
**Revision of the
Rules of Operation of the
Commonwealth Automobile Reinsurers
Docket No. C2004-02**

**Decision and Order on Changes to Rules of Operation 2,
9 through 14, and 17, and Rules 21 through 40**

I. INTRODUCTION AND PROCEDURAL HISTORY

By letter dated April 29, 2004, the Commissioner of Insurance (“Commissioner”) directed Commonwealth Automobile Reinsurers (“CAR”) to change its Rules of Operation (“Rules”) because the current Rules do not provide for the equitable distribution of private passenger automobile insurance premiums and losses among Servicing Carriers. On June 30, CAR submitted to the Commissioner an extensive set of proposed changes to the Rules (the “Proposal”). The Proposal included amendments to Rules 2, 9 through 14, and 17, and a series of new Rules, numbered 21 through 40, that create a new assigned risk plan, the Massachusetts Automobile Insurance Plan (“MAIP”).

The Commerce Insurance Company (“Commerce”), pursuant to Article X of the CAR Plan of Operation (“CAR Plan”) requested a hearing on the Proposal. A hearing notice was issued on July 1, scheduling a hearing for July 22. Twenty-seven individuals spoke at the well-attended hearing; others submitted written statements. The record was left open until July 30. During that period the Commissioner received supplemental

statements from several of the participants in the hearing as well as comments from those who had not previously submitted statements.

On August 27, the Commissioner issued an order remanding the Proposal to CAR (the "Remand Order") to address concerns about its effect on the size of the residual market and its approach to issues of policyholder protection. She noted that testimony at the July 22 hearing had questioned the feasibility of some aspects of the Proposal, and had offered alternatives that were intended to improve the assigned risk plan. The Commissioner's Remand Order, in addition to identifying issues that appeared to be most problematic, also expressed concern about omissions from the Proposal, issues that CAR reserved for later consideration. She ordered CAR to submit a new Proposal no later than September 24, and scheduled a hearing on it for October 4. CAR timely submitted its new Proposal (the "Revised Proposal"). Upon examination, the Commissioner determined that additional time was needed to ensure adequate review by all interested persons, and continued the October 4 hearing to October 20. On October 8, CAR filed additional revisions to Rule 11, which addresses the allocation of CAR expenses and the profits and losses of policies ceded to CAR among CAR members. In recognition of the importance of these matters, the Commissioner continued the October 20 hearing to October 29, to allow additional time for analysis of the additional revisions.

The Revised Proposal followed the format of the first Proposal. Part I includes changes to Rules 2, 9 through 14, and 17, as they relate to private passenger automobile insurance, and establishes procedures for operation of the residual market until the MAIP is fully implemented as of January 1, 2008. Because they relate to a specific three-year time period, the Part I changes have been referred to as the "transitional" rules. Part II of the Revised Proposal relates to the MAIP. The October 29 hearing on the Revised Proposal, like the July 22 hearing, was well-attended. Twenty-five individuals spoke, and several others submitted written commentary. The record remained open through November 2; several additional written comments were received in that period.

On November 18, CAR submitted to the Commissioner proposed changes to CAR Rules of Operation 11 and 12. On that same date, the Plymouth Rock Assurance Corporation ("Plymouth Rock") requested a hearing on the proposed amendments; Commerce filed a similar request on November 19.

On November 23, the Commissioner issued a second order (the “November 23 Order”) concluding that CAR’s Revised Proposal, while responsive to some concerns expressed in the Remand Order, only partially addressed a number of critical issues that relate to successful implementation of an assigned risk plan that is fair to consumers, equitably distributes the burden of the residual market among companies, and which may encourage greater investment of resources in the market for Massachusetts private passenger insurance. Therefore, in the November 23 Order the Commissioner amended and redrafted portions of the transitional rules, CAR Rules 2, 10, 11, 12, 13, 14 and 17, and approved them, as revised, together with Rule 9.

With respect to the MAIP Rules in Part II of the Revised Proposal, the Commissioner amended Rules 23, 24, 25, 27, 33, 34, 35, 37, 39 and 40 to ensure clarity and consistency and, as revised and amended, approved them. In order to achieve the goal of creating a MAIP responsive to her express concerns, the Commissioner made more extensive changes that were incorporated into proposed Rules 21, 22, 26, 28 through 32, 36 and 38. As changed and amended, the Commissioner approved those Rules. The November 23 Order also scheduled a public hearing on all of the Rules for December 17.

