Commonwealth Automobile Reinsurers'

Proposed Changes to the Rules of Operation

Docket No. C2004-02

Order

I. Introduction

On June 30, 2004, Commonwealth Automobile Reinsurers ("CAR") submitted to the Commissioner of Insurance ("Commissioner") an extensive set of proposed changes (the "Proposal") to the CAR Rules of Operation ("Rules"). The Proposal included amendments to Rules 2, 9 through 14, and 17, as well as a series of new Rules, numbered 21 through 40. On that same date, the Commerce Insurance Company ("Commerce"), a member of CAR, pursuant to Article X of the CAR Plan of Operation ("CAR Plan"), requested a hearing on the Proposal. A hearing notice issued on July 1, scheduling a hearing for July 22. A number of statements of intent to speak at the hearing were submitted prior to the hearing, principally from other members of CAR and representatives of trade associations, all of which are members of the Coalition for Auto Insurance Reform ("CAIR"). Other individuals and entities submitted written testimony. Twenty-seven individuals testified at the hearing.

At the conclusion of the hearing, the record was left open until July 27; Commerce requested that it be left open for a longer, indefinite period to permit it time to make additional submissions based on material that it anticipated receiving from the

Attorney General ("AG") and the Division of Insurance ("Division") in response to public record requests that it submitted to them on July 1st and 2nd, respectively. Commerce's request was denied on the ground that the request for additional time was indefinite. On July 26, Commerce moved for reconsideration of the decision to close the record, stating that it had received no responsive documents from the AG and a "preliminary and partial" response from the Division to its public record request. Commerce requested that the record be left open for at least ten days after the Division and the AG had both responded fully to Commerce's public record requests. An order issued on July 26 requiring the AG and the Division to respond to the Commerce motion by the close of business on July 27. After review of the responses received from the AG and the Division on July 27, an order issued to keep the record open through July 30, an additional three days. Written statements were received from people who had not been present at the hearing; in addition, several participants provided supplements to their initial submissions.

II. Background

CAR, an entity established pursuant to G.L. c. 175, §113H, is responsible for the establishment and operation of the residual market for motor vehicle insurance in Massachusetts. The CAR Plan, among other things, allows CAR to promulgate rules which, following approval by the CAR Governing Committee, are then submitted to the Commissioner for her approval. The CAR Rules may be broadly divided between those which relate to matters of general corporate governance (*e.g.*, membership requirements, powers of the Governing Committee, and officers), and rules which directly address the operation of the residual market, including the identification of servicing carriers, appointment of exclusive representative producers ("ERPs"), the responsibilities of servicing carriers and ERPs, and the allocation to CAR members of the financial burdens associated with the operation of the residual market. Over time, many proposals have been made to change the Rules; some have taken effect without controversy while others have been the subject of hearings pursuant to Article X of the CAR Plan. Historically, proposals to change the rules relating to allocation of CAR expenses and distribution of the CAR deficit have engendered controversy.[1]

In recent years, as noted by several individuals at the hearing, proposals have been made to change the allocation of the CAR deficit among its member companies. Allegations of inequities in the existing system led to a study by the Attorney General, which culminated in a June 2002 letter to the Commissioner, and to the Commissioner's calling of a periodic special examination of the consequences of the application of the CAR Rules to the private passenger automobile insurance market. Tillinghast Towers Perrin, which conducted that examination, produced its report in April 2004 (the "Tillinghast Report"). On April 29, 2004, the Commissioner sent a letter to the CAR Governing Committee stating that, based on her review of the Tillinghast Report, she had concluded that the existing system did not distribute the financial burdens associated with high risk drivers in a fair and equitable manner. She identified issues that needed to be addressed in order to achieve the fair and equitable distribution of that burden, and ordered CAR to change Rules 9 through 14, and Rules 16 through 18, to address issues associated with CAR's involuntary market structure and claims oversight review. She also ordered CAR to review Rules 2 through 8, 15, and 19 through 20, and to propose modifications to those rules to effect the changes in Rules 9 through 14 and 16 through 18.

Part I of the Proposal included changes to Rules 2, 9 through 14, and 17, as they relate to private passenger automobile insurance; these revisions establish new rules for the operation of the residual market through calendar year 2007. At the hearing, several individuals referred to these as "transition rules." Part II of the Proposal articulatedRules 21 through 40. The new Rules govern the operation of the Massachusetts Assigned Insurance Plan ("MAIP" or the "assigned risk plan"), a plan that effects a change in the

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[1] *See*, *e.g*., the following decisions: *Proposed Amendments to Rules 2 and 11 of the Rules of Operation of Commonwealth Automobile Reinsurers*, 86-8; *Rule 11, "Assessments and Participation" of the Rules of Operation of Commonwealth Automobile Reinsurers*, 86-12; *Proposed Amendments to Rule 11, "Assessments and Participation," of the Rules of Operation of Commonwealth Automobile Reinsurers,* 87-13; *Proposed Amendment to Rule 11, B, 1, b of the Rules of Operation of Commonwealth Automobile Reinsurers,* G90-27; *Proposed Amendments to Rule 11 and Rule 14 of the Rules of Operation of Commonwealth Automobile Reinsurers*, G90-33; *Proposed Amendments to Rules 11, 12, 14 and 17 of the Rules of Operation of Commonwealth Automobile Reinsurers,* G90-41; *Proposed Amendments to Rule 11 of the Rules of Operation of Commonwealth Automobile Reinsurers*, G91-38; and *Proposed Suspension of Rule 11, B, 1, 2 of the Commonwealth Automobile Reinsurers' Rules of Operation*, C97-04.

residual market from a system focused on business written by a subset of producers appointed to carriers as ERPs to a system focused on the assignment of individual risks to carriers, in proportion to the amount of business that the carrier writes on a voluntary basis. The Proposal anticipates that implementation of the new system for assigning risks will begin as of January 1, 2006, and that the transition to the MAIP will be complete as of January 1, 2008.

Based on our review of the testimony at the July 22 hearing and the written submissions made then and thereafter, we conclude that while much of the Proposal represents significant movement towards the objectives identified in the Commissioner's April 29 letter, concerns remain about the extent of the consumer protections provided in the Proposal, and the precise impact that the rule changes would have on the residual market. For example, CAIR filed written testimony after the hearing objecting to the imposition of certain recommended consumer protections without the opportunity for an additional hearing regarding these recommendations. Other testimony recommended technical changes which, in particular, address the feasibility of some aspects of the Proposal and revisions intended to improve the Proposal's effectiveness at meeting the goals of developing an assigned risk plan that will benefit consumers and the industry and that will minimize market disruption during the transition to that assigned risk plan. We also note that the Proposal reflected significant omissions, *i.e.*, items which CAR expressly reserved for later consideration. Therefore, for all of these reasons, we remand this Proposal to CAR for further review and development in accordance with this Order. In order to assist the Governing Committee in its reconsideration of its Proposal, we have identified the issues that appear most likely to be problematic based on the testimony and proposals presented at the hearing.[2] The current state of the private passenger automobile insurance market in Massachusetts is such, however, that it is critical that CAR act expeditiously. Therefore, we will order the CAR Governing Committee to resubmit the revised Proposal to the Commissioner no later than September 24, 2004. The Division will hold a public hearing on the revised Proposal on October 4, 2004.

