

Q. How would you characterize it?

A. When you say that the Commissioner is trending something, I'm not sure what that means or how it impacts the numbers. If the Commissioner would have otherwise approved a 4 percent increase and then he trended the numbers, he or she trended the numbers and -- and came up with a 5 percent rate change that he agreed to because of a change in the effective date, that might reduce the need for this.

There's still significant rate inadequacy on the table, but the -- the change that would need to occur to remove the -- to remove this portion of the contingency provision is that a change in effective date would have to be reflected in the calculations that then impacts the decision. If a decision is made before any changes are made, it -- it -- it just doesn't affect anything.

Q. Could that be worked out after the decision, so long as he ordered that it be trended?

A. It could be. Certainly, it's possible. Yeah.

Q. Okay.

A. Changing an effective date is relatively easy. It would not be a big lift or a big effort. There are other concerns about wanting to maybe add additional data, add an additional year of experience into the analysis.

That's incredibly time consuming, incredibly burdensome that -- I mean the committees would have to reconvene and reselect trends and go through the whole process again because you add a year of data and you drop off an older year of data, it affects the entire analysis. It affects every single component of it, the trends, the underlying loss experience, the modeled hurricanes and net cost of reinsurance.

So if you were to expand on this concept and say, oh, can we just add a new year of data? Again, that's a whole new filing. It's a whole new analysis, and we've heard or we've talked about how long that review process is.

You know, if the data was readily available, it's six to nine months for the Rate Bureau to review and approve the rate review process. If it means ISO has to aggregate the data, that's the 12- to 14-month time frame. Changing an effective date is very quick.

Q. And if it were only the Commissioner's actuaries who were trending it, that wouldn't be, then, a delay for the Bureau. It might mean that there was rate inadequacy, as you call it, but it wouldn't mean that there was a delay for the Bureau in trying to accumulate those extra six months of data.

A. Yes. I suspect the Rate Bureau would want to know what those calculations are and understand them. So --

Q. I have --

HEARING OFFICER FUNDERBURK: Mr. Friedman, do you have -- Mr. Friedman, do you have additional cross?

MR. FRIEDMAN: Yes. I have about one or two questions.

BY MR. FRIEDMAN:

Q. Could you turn to RB-18 in Book 1? And I'm trying to figure out exactly -- that is not your exhibit. I believe it is Ms. Mao's exhibit. Is that correct?

A. That's correct.

Q. Okay. And you've tested that the CAR is not intended to address assessments per se?

A. That's correct. It's not a provision for expected assessments.

Q. On page 5 of that exhibit --

A. Yes.

Q. -- do you see the columns that states cost of funding assessments?

A. Yes.

Q. And then on page 9, do you see another column including the cost of funding assessments?

A. Yes.

Q. Okay. So given that those are included in Ms. Mao's analysis of the CAR, do you still say that assessments are not, per se, the concentration of the CAR?

A. Correct.

Q. Okay. How do you reconcile those?

A. So the average assessments or expected assessments is really -- I would consider a subset of the modeled hurricane losses. And that might sound unusual but what is likely to trigger assessments would be a -- maybe a major hurricane event.

The modeled hurricane losses are built into the overall rate indication, determines the overall premium for the entire industry. A portion of that premium goes to the Beach Plan and FAIR Plan. It's intended to cover their share of the modeled hurricane losses.

Major event occurs. They run out of surplus. They need to issue assessments. Those assessments, again, correspond directly to hurricane losses that are already built into the rate indication through the modeled hurricane provision.

So assessments, average assessments, expected assessments, it's already in the filing, as they -- I mean, it's -- it's -- it's represented by the model hurricane losses.

Member companies get their share of the premium based on their exposure, their policies. They're collecting premium that corresponds to the policies they write. However, if the Beach Plan or FAIR Plan issues an assessment, the companies cannot recoup a significant portion of those assessments through some small portion that they can. They are now responsible for the Beach and FAIR Plan's share of the losses. The companies collected a premium for their share of the losses.

They did not collect premium for the Beach and FAIR Plan's share of the losses, but now they are responsible for that through the assessments.

So all the member companies need to hold additional capital, need to have additional money in the bank to pay for these potential assessments for losses attributable to the Beach and FAIR Plans' premium not corresponding to their premium. Their premium covers their losses. The Beach and FAIR Plan premium did not cover all their losses. They ran out of money.

Compensation for assessment risk is the compensation that's required on the capital that the companies are holding to cover these potential assessments.

Pick a member company. They have to hold additional money in the bank because they may get an assessment that they cannot recoup from the -- the policyholders. If they have more money in the bank to cover the assessments of the Beach and FAIR Plan. Dr. Zanjani testified on the cost of capital to have more money in that in capital and surplus has a cost associated with that, and that's what this is.