By letters dated December 1, the Commissioner acknowledged the requests made by Plymouth Rock and Commerce for a hearing on CAR’s November 18 proposed changes to Rules 11 and 12. She pointed out that her November 23 Order, that was issued subsequent to CAR’s November 18 submission, was responsive to changes to those rules in CAR’s Revised Proposal. In order to ensure that all issues relating to Rules 11 and 12 were before the Commissioner at the December 17 hearing, she scheduled the hearings requested by Plymouth Rock and Commerce for the same date and time.

The December 17 hearing was, like those held on July 22 and October 29, well attended, although fewer of those present chose to speak or make written submissions. The record was left open through December 22 to receive additional commentary. Several such submissions were received.

At the outset, we note that, in general, we are accepting our November 23 Order as a final decision that has been subjected to some clarifications and minor revisions. Therefore, this Decision should be read in conjunction with the November 23 Order. The majority of the post-November 23 revisions are discussed herein; all are incorporated into

the two Appendices to this Decision. In order to facilitate an expedited understanding of these clarifications and revisions, we are producing two sets of Transitional and MAIP Rules. Appendix A constitutes the Final Rules that we approve in this Decision. Appendix B is a “red-lined” version that identifies all changes from the November 23 Order.

Our Decision addresses concerns raised at the hearing and in the written statements from interested persons, several of whom submitted specific alternative suggestions to the Rules as appended to the November 23 Order. Where we find that such language constitutes an improvement to earlier drafts, we have incorporated it into the Rules. Our reasons for accepting or rejecting suggested substantive revisions are, for the most part, addressed in this Order.

II. THE TRANSITIONAL RULES

We note at the outset that CAR has recommended a number of technical changes, generally in the form of editorial comments, intended to ensure consistent citations and formatting throughout the Rules. Such proposed changes do not affect the substance of these rules, and have therefore been adopted and approved. A recommended change that updates the exposure adjustment chart in Rule 11 to include newly approved motorcycle classifications is also adopted. Specific recommendations and suggestions regarding each of the transitional rules from CAR and other persons, in the form of both written and oral comments submitted in connection with the December 17 hearing are discussed below.

Rule 2

CAR recommends: 1) adding to the definition of the Manual of Administrative Procedures a reference to its acronym; 2) clarifying that the definition of the term “New Business” relates to the transition period between January 1, 2005 and December 31, 2007; and 3) substituting the definition of “Subsidy” as it appears in Rule 12 for the definition now in Rule 2. We have examined that definition and concluded that, with a single change that substitutes the word “combination” for the word “cell,” CAR’s suggestion is reasonable. We will therefore approve CAR’s recommended changes, including removal of the definition of “Subsidy” from Rule 12. In addition, we determined that the definition of “Representative Producer” required clarification, and revised it accordingly.

At the December 17 hearing, Commerce asserted that the definition of High Loss Ratio Exclusive Representative Producers (“HLR ERPs”) did not consider the effect of subsidies in the rates. Contrary to its position, we note that the selection of the threshold for identifying an HLR ERP, a 125 percent loss ratio for three years, was based on the methodology utilized by Tillinghast Towers Perrin in its report to the Commissioner. According to that report, an agency with a distribution of risk equal to the statewide average distribution would have an expected loss ratio in the 70 percent range. A loss ratio of 125 percent or more is sufficiently above that expected loss ratio to reflect any differences that result from subsidies in the rates. We therefore reject Commerce’s position that the rules require additional detail on the identification of HLR ERPs.

Rule 11

CAR recommends changes to Rule 11.B.1.a to clarify that exposures acquired by an HLR ERP through mergers or acquisitions of another producer will not be considered HLR ERP exposures for purposes of calculating participation ratios or determination of the HLR ERP deficit. We agree with this clarification, but note that CAR’s reference to voluntary “agent” should be changed to voluntary “producer.” In the second sentence, we also substitute the phrase “appropriate to those agencies” for the phrase “that would have applied.”

CAR proposes changes to Rule 11.B.1.d to clarify the calculation of participation ratios for new entrants’ shares of the HLR ERP deficit. It recommends splitting subsection d into three parts, to be lettered d, e and f. The changes make specific a formula for determining participation ratios for companies that CAR classifies as “Newly Emerging/Newly Writing.” We approve the principle underlying the proposed change, but will substitute the term “Newly Active Member” for “Newly Emerging/Newly Writing” company or companies in the heading and the text of the Rule, to make clear that the rule applies to currently inactive CAR members who resume writing private passenger automobile policies in Massachusetts. We have also revised Rules 11.B.1 and 11.B.2. to provide that, in addition to exposures for antique vehicles, exposures written by representative producers assigned to Servicing Carriers will not be included in the calculation of utilization ratios.