[2] The ultimate goal of moving toward a more competitive rating system will be aided by the adoption, to the extent possible, of nationally recognized standards and best practices. For example other assigned risk plans are based on The Uniform Automobile Insurance Plan, published by AIPSO, an organization that services assigned risk plans in 35 states.

III. Discussion and Analysis of Part I of the Proposal

As a preliminary matter, CAR has proposed technical changes to the Rules that address issues such as the shift to a producer licensing system from one that separately licensed agents and brokers, and the form of citation to the Massachusetts General Laws. No objections were voiced to such changes which, in essence, update the Rules and help to achieve consistency between the CAR Rules and current Massachusetts statutes. However, because these changes were not made uniformly throughout the Proposal, CAR is instructed to perform a comprehensive review of the Rules and to make appropriate technical changes to ensure that all the Rules conform to a single standard.[3]

In reviewing the substantive changes to each of the Rules, we identified a number of concerns, and have organized our comments accordingly. Our intent is to provide guidance to CAR, not to mandate that an identified concern be addressed exclusively in that Rule. Particularly in light of the comprehensive nature of the changes that CAR has proposed, and the complexity of the issues under consideration, it is critical to ensure that the Rules are internally consistent.

Rule 2. Definitions.

CAR Proposal. The Proposal adds definitions of Designated Servicing Carrier and High Loss Ratio Exclusive Representative Producer. With respect to Exclusive Representative Producers and Representative Producers, the proposed rule conforms the rule's statutory references to the 2002 law changes governing the licensing of insurance producers.

Discussion. The changes to Rule 2 consist of adding two new terms and definitions, "Designated Servicing Carriers" ("DSC") and "High Loss Ratio Exclusive Representative Producers" ("HLR ERP"). We note that the rule defining HLR ERPs does not specify a complete methodology for calculating an ERP's loss ratio. Testimony at the hearing indicated that the proposed definition was based on a methodology developed by Tillinghast/Towers Perrin in its Report. To ensure consistency in identifying HLR ERPs, however, the Proposal should incorporate and articulate a standard approach to measuring loss ratios. This standard should exclude from the

[3] For example, in Rule 14, both the added sections and much of the rest of the rule refer to agents and brokers, although the appropriate statutory reference is to "producers."

definition of HLR ERP those producers whose books of business do not meet the minimum production requirements, as those books are too small to provide a credible claims history. The definition of DSC refers to servicing carriers with an exposure based 2003 market share of seven percent or more, "and others as may be determined by the Commissioner of Insurance." This definition is inconsistent with the application of this term in proposed Rule 13, which refers to the DSC as "others which volunteer and are approved by the Commissioner of Insurance."

A Subsidy Clearinghouse is created and defined in Rule 12, but is not defined in Rule 2. Placing the definition of Subsidy Clearinghouse with the remainder of the definitions contained in Rule 2 will improve Rule 2. Additionally, we have noted that the following terms appear in various places within the Proposal but are not defined in Rule 2: "Dual Status Producer" (Rules 13 and 14), "rehabilitation plan" and/or "high loss ratio improvement plan" (apparently used interchangeably in Rule 13), "assigned risk plan" (Rule 13 *et al.*) and "new business" (Rule 13, *et al.*). To improve the clarity of the proposed rules, a definition of these terms should also be articulated in Rule 2. This list may not be exhaustive, and we urge CAR to undertake its own review of its Proposal to achieve this goal.

Rule 9. Audit Review.

CAR Proposal. The Proposal adds to the current rule the authority to audit policies written by a member of CAR, or any other entity subject to the CAR Plan and Rules, for anything that has a bearing on deficit sharing, as well as on credits or penalties. The proposed rule also extends review and audit authority of CAR to any successor entity to CAR.

Discussion. No objections were voiced to the proposed changes to Rule 9, and we note no concerns.

Rule 10. Claim Practices.

CAR Proposal. The proposed rule would require the Governing Committee to establish procedures for the review of claim practices of Servicing Carriers, to ensure compliance with CAR's Performance Standards for the Handling and Payment of Claims by Servicing Carriers, and to monitor Servicing Carriers' performance. It adds a new requirement that, in conducting periodic audits of claim practices, CAR review both reinsured (ceded) and voluntary business. Language in the current rule that permitted carriers to "adopt and implement reasonable standards for the prompt investigation of claims" has been deleted, and replaced with the requirement that carriers must conduct internal claim quality audits for residual market business commensurate with their audit procedures for voluntary business. The proposed rule also requires carriers, on their internal audit reports of their claim departments, to consolidate comments relating to both residual market and voluntary claim adjustment, rather than permitting them to do so at their discretion.

Rule 10 E currently permits special reimbursements for excess judgments on claims arising out of ceded policies; as amended, that section would only be effective for policies written prior to January 1, 2008.

Finally, the Proposal specifies that company claim practices must comply with the requirements of G.L. c. 175, §113H, and replaces the term "CAR claims" with "residual market claims."

Discussion. These amendments will serve to ensure that carriers employ consistent claims handling practices with respect to both ceded and voluntary claims, thereby ensuring the fair treatment of all consumers, and the minimization of payments on excessive or fraudulent claims, whether the policies are written voluntarily or involuntarily. However, to ensure that claims handling procedures conform to national standards, we suggest that CAR incorporate into the Rule a requirement that the performance measures, such as the acceptable error rate, be consistent with those established by the NAIC, and that an adequate enforcement mechanism is implemented to ensure compliance.

Rule 11. Assessments and Participation. ***CAR Proposal***. Rule 11.A, which relates to participation in CAR expenses, currently provides that CAR expenses that are not chargeable to the profit and loss of risks ceded to CAR are shared by members according to a formula that reflects the individual member's Massachusetts direct written motor vehicle insurance premiums, as reported on the most recent calendar year Annual Statement, as a percentage of the total of such premiums for all members. The proposed rule would provide that premium derived from writing motor vehicle insurance for classifications and coverages that companies need not report to CAR under the current statistical plan, and all premium from writing antique vehicles, would be excluded from the expense calculation. For policy years 2005 through 2007, private passenger written premium from producers designated as HLR ERPs would also be excluded from this calculation.

Under Rule 11.B, which relates to company participation in the CAR deficit, companies licensed in Massachusetts report statistical data to CAR to establish a basis for the allocation of that deficit. CAR member participation in the deficit is then calculated in accordance with specific procedures. For policy year 2004, ceded exposures from HLR ERPs with policy effective dates of July 1, 2004 through December 31, 2004 would be excluded from the participation formula. The existing pool depopulation credit mechanism is applicable only through policy year 2004, as a Subsidy Clearinghouse is proposed to take effect for policy years 2005 and later.

CAR's Proposal for 2005 through 2007 divides the current deficit pool into two pools: One for all business ceded by ERPs, the other for business ceded by non-ERP producers. The Proposal establishes two different methods of sharing the deficits of the two pools. For non-ERP business, the current deficit sharing formula which involves a K factor of 4.0, would be maintained; for ERP business, a member's share would be determined by revising the current formula in two respects: the K factor would be reduced from 4.0 to 1.0, and all ERP business would be considered a "free cede", *i.e.,* the K factor would not apply to that business.[4]

Under the Proposal for policy years 2005 through 2007, premiums, losses and expenses attributable to private passenger exposures written by ERPs (including HLR ERPs) and ceded to CAR would be shared among all companies. Company shares would be based on participation ratios that are determined as a function of the company's retained and ceded exposures produced by non-ERP producers, and the exposures retained under voluntary contracts with Dual Status Producers for the prior calendar year.