Q. So the CAR includes the cost of capital and surplus?

A. Trying to think of the best comparison here. I would maybe compare this to the net cost to reinsurance in a sense. Hopefully that -- hopefully -- I mean, essentially the insured -- the member companies are essentially reinsuring the Beach and FAIR Plan for this portion that could be attributable to assessments.

Q. So my question stands. The CAR is based, in part, on capital and surplus?

A. It is, yes. It is based on the need to hold more capital to cover potential assessments from the Beach and FAIR Plan. It is not -- the capital that they're required to hold is not funding their insurance operations. It's funding somebody else's insurance operations.

Q. And meanwhile, while they're holding that capital and surplus, is it invested?

A. Presumably so. Yes.

Q. Two last questions on direct. One --

MR. FRIEDMAN: Could I have -- could we have a five-minute break or a three-minute break even for me just to talk with --

HEARING OFFICER FUNDERBURK: You can

have a three-minute break.

(Discussion off the record)

HEARING OFFICER FUNDERBURK: All right. We're back on the record.

BY MR. FRIEDMAN:

Q. If the Rate Bureau made a homeowners' filing that was based on methods that the North Carolina courts had ruled were unlawful, and if it took the Department, let's say, ten months, to work out how they were unlawful or else to arrive at a settlement that was lower than the request because, in fact, those methods were unlawful, is that regulatory delay attributable to the department?

MR. BEVERLY: Object to form. I don't wish to be heard, Your Honor.

HEARING OFFICER FUNDERBURK: Sustained. Next question.

BY MR. FRIEDMAN:

Q. If the Rate Bureau submitted a filing that were based on incorrect data and it took the Department ten months to figure out what was incorrect about it and then negotiate a settlement that reflected the correct data, would that be regulatory delay attributable to the Department or the Bureau?

A. In the calculations on RB-21, it's

agnostic to what causes the delay. It's just that there is an observable, measurable delay. I'm not -- the Rate Bureau, I'm not concerned about what's causing the delay.

There's a consistent delay in the regulatory process here, regardless of who or what causes it, and -- and that's because it's quantifiable. That's the basis for this particular component that contributes to the contingency provision.

Q. So under your RB-21, even if the Department -- excuse me -- even if the Bureau caused the delay, they should still get a consideration in the contingency provision for that delay.

A. Yes.

MR. FRIEDMAN: Thank you. That's all I have on direct (sic).

HEARING OFFICER FUNDERBURK: Thank you.

Mr. Beverly, will you have redirect? And I'm also noting what time of day we're at.

MR. BEVERLY: Yes, Your Honor. We anticipate probably 20 minutes, maybe a tad more of a redirect, so we'll take direction from you. And we would need to level set, if possible, please, with Mr. Anderson and -- and our group in order to start. So I'd build in another 10, 15 minutes to that estimate.

HEARING OFFICER FUNDERBURK: Okay. So it -- it sounds like we're better served by doing redirect in the morning?

MR. BEVERLY: I will not oppose that, Your Honor.

HEARING OFFICER FUNDERBURK: Any concerns, Mr. Friedman? Okay. Then that's what our plan will be. We'll be back in session promptly at 9:00 a.m. tomorrow morning. We'll start with redirect of Mr. Anderson.

Sorry if you have plans to go home tonight. Okay. We'll start promptly at 9:00 a.m. with redirect of Mr. Anderson, expecting that to take in the range of 20 to 30 minutes, and then move on to, I believe, your direct of Ms. Mao.

MR. BEVERLY: Thank you, Your Honor.

HEARING OFFICER FUNDERBURK: All right. Thank you. We're in recess.

MR. FRIEDMAN: Your Honor, would you like to address on the record the issue of scheduling or timing? The time -- you expressed some concerns about the time it is taking.

HEARING OFFICER FUNDERBURK: Not -- not at this time. I'm mindful that we have said we would be gone at 4:00 today, and people may have family commitments that they need to attend to.

MR. FRIEDMAN: Oh, sure. Sure. So we need to speak about --

HEARING OFFICER FUNDERBURK: I want to get -- we'll -- we'll speak about that potentially tomorrow or Thursday.

MR. FRIEDMAN: Can I just understand, so I'm prepared to address, were you speaking about the timing as in getting out at 4:00 or the timing generally of the number of days it may take?

HEARING OFFICER FUNDERBURK: The timing generally of the days that it may take. We're in recess. Thank you.

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(Hearing adjourned at 4:21 p.m.)

CERTIFICATE OF REPORTER

STATE OF NORTH CAROLINA

COUNTY OF WAKE

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

This, the 8th day of October, 2024.

WENDY SAWYER, Court Reporter

Notary Public #202411500157

Commission Expires April 23, 2029