We reject CAR's proposed changes to Rule 11.B.2 that would limit eligibility for a cession exclusion incentive and subject cancelled producers to a K-factor of 13 to voluntary producers that had voluntary contracts with companies that qualified for Servicing Carrier status as defined in Rule 13.A. CAR's proposal would distinguish producers who have contracts with Servicing Carriers from those who have voluntary contracts with non-Servicing Carriers; we are not persuaded that such a distinction is appropriate. CAR has also raised a question regarding the handling, for participation purposes, of acquisitions of HLR ERP exposures by a voluntary agent or non-HLR ERP. The proposed Rules do not alter the current practice relating to the classification of exposures when an agency is purchased.

At the December 17 hearing, the suggestion was made to re-evaluate the sliding K-factor incorporated into these Rules in light of the change to Rule 12 that awards credits for retaining business written by all producers. K-factors are a method of controlling cession rates to the residual market, and are set by CAR. The Commissioner's stated goal is to limit the size of the residual market to no more than fourteen (14) percent of exposures. If it appears that, in order to maintain that cession cap, further adjustments are required to the K-factors, CAR is directed to prepare and submit for approval changes to the K-factors that will assist in achieving that goal. However, we will not, at this time, change the K-factors contained in the Rules incorporated in the November 23 Order, as they continue to be the best available means for accomplishing the stated goal.¹

Commerce also remains critical of the three-pronged approach to allocating the deficit; we have considered the alternatives and conclude that Rule 11, as revised, provides a fairer system for allocating specific deficits during the transition period. We remain unpersuaded that the rules should not be changed because companies, had they anticipated change, would have made different cession decisions. The purpose of the changes is to achieve fair and equitable sharing of the deficit and to limit the artificial manipulation in the marketplace.

CAR, and participants in the December 17 hearing, raised questions about retention in the Rules of sections that were deleted in the November 23 Order. The November 23

¹ Plymouth Rock, in a post-hearing submission, proposed an alternative by which the subsidy-adjusted deficit would be shared according to the "normal" Rule 11 utilization formula, using a K-factor of 2. However, because it did not model the result of applying its proposal, we are unable to evaluate it fully.

Order incorrectly referred to deletion of Rule 11.B.2.c, rather than to Rule 11.B.1.c. The purpose of the deletion was to remove the minimum allowable exposure penalty only as it related to HLR ERPs, and the correct section, Rule 11.B.1.c, was in fact deleted from the Rules in the November 23 Order. Therefore, the reference on page 63 of the November 23 Order should be corrected to state that Rule 11.B.1.c is deleted, rather than Rule 11.B.2.c. Commerce remains critical of the financial obligations placed on insurers who withdraw from the market for private passenger automobile insurance. We note that the November 23 Order makes clear the obligations that a company that withdraws during the transition period will incur.

Rule 12

CAR recommends changes to Rule 12.A.1 to define more precisely the calculations underlying the Policy Year 2005 credit provisions. It adds language clarifying that physical damage credits are to be calculated separately for the collision and comprehensive coverages, and clarifies the operation of the Subsidy Clearinghouse accounts in 2006. We have made minor adjustments to this rule in order to simplify and clarify the procedures for determining credits.

Plymouth Rock urges adoption of a credit system proposed by CAR on November 18 that, in essence, consisted of the traditional credit mechanism based on the subsidy matrix, only for voluntary and non-HLR ERP business. The proposed credits assumed that no credits would be offered for retention of HLR ERP business. We are persuaded that fairness dictates that credits be allowed for retention of all business, regardless of the source. We therefore decline to adopt Plymouth Rock's and CAR's November 18 recommendation. The goal of Rule 12, as in effect during the transition period, is to true up the rate for subsidies in all driver classes and territories, and thereby to encourage companies to write business in all geographical areas and for all driver classes. The traditional methodology is inappropriate to achieve that purpose. An alternative approach that would provide supplemental credits for particularly difficult driver classes and territories is not unreasonable, but a methodology would need to be developed that is not based on subsidies. No such proposal has been made at this time.

Rule 13

CAR questions retention of the first paragraph of Rule 13.A.1 relating to the requirements for becoming a servicing carrier and those sections of Rule 13.C.3 that prescribe procedures for subscription relief. We concur that, as of January 1, 2005, the first paragraph of Rule 13.A.1 will no longer be in effect and therefore should be deleted. Further, we have deleted those sections of Rule 13.C. 3 that, because they address a procedure for reviewing Servicing Carrier requests for relief from oversubscription that will not exist under the revised Rules, are now redundant.