CAR's Proposal specifies that certain details concerning "Miscellaneous Rated as Private Passenger" exposure adjustments remain to be finalized by CAR committees.

[4] Determination of a company's share of the CAR deficit begins with a determination of its total market share. CAR uses a K factor to adjust a company's exposure-based market share to reflect the extent to which the company's cession rate is higher or lower than the industry average.

Those details include, but are not limited to, K factor information for policy years 2005 through 2007.

The CAR Proposal also addresses the requirements imposed on companies that elect to withdraw from the Massachusetts private passenger automobile insurance market for policy years 2005 through 2007. Under the Proposal, a withdrawing company's financial obligation will be determined based on the company's estimated share of the total residual market burden over the three-year period following its election to withdraw, and will include the company's share of the non-ERP/Dual Status Producer deficit, the ERP deficit, and the MAIP obligations.

Discussion. For policy year 2003, approximately seven percent of private passenger automobile risks were insured through the residual market. CAR staff recently analyzed the composition of the 2003 residual market deficit by producer type. Its analysis showed that approximately $312 million of the $356 million deficit, or 88 percent of the deficit, was generated by business ceded by ERPs, and that only twelve percent of the deficit was attributable to non-ERP ceded business. Based on an earlier CAR analysis of the 2002 deficit, an estimated $160 million, or 45 percent of the total deficit, may be attributable to HLR ERPs.[5] Proposed Rule 11 is likely to lead to a significant increase in the size of the residual market due to 1) the "free ceding" of all business from HLR ERPs for policy years 2004 through 2007; 2) the reduced K Factor and free ceding for all ERP business for policy years 2005 through 2007; and 3) the corresponding reduced cost of ceding that business relative to non-ERP business.

First, allowing the ceded business of HLR ERPs to be treated in the current utilization formula as a "free cede" for policy year 2004 (or a K factor of zero) would likely increase the size of the residual market pool to nine to ten percent from its current level of approximately seven percent.[6]

Second, for policy years 2005 through 2007, the cost of ceding ERP business to the pool is considerably less under proposed Rule 11 because the K factor used to allocate the deficit among companies has been reduced from 4.0 to the equivalent of 1.0. This change reduces the marginal cost of ceding that business relative to the marginal

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5 See Testimony of Cara Blank, Attached Exhibit 8, CAR Analysis 04/30/2004.

6 CAR's proposal provides for implementation of some of its changes as of July 1, 2004. We recommend that CAR consider whether this commencement date remains feasible.

cost of retaining that business, thereby motivating companies to cede such business, and to offer fewer voluntary contracts to ERPs than what they currently "retain" under the rules.[7]

Third, maintaining the current utilization ratio, with a K factor of 4.0 for voluntarily contracted business ceded by non-ERPs and Dual Status producers, makes the marginal cost of cession higher than the marginal cost of retention for these producers. This may have the effect of accelerating the termination of non-ERP producers that have only one voluntary contract so that the company is not burdened with this higher cost of cession. The dual standard for cession may also cause a reduction in the number of companies willing to write business with a particular agency, an increase in policy non-renewals initiated by the company, or pressure by the company to have the non-ERP agent move the business to another company or agency.[8, 9]

Because of the potential effect of proposed Rule 11 on the size of the residual market, CAR should make substantial revisions to its Proposal that address that effect. The K factor used in the current utilization formula has long been recognized as an important means of minimizing the size of the residual market pool. The last time CAR specifically evaluated the value of the K factor in connection with private passenger automobile insurance deficit sharing was 2002. According to the records of the CAR Actuarial Committee meeting of August 20, 2002, the "Committee members agreed that the current K factor of 4.0 has served well to ensure that the cost to cede is greater than the cost to retain, and therefore results in sufficient incentive to maintain minimal cession rates. Accordingly, there was consensus that a change to the K factor is not required at this time." At 3.

Counting a ceded risk as four ceded risks for the purpose of calculating deficit share motivates companies to retain business with a higher loss ratio than would otherwise be the case, because it raises the marginal cost of ceding relative to the marginal cost of retaining. In a market in which companies naturally gravitate to

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[7] Reducing the K factor to 1 and allowing the "free cede" for all ERP business ceded to the pool is likely to increase the pool size to 15-20 percent of all vehicles.

[8] We note that the residual market for commercial business has proposed abandoning a dual pool system which uses different K factors.

[9] Maintaining two pools and distinct deficit share formulas may cause the pool to increase to as much as 30 percent of the market.

"subsidy paying" business, which is likely to have a lower than average loss ratio, this element of the formula motivates companies to voluntarily "bundle" the "subsidy payers" with the "subsidy receivers".

The Tillinghast Report concluded that while territory and driver class rate subsidies will push loss ratios to the range of 125 percent, these subsidies alone cannot explain the HLR ERP's loss ratios, some of which reach 400 percent.[10] This range of loss ratios suggests that fraudulent claims also may be contributing significantly to losses. These factors suggest that a guaranteed issue underwriting environment and a shared residual market deficit pool give companies a reduced incentive to maintain strong claims handling practices on ceded business, including the detection and prosecution of fraud, since the resulting financial savings are worth only the company's diluted "participation" ratio in the pool and are, effectively, shared with every other company in the market.

One of the primary reasons for supporting the residual market's shift toward an assigned risk plan is that the results of the risk will be assigned 100 percent to the carrier's balance sheet, thereby motivating companies to address claims more carefully. Heightened scrutiny should serve to reduce the loss costs of the system. The Proposal, which could allow the present residual market pool to quadruple in size during the transition period, is inconsistent with the ultimate goal of an assigned risk plan.

The proposed Rule 11 also does nothing to eliminate the perception of a two-tiered producer system. By creating two separate pools based on producer type, it reinforces the distinction between ERPs and non-ERPs regardless of their business performance. Individual drivers and households purchase insurance – not producers. Varying the cession criteria by producer type unnecessarily "pre-judges" the risk characteristics of different types of producers' customers, even though the customers may be, in all other respects, identical.

Finally, proposed Rule 11 relaxes the barriers for a company to exit the market during the transition. While the proposed rule incorporates a minimum allowable standard of annual exposure reduction, the penalty for violating that standard is substantially reduced by the use of a 1.0 K factor rather than a 4.0 K factor for the ERP

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[10] The territory and driver class rate subsidies contribute less than 20 percent to the CAR deficit. For policy year 2003, the CAR deficit attributable to these rate subsidies was approximately $67 million for all coverages.

pool. Further, nothing in the Proposal addresses the changes in market distribution by producer type that are expected to occur during the transition.