We have also eliminated the requirement that a company seeking relief from oversubscription compensate an ERP that is reassigned as the result of its request. Under the Revised Rules, a request for such relief is permitted only after redistribution of HLR ERPs and other ERPs whose current Servicing Carrier no longer has that status. We are not persuaded that it is reasonable to require compensation for a request that arises in connection with a one-time global redistribution mandated under these Rules, particularly in view of the fact that we, rather than individual Servicing Carriers, are initiating this reform and the specific redistribution. Moreover, the equitable distribution required by the rules may reasonably be expected to achieve subscription levels that fall within a five percent range of 100 per cent. In any event, such compensation is available only when a Servicing Carrier seeks relief from oversubscription. It does not apply when an ERP is reassigned because its Servicing Carrier withdraws from the market or ceases, for other reasons, to be a Servicing Carrier. Thus, it would not be available to ERPs that are redistributed by operation of these Rules, rather than in response to an insurer's request. Furthermore, to the extent that the compensation requirement is intended to assist ERPs to meet extraordinary costs associated with reassignment, we note that the *Decision on 2005 Private Passenger Insurance Rates* increased the commission expense pure premium distributed to producers. Indeed, we noted in that *Decision* that the increase would partially defray any additional costs associated with reform of the residual market.

A question was raised at the December 17 hearing seeking clarification of the formula for determining subscription shares for purposes of reassigning ERPs after redistribution of HLR ERPs and exclusion of low loss ratio ERPs. The term "voluntarily produced" as it appears in Rule 13.C.3.a. and elsewhere in these Rules, uniformly means

business that is voluntarily produced, whether through a producer for an agency company or by a direct writer.

We have revised Rule 13.A.1.a.(1) to clarify that current Servicing Carriers with more than two percent of statewide reported written property damage liability exposures for the most recent policy year will continue in that status as of January 1, 2005. In the future, any company that meets that threshold requirement will become a Servicing Carrier effective January 1 of the policy year next following notification that it has met that threshold.

Commerce objects to setting the threshold for automatic Servicing Carrier status at two percent of the market, on the ground that all carriers should share the total burden of servicing the residual market, rather than simply sharing the deficit. It argues that Servicing Carriers are limited in their ability to offer preferential pricing and treatment to their voluntary risks, and that companies that do not have that status may seek out the best risks in the market, without concern that any preferential pricing offered to that group will also have to be applied to business written by ERPs or to ceded business. In a fix-and-establish system, where all companies must apply the same rates to both retained and ceded business and to business generated by voluntary producers and ERPs, the basis for Commerce's concerns is unclear. Further, it is based on the premise that ERPs universally write risks that are not "good" and therefore should not benefit from whatever preferential treatment might be available. We are not convinced that such a blanket indictment of the constituencies in the residual market is fair. Overall, we do not find persuasive Commerce's position that a two percent threshold is inappropriate.

Rule 14

CAR recommends clarifying the assignment mechanism for newly emerging ERPs by revising Rule 14.A.2.a to state that the assignment will be made on the basis of the relationship between the Servicing Carrier's total market share in all market need areas and its total statewide market share. We agree that this change should be made. CAR also observed that the proposed Rules did not address the eligibility of producers who have a voluntary contract with a non-servicing carrier for an ERP appointment to a Servicing Carrier. We have therefore added, as subsection b to Rule 14.A.1, a provision that in those

circumstances the producer may apply for assignment to a Servicing Carrier as a Representative Producer, as defined in Rule 2.

Commerce asserts that the provision of Rule 14 that assigns a voluntary producer as an ERP to the company that cancelled the producer's last voluntary contract penalizes the last carrier and will create a rush to cancel marginal agents. Its comment assumes that marginal agents have more than one voluntary contract to write private passenger automobile insurance and that reassignment is intended to penalize the carrier that is last in line. As noted in the November 23 Order, more than half of all insurance producers have contracts with only one company. Furthermore, reassignment of a voluntary agent to its former carrier as an ERP serves the important purpose of minimizing disruption to consumers.

At the December 17 hearing, Sumner Gilman, president of the Exclusive Representative Producers of Massachusetts ("EPRM") opposed Rule 14.B.2.s, which prohibits co-brokering. He argued that the current system, which allows brokering, has worked without significant problems, and considers that there is no reason to restrict brokering by or to ERPs during the transition period. He stated that brokering occurs for many reasons related to market pressures, and should not be governed by regulation. We understand Mr. Gilman's concerns, and note as well his additional testimony on the pressures that have been placed on ERPs. The regulation of co-brokering is intended, however, to reduce market manipulation and transfers of risks that artificially structure books of business. The provision, as drafted, prohibits co-brokering except for the purpose of ensuring consumer access to discounts. We find that it reasonably balances the need to reduce the possibilities of gaming the system with the preservation of consumer benefits.

Rule 17

CAR recommends a change to Rule 17 to make clear that the Paid Loss Ratio Incentive Plan ("PLRIP") measures the improvement in results from ceded business generated by all producers, not just improvements in business produced by HLR ERPs. We agree that CAR's proposed language increases the clarity of the Rule and therefore adopt its recommendation.

At the December 17 hearing, Commerce and others espoused the position that the PLRIP incentives should not be based on collective improvement in the loss ratio results of

ceded business but should only reward individual companies for their results. No company, they argue, is likely to increase its efforts to improve ERP loss ratios unless it is certain that every other company is matching those efforts. The perception that some companies are unwilling to fight fraudulent claims is contrary to the public stance taken by the industry as a whole, and demonstrates a regrettable cynicism about the industry's willingness and capacity to cooperate both for their mutual benefit and for that of Massachusetts policyholders. We are not persuaded that the incentives that the PLRIP offers are inadequate to encourage companies to undertake meaningful efforts to reduce the loss ratios associated with ceded business. Further, we note that, because insurance claims from accidents often involve more than one carrier, cooperation is essential to effective claim investigation and review.

We agree, however, that the PLRIP incentives should not ignore individual company efforts, and accept the industry's comments to that end. We note that, although Rule 17 bases PLRIP incentives on industrywide efforts to improve ceded loss ratios, it does not prescribe a particular formula for dividing the deficit savings among individual Servicing Carriers or Members. CAR is directed to develop a formula that will equitably allocate savings; such formula should include a procedure that identifies and rewards particularly effective approaches to deficit reduction.

III. THE MASSACHUSETTS AUTOMOBILE INSURANCE PLAN

At the December 17 hearing, arguments were again made that legislative approval is required in order to implement an assigned risk plan in Massachusetts, and that an assigned risk plan is inconsistent with the principle that Massachusetts insurers must "take all comers." The November 23 Order addressed those arguments at length, and its conclusions need not be repeated here.

As with the transition rules, we note that CAR has recommended a number of technical changes, generally in the form of editorial comments, intended to ensure consistent citations, language and formatting throughout the Rules. Such proposed changes do not affect the substance of these rules, and many of them have therefore been

adopted and approved.² Similarly, we have identified and made minor stylistic changes to improve clarity and readability; none of those changes affect the substance of the MAIP.

The MAIP Rules create a system that, to operate smoothly, will require the development of uniform procedures.³ In addition to CAR, insurers and producers have raised a number of questions that seek detailed guidance on the operational aspects of the MAIP. Our November 23 Order anticipated, and we reiterate that, as with the current system, a Manual of Administrative Procedures will be developed to guide insurers and producers as the system is implemented and, as appropriate, to establish uniform procedures. We note questions raised at the December 17 hearing about the time frames relating to insurance applications submitted to the MAIP. Among other things, the manual provisions should be designed to establish practical and efficient systems for the timely processing of applications. They should also be designed to ensure that policyholders who are assigned through the MAIP receive the same level of service as do policyholders insured in the voluntary market. CAR, as the entity responsible for management of the assigned risk plan, is again directed to develop and document operating systems and to distribute an administrative procedures manual to its Members and producers that is specific to the MAIP. It is anticipated that the manual will be developed with the assistance of the various constituencies that it will affect. CAR should also consider development of educational materials for applicants that will help them understand the application process.

Specific recommendations for each of the MAIP rules made by CAR and other interested persons, in the form of both written and oral comments submitted in connection with the December 17 hearing, are discussed below.

Rule 22

As recommended by CAR, we have replaced the current definition of “Subsidy” in Rule 22 with the definition appearing in Rule 36.⁴ We have added definitions of “Assigned Risk Policy” and “Governing Committee” to Rule 22.

² We have, however, not adopted proposed changes that do not add clarity to the Rules. As an example, we reject CAR’s recommendation to substitute “MAIP policies” for “assigned risk policies” in Rule 23, because the MAIP itself does not issue policies.