Based on information presented, it is recommended that CAR revise its Proposal to create deficit sharing formulas for the transition period by addressing the following objectives:

1. Beginning with policy year 2005, company participation for the policy year underwriting deficit arising from business ceded by HLR ERPs should be based on each company's "ought-to-have" market share based on each company's written exposures.
2. Company participation for the policy year underwriting deficit arising from the business ceded by producers other than HLR ERPs should be based on the current Rule 11 pre-credit utilization formula. CAR should develop a K factor greater than 1.0, to ensure that the proportionate size of the current pool, in total, as measured by written exposures, does not increase by more than 100 percent during the transition period. The K factor used for ERPs other than HLR ERPs and voluntary producers should be the same.[11] Consideration may be given to capping each company's pre-credit utilization deficit share or overall cession rate as part of the participation ratio calculation.
3. Ceded exposures for inexperienced operators (0-3 years licensed) and operators with an SDIP step of 20 or higher should continue to be "excluded" from the definition of ceded exposures as applied to the pre-credit utilization formula for producers other than HLR ERPs throughout the transition period.
4. CAR should revise the minimum allowable provisions in Rule 11 to limit the reduction in voluntarily acquired (whether through a non-ERP or Dual Status Producer) market share participation ratio to 20 percent per year. As noted in the Notice of the June 15 CAR actuarial committee meeting attachments, "this approach represents a stronger barrier than the exposure capping provision, as carriers would be penalized not only for decreasing voluntary agent exposures,

[11] As noted in our discussion of proposed rule 12, implementation of a Subsidy Clearinghouse beginning in policy year 2005 should help level the playing field between producers other than ERPs and non-HLR ERPs. Therefore, the K factor applied in the calculation of each company's participation ratio whould be the same for all such producers.

but also for not keeping pace with an industry increase in voluntary agent exposures as a result of voluntary contracts offered to ERPs."

The company participation ratio thus developed should be applied to the 2005 through 2007 policy year deficits, calculated using premiums that are adjusted to exclude the effect of the net ceded subsidy in the deficit calculation, as discussed in the section on Rule 12.

Rule 12. Credit Provisions.

CAR Proposal. The current system assigns residual market participation credits to CAR members based on voluntarily retained business in certain territories, and in certain rate and statistical classes that would be otherwise disproportionately represented in CAR.[12] The proposed Rule 12 stops such credit assignments at the end of policy year 2004 and establishes a "Subsidy Clearinghouse" for policy year 2005 and thereafter. Under the clearinghouse system, each CAR member would have a clearinghouse account, with sub-accounts for 'voluntary agent retained,' 'voluntary agent ceded,' and 'ERP-ceded' business. Members would be credited positive dollar amounts for writing under-priced risks, and negative dollar amounts for over-priced risks. Payments to and distributions from the Clearinghouse account would be made quarterly by CAR.

Discussion. There can be little doubt that the current credit system is not only flawed, but that it has significantly contributed to many of the most serious problems in the Massachusetts private passenger automobile insurance marketplace. The single most problematic result of this system is the disproportionately high representation of urban and inexperienced operators in the pool.[13] The current credit system is also a primary factor in the inequitable distribution of the financial burden of the residual market. It is imperative that that credit system be replaced with one that fairly and equitably distributes the burden of the residual market and, in so doing, improves the overall market for both consumers and the industry. The proposed Subsidy Clearinghouse is a

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[12] As examples, credits are given for retained business written in the higher-rated territories and on inexperienced operators.

[13] The current credit mechanism does not keep urban drivers who have no accidents or violations from being disproportionately represented in the residual market pool. This appears to be a direct function of a longstanding practice by CAR of measuring credits by driver class and rating territory independently rather than conjunctively. Further, the current methodology has also highly leveraged some companies' final participation ratios due to the excessive number of credits in the system.

significant step toward the achievement of that goal, but the system for determining clearinghouse credits requires considerable revision before it will effectively achieve that end.

CAR has reviewed and considered alternative methods for determining the retention credits for retained business. Its records show that on June 15, 2004, the CAR Actuarial Committee met to begin valuing the retention credits for policy year 2005. The AIB had submitted to CAR revised subsidy calculations that recognized the interaction between the two variables of rating territory and rating/statistical class, rather than evaluating the two variables independently. CAR staff prepared and presented an analysis of the credits that would be derived under the current system and also used a matrix analysis. CAR records also show that the Premier Insurance Company submitted a letter to CAR asking the Actuarial Committee to consider alternative credit structures during the private passenger automobile reform transition period.[14]

For the next meeting of the CAR Actuarial Committee, held June 28, the members also reviewed a proposal by the CAIR, which gave a conceptual description of a Subsidy Clearinghouse, and an example of how it might work. While it references as its basis a class/territory matrix analysis, it does not specify in detail how that analysis would be reflected in the proposed clearinghouse system, or exactly how Rule 12 should be rewritten.

The benefits of a Subsidy Clearinghouse mechanism include:

1. the ability to determine credit values independent of the size of the retained market, the number of credits actually written, or the ultimate value of the CAR deficit;
2. measuring credits directly on the basis of the subsidy, which will allow the actual credit values for the current policy year to be used during that policy year. In periods of change, this will permit a more accurate credit system;
3. uniform credit values for each company, regardless of the number of exposures a company cedes to the pool; and

[14] See, Testimony of Cara Blank, Attached Exhibit 14, Notice of Meeting, June 15, 2004, Internal Exhibit 3.

4. facilitation of an open market for all driver classes and territories under an assigned risk plan.

Analysis prepared by the SRB concluded that, while the current credit valuation methodology is theoretically sound, the method used to derive the number of credits for driver classes and territories is significantly flawed because it allows companies to receive credit for retaining "subsidy paying" risks, and fails to provide enough credit for risks retained which receive very large rate subsidies. Credit values were particularly weak for inexperienced operators in urban areas, and, as a result, a disproportionate number of them are currently insured through the residual market pool. The SRB analysis also concluded that the current method of valuing credits artificially inflated the number of credits in the system, and resulted in extremely high leverage to some company participation ratios.

The Proposal balances subsidy debits and credits in the form of revenue transfers rather than as a proportional allocation of the current deficit. The SRB analysis of the proposed Rule 12 concluded that the subsidy matrix necessary for such a revenue-based system has yet to be developed, and that without greater refinement, such a system will not necessarily promote equal access in all rating classes and territories during the transition period. According to the SRB, all current measures of subsidy, when used as a basis for credit, including the recent updates from the Automobile Insurers Bureau, have never been used on a revenue basis.[15] The application of these subsidies in the current credit valuation methodology has always been for the purpose of establishing the <u>number</u> of credits per motor vehicle that are then subsequently used in the calculation of <u>ratios</u> reflecting each company's participation in the deficit. The level of precision built into the current rate subsidy estimates with regard to deficit share is sufficient only to determine a relative obligation, not an absolute obligation.

The SRB also identified another problem with the CAR Proposal: the method by which the credit "clears." Subsidies are introduced in the rates on a revenue-neutral basis statewide so that positive and negative subsidies balance, and no additional revenue, or deficit, is created. The proposed rule "clears to zero" within the four separate sub-

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[15] The Automobile Insurers Bureau annually calculates the subsidies in the Commissioner's fixed-an-established rates for distribution to the companies.

accounts (non-ERP retained, ERP ceded, non-ERP ceded, and MAIP). An analysis of the net subsidies for each company in 2003, based on the producer type and whether the business was ceded or retained, indicates, however, that it is extremely unlikely that each of the first three sub-accounts will balance to zero independently. The ratemaking methodology for introducing rate subsidies through off-balance factors means that the system balances to zero for all business, without regard to the status of the producer or whether the business is written through CAR.

Under the current system, once a decision to cede is made, the premium on that risk is transferred from the company to CAR. On average, the net subsidy associated with ceded premium is negative, while the net subsidy associated with retained premium is positive. A company with a positive net retained subsidy will "clear" that subsidy when it receives its deficit allocation for the policy year. This system does not ensure that a company's "net overall subsidy" is zero. The subsidy clearinghouse makes a zero overall net subsidy possible for each company.

Based on the SRB's analysis, the net retained subsidy of each company is shown to vary considerably. Since the subsidies are introduced on a revenue neutral basis, the corresponding net subsidy for the ceded book of business should, in total, balance against the net retained business. One method of adjusting for subsidy in a clearinghouse manner within the structure of a facility would be to adjust the deficit for the portion that is the result of the subsidy, rather than for the portion that directly reflects losses and expenses. It would then be possible to construct allocation methods to clear the subsidy portion of the deficit separately from the allocation applied to the true deficit.

The SRB's actuary has testified that, given the present structure of the involuntary market and current subsidy estimates, one way of recognizing the varying distribution of net subsidy within the retained portfolios of each company is through a ratio adjustment rather than through an absolute accounting transaction.

The Subsidy Clearinghouse has clear advantages both in its simplicity and its responsiveness to changes in the market place. However, based on the provisions of Article VI of the CAR Plan, no credit may be given to any risk insured through the plan. As a result, the concept of the Subsidy Clearinghouse within the context of a reinsurance facility needs to be modified for the transition period. Once the MAIP is in place, the concept of the Subsidy Clearinghouse as outlined in this record will be much simpler to apply directly.

There is very little detail in the record concerning the specific operation of a Subsidy Clearinghouse either pre- or post-implementation of a MAIP. CAR should outline the steps necessary to introduce the Subsidy Clearinghouse beginning January 1, 2005, and consider incorporating the following features:

1. <u>Reinsurance Facility</u>

    a. CAR should identify the coverage level detail required to accurately measure the average net retained and ceded subsidy levels for the purpose of deficit sharing. Such measures would include specification of the method for measuring the portion of the deficit that is attributable to rate subsidy;
    b. CAR should assess the subsidy calculation most appropriate for deficit sharing in a clearinghouse manner, assuring that every effort is made to balance the subsidies to zero; and
    c. CAR should recognize subsidy credits only for retained business that is produced under a voluntary contract.

2. <u>MAIP</u>

    a. CAR should identify the level of accuracy necessary in the estimation of the subsidies to make the Subsidy Clearinghouse suitable for revenue transfer. Issues of coverage type and option should be resolved and specified, as well as the frequency of accounting reconciliation; and
    b. CAR should identify (or establish) a method for determining credits, in addition to the Subsidy Clearinghouse mechanism, for certain risk types, during and after the transition in order to encourage voluntary writings.

Rules 13 and 14. Servicing Carriers and ERPs.

Rules 13 and 14 address, respectively, the obligations of servicing carriers and exclusive representative producers. The proposed rules relate in part to issues that directly affect each group separately and in part establish interrelated provisions relating to Dual Status Producers and to the obligations of carriers that become DSCs and the HLR ERPs assigned to them. The proposals that directly relate to one of these groups will be addressed first. Because the provisions for Dual Status Producers ("DSPs"), DSCs and HLR ERPs mirror each other, and the objections to them are relevant to both, the sections of the two rules that address those proposals are considered together.

Rule 13. Servicing Carrier Responsibilities.

CAR Proposal. CAR's proposed Rule 13 provides that carriers with a 2003 exposure-based private passenger automobile market share of seven percent or more (and any other carriers that volunteer and are approved by the Commissioner) shall be DSCs with respect to private passenger business written between January 1, 2005 and December 31, 2007. Any member may contract with another company to handle its ERP business subject to certain restrictions. The identification of HLR ERPs is to be reviewed annually, and producers added or removed from that list as based upon the annual review. HLR ERPs are to be appointed to DSCs. The proposed rule provides for equitable distribution of HLR ERPs based on the HLR ERP's exposure volume and loss ratio, and the DSC's total market share. Each DSC is to develop jointly with the HLR ERP a rehabilitation plan. Such rehabilitation plans are to be filed annually with the Commissioner, with a copy to CAR, on or before April 15 each year. Each rehabilitation plan must, at a minimum, reflect the requirements in CAR Rules 10, 13, and 14, and the High Loss Ratio Improvement Plan in the CAR Manual of Administrative Procedures ("MAP").[16] The proposed rule adds "failure to comply with the requirements of the High Loss Ratio Improvement Plan" to the conditions that may be grounds for termination of an ERP based upon thirty days written notice.

Proposed Rules 13.B.4.c and 13.B.4.d change the procedures that Servicing Carriers must follow for reporting coverages written to CAR. Under subsection (c) of the current Rule, a Servicing Carrier may elect to cede to CAR all the new business written by an ERP. The proposed rule changes subsections (c) and (d), and limits that election, for private passenger new business, to policies effective before January 1, 2005. The new

[16] As discussed above, CAR's proposed rules use two terms to discuss these plans: rehabilitation plan and High Loss Ratio Improvement Plan. The two terms appear to be used interchangeably. In its reconsideration, CAR should select a single term to use in referring to these plans.

subsection (c) requires a Servicing Carrier to cede 100 percent of the new and renewal private passenger business written by an ERP with effective dates from January 1, 2005 through December 31, 2007. Thus, in order to retain any portion of an ERP's business, a carrier must execute a voluntary contract with the ERP. The provision that "all business from ERPs, excluding DSPs, shall be automatically backdated" acknowledges that this business will be ceded as of the date that the business was written, not the date that it was ceded.

For ERPs that obtain voluntary contracts, ceded business effective January 1, 2005 through December 31, 2005 and ceded renewal business effective January 1, 2006 through December 31, 2006, shall continue to be written by its assigned Servicing Carrier. New business effective on and after January 1, 2006 and renewal business effective on and after January 1, 2007 shall be eligible for the Assigned Risk Plan if the carrier does not write it on a voluntary basis.

Rule 14. Representative Producer and ERP Requirements.

CAR Proposal. The proposed rule changes the DSP Rule, to provide that any ERP which obtains a voluntary contract for policies effective December 31, 2004 and prior with another Servicing Carrier or non-servicing carrier for the same type of business will retain the involuntary assignment, for renewal business only, for three months from the effective date of the voluntary contract. At the end of that period, the involuntary assignment for renewal business will terminate. An ERP which obtains a voluntary contract for private passenger business effective January 1, 2005 and later, retains the ERP status for private passenger business for new business written in calendar year 2005 and renewal business effective in calendar year 2006 which is not written on a voluntary basis by the voluntary carrier. New business written by dual status producers, with an effective date in calendar year 2006 and renewal business effective in calendar year 2007, if not written by the carrier on a voluntary basis, shall be eligible for the Assigned Risk Plan.

The proposed Rule 14.B adds a new section, Rule14.B.1, which establishes the obligation of an HLR ERP to jointly develop with its DSC a rehabilitation plan to be filed with the Commissioner, with a copy to CAR, that shall, at a minimum, reflect the requirements for servicing carriers and ERPs in Rules 10, 13 and 14, and the HLR

Improvement Plan as contained in CAR's MAP. It increases the list of requirements which ERPs must fulfill, and which may be grounds for termination if the ERP fails to do so, by adding compliance with the requirements of the High Loss Ratio Improvement Plan.