³ For example, the Governing Committee is authorized to establish a process for appeals by policyholders relating to placement in the MAIP.

⁴This action parallels our action with respect to Transition Rules 2 and 12.

Rule 23

Subsection B has been revised to make clear that any inactive member of CAR that issues a motor vehicle insurance policy must concurrently obtain a reporting number and, as of the date it issues the policy, fully assume the obligations of an active member.

Rule 26

At the December 17 hearing, concerns were expressed about the requirement that an applicant for coverage through the MAIP first obtain a letter from an insurance company confirming that the applicant had been unable to obtain insurance on the voluntary market. We have concluded that, while eligibility for the MAIP should be conditioned on the inability to obtain voluntary coverage, it is reasonable to allow the applicant to submit a statement certifying, under the pains and penalties of perjury, that he or she has been unable to do so. This change will streamline the process for obtaining coverage through the MAIP and is responsive to concerns that the system should address the need for efficient access to insurance by applicants who must obtain coverage in order to register a vehicle. We remain unpersuaded by Commerce's argument that a policyholder should not be informed of the reasons why an insurer declines to write coverage voluntarily. Fairness dictates that consumers be informed of the reasons why they are denied voluntary insurance, so that they can resolve any misunderstandings and perhaps remove the stated barriers.

We have simplified Rule 26.A.2 to provide that the risks eligible for assignment through the MAIP include all types of vehicles that may be insured under the standard Massachusetts Private Passenger automobile insurance policy, pursuant to the Private Passenger Automobile Insurance Manual published by the Automobile Insurers Bureau.

Rule 26.A.3.b sets out the circumstances which will render an applicant for insurance ineligible for placement in the MAIP. One such condition is that the applicant has not been found to be at-fault for an accident that generated an insurance claim, including a claim under the personal injury protection coverage ("PIP") within the thirty-six months immediately preceding the effective date of the policy. We note that, in order to implement this Rule, as well as Rule 30.C.1.a, insurers will be required to report PIP claims to the Merit Rating Bureau. CAR must therefore ensure that the Manual of Administrative Procedures addresses changed reporting requirements.

Rule 26.C.2 has been clarified to state that a company that cancels a policy assigned through the MAIP must provide the documentation required under Massachusetts statutes. CAR requested that we remove the phrase “of a material nature” from the standards for determining when an application to the MAIP has been made in good faith. We decline to do so. An applicant should not be penalized if he or she makes a minor error on an application that does not relate to underwriting criteria.

In the course of this hearing, the Arbella Mutual Insurance Company (“Arbella Mutual”) and Commerce have argued that Rule 26.A.3.b.ii, which prohibits placement in the MAIP of risks receiving group discounts. They argue that this provision ignores the clear mandate of G.L. c. 175 §193R that “insurance issued pursuant to a group marketing plan shall be cedeable.” The seventh paragraph of the statute, in total, reads as follows:

The commissioner shall make and at any time may alter or amend reasonable rules and regulations regarding insurance issued pursuant to a group marketing plan; provided, however, that insurance issued pursuant to a group marketing plan shall be cedeable and the experience of each group plan, both voluntary and ceded, shall be used in determining a company’s losses and expenses in accordance with the attribution rules established under the provisions of section one hundred and thirteen H.

The position that the MAIP rule violates G.L. c. 175, §193R, assumes that the reference to “cedeable” in § 193R means that insurance exposures *must* be cedeable to CAR. We find this interpretation to be overly narrow and inconsistent with the spirit of the statutory mechanism surrounding the residual market. We recognize that, historically, the residual market plan has involved ceding undesired risks to CAR, including exposures written through group marketing plans, but we are not persuaded that the reference in §193R to “cedeable” is limited to transactions relating to CAR. The ceding of insurance exposures is not limited to a statutorily created shared risk system, and its use in § 193R should not be so narrowly applied. Indeed, §193R makes not reference to the assigned risk pool, or any residual pool for that matter.

Ceding of insurance exposures is a transaction that takes place in a reinsurance context. The Reinsurance Association of America (“RAA”) defines “cede” as “To transfer to a reinsurer all or part of the insurance or reinsurance risk written by a ceding company.” Fundamentals of Property Casualty Reinsurance 22 (RAA 2004). The “ceding company”

is “ the insurer which cedes all or part of the insurance or reinsurance risk it has written to another insurer/reinsurer. Id.