Discussion.

1. Designated Servicing Carriers

Under proposed Rule 13, a carrier which had an exposure based market share of seven percent or greater in 2003, automatically becomes a DSC. Commerce stated that only six companies have a market share of that size, and argued that the proposed rule therefore violates G. L. c. 175, §113H (C), which requires the appointment at all times of no fewer than twenty servicing carriers. We note that the number of carriers who become DSCs under the proposed rule, either as a result of their market share or with the Commissioner's approval, may be less than twenty. We also note that the number of companies operating in the market, and the market share distribution, may constrain the number of servicing carriers. CAR should address any questions that may arise relating to compliance with the statutory requirement in light of these constraints.

The proposed rule also permits CAR members to contract with another company to handle their DSC responsibilities; it parallels the provision in the current rule that allows members to contract out management of their ERP business. CAR retains responsibility for reviewing and approving such agreements. No objections were raised to this provision.

2. Dual Status Producers

Rule 13.B.4 addresses a Servicing Carrier's obligation to report coverages it writes to CAR. The proposed rule limits a Servicing Carrier's option to cede new private passenger business written by an ERP only to policies effective before January 1, 2005. It further requires that for private passenger business effective January 1, 2005 through December 31, 2007, a Servicing Carrier must cede all of the new and renewal business of an ERP, except business from DSPs.

The proposed rule excludes business from DSPs from the 100 percent ceding requirement. However, for ERPs that obtain voluntary contracts, ceded business effective January 1, 2005 through December 31, 2005 and ceded renewal business effective January 1, 2006 through December 31, 2006, shall continue to be written by that ERP's assigned Servicing Carrier.

Proposed Rule 14.A.c.1 revises the current DSP to provide that any ERP which obtains a voluntary contract for policies with effective dates on or before December 31, 2004 with another Servicing Carrier or non-Servicing Carrier for the same type of business, retains the involuntary assignment, for renewal business only, for three months from the effective date of the voluntary contract. An ERP which obtains a voluntary contract with a Servicing Carrier or non-Servicing Carrier for private passenger business with effective dates of January 1, 2005 and later retains its ERP status for new private passenger business which the new carrier does not write on a voluntary basis through 2005, and for renewal private passenger business written with effective dates of January 1, 2006 through December 31, 2006.

The current DSP rule applies when an ERP obtains a voluntary contract, and establishes a period in which the involuntary assignment is continued for renewal business. The Proposal does not change the concept of DSP, but changes the coverage which may remain with the Servicing Carrier to include new, as well as renewal, business and expands the period in which the ceded business may remain with the Servicing Carrier. As noted below, the concept of a DSP requires clarification.

Proposed Rule 13 refers to DSPs, a term which is not specifically defined in the Proposal although it has been incorporated into the CAR Rules at least since before 1997. Our comment on Rule 2 concludes that it is appropriate to add to it a definition of DSP. The definition should, among other things, make clear that a Servicing Carrier may offer a voluntary contract to an ERP now assigned to another Servicing Carrier which would establish a purely voluntary relationship rather than create a DSP relationship. Under these circumstances, the new Servicing Carrier would make cession decisions. Testimony at the hearing indicated that one objective of the transition rules is to encourage Servicing Carriers to offer voluntary contracts to ERPs; clarity in the rule relating to the consequences of entering into such contracts will help facilitate such transactions.

A second concern expressed by participants in the hearing is the growth in the size of the residual market. To that end, we note that proposed Rule 13, as it relates to

DSPs, states that the prior carrier's ceding decisions shall continue. Rule 14, however, retains the producer's ERP status only for business that is not written voluntarily by the new carrier. Carriers that offer voluntary contracts to ERPs formerly assigned to other Servicing Carriers should be encouraged to make their own cession decisions. Therefore, proposed Rule 13 should be revised to make clear that the new voluntary carrier may make its own decision on retention of formerly ceded business.

Recommendations offered at the hearing included developing rules that will define the factors that companies must consider in assigning risks to an assigned risk plan, including a so-called "clean in three" rule. Such a rule would ensure that good drivers are not placed in the residual market, and that that market will remain small. We urge CAR to develop rules consistent with those principles, to ensure that decisions assigning risks are based on objective standards and that good drivers are written voluntarily. To the extent that they apply to an assigned risk plan, such standards must be in place by January 1, 2006.

3. *DSCs and HLR ERPs*

Proposed Rules 13C.1.a and 13C.1.b provide for the appointment of HLR ERPs to DSCs, according to an equitable distribution formula that is based on the HLR ERP's exposure volume and loss ratio and the DSC's total market share. It requires annual review of data relating to the identification of HLR ERPs, and, based on that review, the addition to or removal of producers from that category. Proposed Rules 13.A.2 and 14.A.1 require DSCs and their assigned HLR ERPs jointly to develop rehabilitation plans which are to be filed with the Commissioner, with a copy to CAR, by April 15, 2005 and each such annual period thereafter. Such plans are, at a minimum, to reflect the requirements in CAR Rules 10, 13, and 14, and the High Loss Ratio Improvement Plan in the CAR MAP. The proposed rules add "failure to comply with the requirements of the High Loss Ratio Improvement Plan" to the conditions that may be grounds for a Servicing Carrier to terminate an ERP on thirty days written notice, and add compliance with such a plan to the responsibilities of an ERP.[17]

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[17] We note that Rule 14.B lists the responsibilities of ERPs and states that failure to fulfill those responsibilities may be grounds for termination. As written, proposed Rule 14.B.2.r refers to failure to comply with an improvement plan, and should be revised to state "compliance with" the requirements, etc.

As discussed in the Tillinghast Report, the business generated by a subset of ERPs has exceptionally high loss ratios. The AG also comments that losses associated with HLR ERPs are disproportionately high both in the residual market and within certain company portfolios. CAIR testified that it supported the concept of identifying HLR ERPs and taking steps to help reduce losses generated by their books of business. One speaker noted that, under the current system, business from HLR ERPs has been shifted repeatedly with no effort to address the underlying causes of the high loss experience. It was also noted that the assignment of this business to DSCs would concentrate it among larger companies that have more resources to address potential management and fraud issues. The general expectation is that more careful attention will improve the loss experience attributable to these HLR ERPs and thereby reduce the overall deficit.

The effects on consumers of reassigning HLR ERPs to DSCs are, in principle, no different from the reassignments of ERPs to Servicing Carriers. ERP reassignments occur routinely in the existing market as a result, among other things, mergers and acquisitions of producers and of CAR decisions relating to compliance with ERP subscription requirements. A customer of a reassigned ERP receives notice that his or her coverage, upon renewal, will be written by a different carrier. The AG has recommended that, to the extent possible, HLR ERPs be assigned to their current servicing carrier, noting that this approach would minimize market disruption by reducing the number of transferred policyholders. It would also allow companies that are familiar with these producers to continue to serve them and to deal more effectively with these producers' issues. The Proposal does not incorporate specific rules for assigning HLR ERPs to DSCs; as revised, it should ensure that such assignments preserve current relationships.

A principal objection to the rehabilitation plan for HLR ERPs, as included in the Proposal, is based on the premise that it holds HLR ERPs to different performance standards and a higher degree of oversight than other producers, including requirements for: 1) the establishment of formal communication channels and periodic meetings between the HLR ERPs and their [carriers]; 2) the application of underwriting criteria, to be developed by insurers, for pre-inspection of vehicles that would otherwise be exempt under 211 CMR 94.05; 3) the recalculation and billing of premiums if discrepancies are discovered, in purported contravention of DOI Bulletin 1999-02; 4) the verification by a company's special investigative unit ("SIU") of garaging and policy facts on a representative sample of policies; 5) the referral of claim files to the SIU if an insured files three accidents in a rolling 12-month period,; 6) company contact with an insured who files three or more glass claims,to verify the facts; 7) obtaining and forwarding to the company copies of licenses for all listed operators and additional operators on the policy; and 8) allowing no policy to be written with a post office box as the garaging address.

The Tillinghast Report supports the undisputed statement that loss ratios attributable to the business of some ERPs are far higher than the statewide average for ERP business. That these losses contribute to the CAR deficit is also unquestioned; further, as part of the rate setting process, such losses are passed on to all consumers. The High Loss Ratio ERP Improvement Plan, proposed in the MAP, was developed expressly to reduce the CAR deficit and the burden placed on good drivers by improving the loss ratios of the producers' books of business. It is based on the premise that the implementation of specific business management practices will prove effective in achieving that goal.

The current CAR Rules outline the responsibilities of servicing carriers and ERPs, but CAR does not require its members to use a standard form contract for their ERPs, and CAR Rule 13A explicitly states that the appointment of a member as a Servicing Carrier does not affect its contractual relationship with its voluntary agents. The specific arrangements between CAR members and their representatives are set out in the contracts they execute. Companies are thus free to develop business practices for their ERPs that will achieve compliance with the CAR requirements and are compatible with the company's internal systems. The current system does not impose uniform approaches to management of the carrier/ERP relationship. The desirability of establishing industry-wide standards is evident in CAR's decision, in Proposed Rule 10, to require all Servicing Carriers to comply with claims handling standards that CAR establishes.

The Improvement Plan, in large measure, does not alter the obligations of servicing carriers or ERPs, but establishes specific methods for fulfilling those obligations. Servicing Carriers, for example, are currently required to confirm operator driving licenses and to verify that representations in the application are accurate. ERPs are currently required to notify the Servicing Carrier of any suspected fraud surrounding a loss and to comply with reasonable written procedures for processing claims. In general, the Improvement Plan identifies a series of best practices that will enable the Servicing Carrier to meet its obligations and to create a more effective working relationship between a Servicing Carrier and its representatives. Some of those practices may already be in place for some companies; on this record we can reach no conclusions regarding the standard practices for any carrier. We note, as well, that one aspect of the Improvement Plan, the maintenance of complaint files, appears to be duplicative of the requirements of G. L. c. 176D, §3 (10), which apply to both companies and producers. We observe, too, that the standard application for private passenger automobile insurance requires the applicant to provide a residential address and a mailing address, where such addresses are different. We find it surprising that any company would consider an application identifying a post office box as a garaging address.

While we agree with the goals of the Improvement Plan, we note that the Proposal inconsistently refers to "rehabilitation plans" and "improvement plans." Because the recommendations relate to management of the relationship between the carrier and producer, we recommend that CAR consider the selection of a single term and incorporate it into Rule 2 – Definitions. To the extent that carriers have not established methods that are equally effective at fulfilling their respective obligations, we agree that these management recommendations should apply to company relationships with <u>all producers</u>.

Commerce asserts that the obligation to recalculate premium if discrepancies in the rating information are discovered violates the terms of Division of Insurance Bulletin 1999-02. That bulletin, in essence, prohibits insurers from <u>unilaterally</u> substituting rating information obtained from third parties for information on an application, without the consent of the insured. It requires insurers who obtain such information to initiate an inquiry to resolve any factual errors and to obtain the insured's consent before adjusting the premium. Refusal to consent to a change may be grounds for cancellation of the policy. We do not find that the Improvement Plan requirement to recalculate bill premiums is inconsistent with the principles expressed in this bulletin; it does not alter the carrier's obligation to act only on information that it has independently verified and to advise the insured before recalculating the premium. We welcome comment, however, on whether and how Bulletin 99-02 should be revised.

We are concerned, however, about the Improvement Plan's requirement that DSCs set underwriting criteria for pre-inspection of vehicles that would normally be exempt under current regulations. It is not clear which exemptions such criteria are intended to address. If CAR has concluded that the exemptions under 211 CMR 94.06 require revision, it is appropriate for CAR to seek such changes.

As stated above, we find that the Improvement Plan parameters, in large part, constitute management practices that are universally appropriate and that, depending on the contract between a servicing carrier and its ERP, may already be in place. Furthermore, these parameters focus on the relationship between carriers and producers; they do not purport to alter the relationship between individual consumers and insurers or producers. Implementation of practices that are anticipated to ensure premium accuracy and careful claims handling will benefit all consumers.

It has been noted that a HLR ERP may be assigned to a DSC that does not offer the same discounts, deviations or credits as the ERP previously offered. Programs such as group discounts, §113B deviations and premium credits on other business placed by a consumer are developed by individual insurers for a variety of reasons. Participation in any such program requires the consumer to establish a relationship with the offering insurer. With the exception of group discounts for employees of a particular employer, the consumer who seeks to benefit from a program must make an affirmative choice to do business with a company or through a producer representing the company that offers it. Consumers who obtain insurance through ERPs have no choice of company but, in some cases, have benefited from programs that the ERP's Servicing Carrier may offer. As noted above, ERP assignments change in the existing market, and such changes already affect the option available to the particular ERP's customers.[18] If the ERP is assigned to a Servicing Carrier that does not offer the same discounts, deviations or credits, the consumer continues to retain the choice to remain with the former carrier or to explore the offerings of other carriers.

[18] Reassignments may, in some cases, make additional options available to consumers.

Commerce is also concerned that the customers of DSPs could lose access to discounts, particularly the multi-car discount that is available when a household insures more than one car with the same company. Commerce asserts that if the DSP's voluntary carrier refuses to write both vehicles, the customers would no longer qualify for the discount. As discussed above, the Proposal requires modification to clarify the rules applicable to ceding business from DSPs. CAR should, in addition, consider modifications to those rules which would resolve this issue.

4. Transition to an Assigned Risk Plan

"New business" is not defined in the current CAR Rules or in the proposed MAIP rules, and we recommend that CAR incorporate such a definition. The SRB has estimated that, if "new business" were to be defined as newly licensed drivers, drivers new to the state of Massachusetts, or drivers with a policy effective date in 2006 whose policy had been cancelled for non-payment of premium in the last 60 days (and there has been at least a one day lapse in coverage in the 30 days prior to the policy effective date), potentially 25 percent of the 2005 residual market pool could be assigned to the MAIP in 2006. The definition of "new business" chosen by CAR should consider the potential impact on the size of the MAIP.

The Proposal outlines the transition of currently pooled business to the MAIP over a three-year period as follows: Beginning January 1, 2006, new business exposures written voluntarily (other than new business exposures from HLR ERPs) will be ineligible for cession to CAR. Instead, these exposures will be placed in the MAIP. New business from HLR ERPs will continue to be ceded to CAR. Beginning January 1, 2007, all new and renewal exposures not written voluntarily (other than from HLR ERPs) will be ineligible for cession to CAR, but will rather be placed in the MAIP. Beginning January 1, 2008, all business from any producer not written voluntarily will be placed in the MAIP.