Looking at the nature of the insurance market as a whole, we find it reasonable to conclude that, by enacting §193R, the legislature established that insurers who issue private passenger automobile insurance policies within the context of a group marketing plan are not prohibited from reinsuring (“ceding”) some or all of the exposures thus written to other insurance/reinsurance companies. Thus, §193R permits reinsurance by private reinsurers; it also has permitted cession to CAR. We find that §193R does not require a particular form for the permitted ceding. Accordingly, Rule 26(A)(3)(b)(ii) does not prohibit “ceding” as contemplated under c. 175, §193R, and insurance companies are not prohibited from “ceding” such risks to another company or a reinsurer.

Secondly, the interpretation urged by Arbella Mutual and Commerce assumes that by using the word “cedeable” in G.L. c. 175, §193R the legislature, when it enacted the statute in 1973, thereby incorporated into law the §113H plan then in effect, thereby removing the freedom that it had given in 1953 and thereafter in G.L. c. 175, §113H to insurance companies issuing motor vehicle liability policies or bonds to “cooperate in the preparation and submission of a plan which shall provide motor vehicle insurance to applicants who have been unable to obtain insurance through the method by which insurance is voluntarily made available.” We are not persuaded that §193R manifests a legislative intent to revoke the broad freedom given to insurance companies by §113H, subject to the Commissioner’s supervision, to create a plan to provide motor vehicle insurance to applicants who have been unable to obtain insurance through the method by which insurance is voluntarily made available.⁵

Further, we are not persuaded that §193R constitutes a legislative fiat ending the flexibility built into §113H. This flexibility was given to active participants in the private passenger automobile insurance business to craft a plan, and then modify, amend or

⁵ As discussed in previous *Orders on Proposed Changes to Rules of Operation 2, 9 through 14, and 17 and Rules 21 through 40*, We find that the plain language of G.L. c. 175, § 113H does not justify a restrictive reading and find that § 113H provides no strictures regarding the mechanism of the plan authorized by § 113H, although there are several requirements about the provisions that must be addressed by ant § 113H plan. Something that we find to be striking about the scope and flexibility if G.L. c. 175, § 113H is that way that the statute merely refers to “a plan”, without describing it at any point in the thirty or so paragraphs of the statute as a plan of reinsurance, a joint underwriting association, a reinsurance facility or as assigned risk system.

replace that plan, based on changes in the Massachusetts insurance market, without further legislative action and subject to the Commissioner's supervision, in order to provide motor vehicle insurance to applicants who have been unable to obtain insurance through the method by which insurance is voluntarily made available. Accordingly, we are not persuaded that Rule 26.A.3.b.ii, as drafted, violates the statute.

Rule 29

CAR recommends that quota shares for MAIP business be derived on an exposure basis, rather than on a combination of premiums and exposures. However, a premium-related system more accurately recognizes credits for operators who would otherwise be disproportionately assigned to the MAIP, *e.g.*, inexperienced urban drivers. A premium-based market share also provides an explicit, easily understood basis that shows companies the reasons for adjustments to their quota shares and more precisely reflects individual company actions and participation in the residual market. Although exposure-based systems are in use elsewhere, other states have a far smaller and more stable residual market. If the Massachusetts market stabilizes at a level comparable to the residual market in other states, it would be reasonable then to consider a purely exposure-based quota system. However, we do not adopt CAR's recommendation at this time.

CAR has also raised questions about the credit programs that affect quota shares. Credits will be assigned for all credit-eligible risks that are kept out or are taken out of the MAIP, either voluntarily or under the mandatory take-out rules. At the December 17 hearing, concerns were expressed about the provision of Rule 29 that allowed the MAIP to make available to all Members a list of those insured through the MAIP. We have therefore revised Rule 29.F.1.a to provide that any person insured through the MAIP may request the MAIP to notify all members that he or she is seeking coverage on a voluntary basis. Other concerns raised about such notification, including privacy issues, the extent and nature of the information to be distributed, notification to producers, and the timing of distributions, should be addressed in the MAP.

CAR correctly observes that under MAIP Rule 29 the only credits available as of January 1, 2006 will be for senior citizen take-out, and asks when credits will be developed for driver classes and territories. 2005 will be the first year of transition toward the MAIP, and the first year of operation of new deficit sharing programs. Depending on the market

response to those factors, it may be possible to develop credit programs for territories and inexperienced driver classes to be implemented in 2006. CAR should take appropriate steps to collect and analyze data that would support expansion of the credit programs for 2006. Any proposal should be developed and submitted to the Commissioner.

Rule 29.G addresses additional restrictions on the distribution of MAIP applicants. We have revised subsection 2 to clarify that, if a vehicle owned by a household member is insured on the voluntary market, an applicant for coverage through the MAIP shall be assigned to the company providing that voluntary coverage. The purpose of this requirement is to preserve the availability of any applicable household discounts. Subsection 3 has been revised to clarify that, within the three-year assignment period, an applicant to the MAIP who has an outstanding premium balance due a company will be assigned to that same company.

Rule 30

At the December 17 hearing, the question was raised about the reason for mandating that insurers take policyholders out of the MAIP once they are eligible to be removed from it. Placing ultimate responsibility on the insurer to determine that a policyholder is no longer eligible for the MAIP does not, however, prevent a producer from ascertaining that changes in eligibility have occurred and taking action to obtain coverage for the policyholder in the voluntary market. The rule therefore does not limit a competent producer's ability to retain customers who no longer qualify for coverage through the MAIP.

CAR also raised a question about the obligation of a company that is a direct writer under Rule 30.C.1.d.iii. If the company making the offer is a direct writer, it may take out the business as a direct writer. The rule does not express any intent with respect to direct writers or agency companies; it recognizes that insurers have different distribution channels for their products. CAR also requests clarification of the rules relating to eligibility for voluntary writing of risks assigned through the MAIP, particularly as they relate to credits. Insurers who voluntarily write risks that are eligible for assignment through the MAIP will receive appropriate credits.

Rule 31

CAR has requested clarification of the relationship between Rule 31.B.2, which requires that eligible risks applying to the MAIP for the first time complete a new business application and Rule 29.E, which refers to assignment periods. Rule 29 provides that a policy is assigned to a carrier for a three-year period, and that the carrier may thereafter choose to renew it. However, if the carrier does not renew, and the policyholder is unable to obtain coverage in the voluntary market, he or she may reapply to the MAIP. Rule 29.E expressly states that the reapplication is considered a new application. Rule 31.B.2 is intended to distinguish the process for renewing an assigned policy during the three-year assignment period from the initial process for applying for coverage. It does not override the explicit language in Rule 29.E that characterizes an application to the MAIP submitted after expiration of the three-year period as a new application.

Concerns were expressed at the December 17 hearing about the mandatory training requirements for producers and their employees. We are not persuaded that the time frame for completion of such training should be extended beyond the six months set out in the Rule. We are persuaded that six months provides an adequate opportunity for the producer to evaluate and make retention decisions about newly hired staff. The MAP should address procedures for training programs, including standards for determining which, if any, producer employees should be exempt from the training requirement.

At the December 17 hearing, a question arose about production requirements for assigned risk producers approved after January 1, 2008. Such producers are expected to satisfy the production requirements in Rule 31.C.

Rule 34

CAR has expressed concern that the rule requires clarification to allow the MAIP to audit producers who place business through the MAIP. We believe that the rule as drafted authorizes such audits. However, we have revised the second sentence to make clear that the audit may review any portion of the motor vehicle insurance business that has a bearing on credits, penalties, determination of a quota share, or any other issue relating to such business. We note that under the MAIP, companies retain the authority to audit the business of assigned risk producers.

Rule 36

As noted in our discussion of Rule 22, we have adopted CAR's recommendation to strike the definition of Subsidy in Rule 36 and incorporate it into Rule 22.

Rule 37

At the December 17 hearing, concerns were expressed about the payment of commissions to Assigned Risk Producers. We have therefore added a paragraph to the rule clarifying that nothing in the rule alters any statutory obligations relating to commission payments.

Rule 38

At the December 17 hearing, Commerce criticized the omission in the MAIP of penalties for withdrawing from the Massachusetts market for private passenger automobile insurance. Commerce does not explain why such penalties are appropriate in a system that no longer requires deficit sharing but places responsibility for losses and expenses associated with an assigned risk on the company underwriting that risk. The rule requires that the company meet its obligations to the MAIP, and further requires the Commissioner's approval of any withdrawal plan. We are not persuaded that the Rule should be revised.

IV. CONCLUSIONS AND ORDERS

The revisions described in this Decision and Order clarify, but do not substantively alter, the Rules attached to the November 23 Order. We have incorporated our revisions to the Transitional Rules and the MAIP Rules into Appendix A, attached to this document. As revised, these Rules are hereby approved. In all other respects, we reaffirm the orders and directives in the November 23 Order including, but not limited to, the time lines for implementation of these Rules.

Dated: December 31, 2004.

Julianne M. Bowler
Commissioner of Insurance

Jean F. Farrington
Presiding Office

Stephen M. Sumner
Presiding Officer