However, the Proposal does not adequately describe the means by which business in the residual market will be transferred to the MAIP during the transition. Among the goals to be achieved during the transition period are training of producers and their staff and the development of electronic processes that will facilitate the assigned risk process. To facilitate this objective, it is desirable that volume assigned through the MAIP in its first year of operation be no larger than necessary to test these new systems and processes.

Several further clarifications within Rule 13 are advisable. The rule also should reflect a three year transition so that "new" business from producers, excluding that of DSPs, HLR ERPs, and ERPs who are not given dual status contracts, is assigned through the plan from January 1, 2006 through December 31, 2006. The rule should provide that any business from producers (excluding that of DSPs, HLR ERPs, and producers who are not given dual status contracts) and "new" business" from Dual Status Producers is assigned through the plan from January 1, 2007 through December 31, 2007. Finally, the rule should provide that any business from any producer may be assigned to the plan beginning January 1, 2008.

5. Other Transition Issues

To help achieve the goal of maintaining a stable market place for both consumers and producers during the transition period, we suggest that Rule 13 C.2 be modified to reflect the following: (1) non-ERP producers that lose their last voluntary contract shall be assigned to their last carrier of record. This will minimize consumer disruption and afford a greater opportunity for that producer to obtain a dual status contract and thereby to retain a voluntary contract with a carrier for at least a portion of the business; (2) encouragement to companies to write voluntary business in geographical areas where the 2003 HLR ERP market share exceeds ten percent, by creating incentives for companies to solicit business in these areas.[19] For policy years 2005 through 2007, favorable cession terms should be afforded to business generated by newly established non-ERP producers or through direct marketing efforts in those areas. It is anticipated that the majority of the customers of such producers will work or live in these communities. Cession incentives for these areas might include the following: First, 20 percent of the new business generated by these producers in their first twelve months of operation shall be considered an "excluded class" for the purposes of cession; second, ten percent of the business written by these producers in their 13^{th} through 24^{th} month of operation shall be considered an "excluded class" for the purposes of cession; third, no more than five

[19] CAR data for policy year 2003, as reported through December of that year, show HLR ERP market share by rating territory. See, Internal Exhibit 1 to the affidavit of David Cochrane, Exhibit AA to the submission made by Commerce on July 22, 2004.

percent of the producer's renewal business may be assigned to the MAIP in his or her 25th through 36th month of operation.

Rule 17. Expense Allowance to Servicing Carriers.

CAR Proposal. The Proposal makes no substantive change to Rule 17.A.1.a., which addresses premium tax and commission expenses. It adds to Rule 17.A.1.b, which addresses unallocated loss adjustment expenses (ULAE), company expenses and general expenses, a provision that, for calendar years 2005 through 2007, the expense allowance for private passenger motor vehicle business shall be calculated separately for HLR ERP business. It does not address how these expenses will be calculated, but states that the specific details of that calculation will be developed at future CAR Committee meetings. The Proposal also adds a new section, Section A.1.c, which establishes a Paid Loss Ratio Incentive Program (PLRIP) for calendar years 2005 through 2007. It provides that Servicing Carriers will be paid an additional ceding expense reimbursement for a specified improvement in the paid loss ratios of their HLR ERPs. Again, however, the Proposal regarding the PLRIP does not sufficiently articulate the details of the proposed rule, which were left to be addressed at future CAR committee meetings.

Finally, the Proposal eliminates subsections 1 and 2 of Rule 17.C, which provided for miscellaneous expense allowances to offset the expenses associated with newly assigned representative producers. The Proposal retains the text of Rule 17.C.3, which states that, on policies written by a Servicing Carrier, each Servicing Carrier will receive a credit against its premium written account for all losses paid on policies which it wrote as a Servicing Carrier, and that allocated loss adjustment expenses (ALAE) are to be treated as loss payments for the purposes of this calculation. The proposed amendments to Rule 17.C also eliminate subsections 4 and 5, which provide, *inter alia*, for the issuance of quarterly statements to members reflecting their accumulated expense allowances, credits, and written premiums.

Discussion. CAR should provide greater detail in its revised Proposal on the method for calculating the expense allowance for HLR ERP business and the PLRIP. Its revisions should address the concerns we express below. The Commissioner's April 29 letter charged CAR with establishing a plan by which each third party carrier would be paid a servicing fee based on two components: (1) claims handling based on frequency;

and (2) a bonus fee that reflects managed improvements in relation to an ERP's three-year loss ratio. The proposed rule makes a distinction between expense allowances for HLR ERPs and non HLR ERPs which is problematic because many of the HLR ERPs are currently assigned to companies that will become DSCs, and should continue that assignment. This group of HLR ERPs would not be moved from a company which will become a DSC under this proposed rule. An estimated 15 to 32 HLR ERPs whose books of business may be reassigned to a DSC represent 20 to 30 percent of all vehicles insured with HLR ERPs. With the exception of those producers, CAR has not explained why the ceding expense allowances for DSCs should be higher than what is given today.

The current rule adjusts each Servicing Carrier's ceding expense allowance by the "ratio of its claim frequency and other appropriate factors for ceded business to the claim frequency and other appropriate factors for all ceded business". Because it provides a higher ceding expense allowance to companies whose business experiences high claim frequency, it establishes an unfortunate dynamic that does not provide an incentive for companies to reduce claim frequency.

The most significant change proposed to this rule, and the most controversial, is the inclusion of a PLRIP. However, the Proposal failed to include a description of the PLRIP. It deferred the provisions of that plan, as well as details on the expense allowance calculation for HLR ERPs, for further discussion at later CAR meetings. Based on the motion made and approved at the May 18, 2004 meeting of the CAR actuarial committee, the PLRIP will vary according to the performance of each individual servicing carrier. Comment on this proposal included an argument that the PLRIP will provide an incentive to DSCs to apply a heightened level of scrutiny to HLR ERPs, and thereby single them out for differential treatment.

The current rule governing the ceding expense allowance to each Servicing Carrier adequately reflects each Servicing Carrier's ceded frequency levels relative to the statewide average. To the extent DSCs take on additional management responsibility for HLR ERPs from other servicing carriers, the existing formula will continue to reflect the relative frequencies expected for those portfolios. Excluding a Servicing Carrier's relative ceded severity level in the allocation of ceding expense allowances eliminates distortions to that allocation that might arise from differences in individual company reserving and claims handling practices.

Use of a paid loss ratio standard as the basis for compensation poses some significant challenges, particularly when considered within the context of a three-year transition period. Questions that need to be addressed include: (1) Whether losses will be measured on an accident, calendar, or policy year basis; (2) The dates at which losses will be valued, and whether IBNR will be included; (3) How changes in the paid loss ratio that result from unusually large claims, rate changes, or other general industry trends that affect all companies will be handled in measuring improvement; (4) How the baseline for improvement will be established; and (5) The basis for paying a higher ceding expense allowance to a Servicing Carrier that is managing a HLR ERP than to one that is not when both can demonstrate improvement in their paid loss ratios.

The Commissioner's April 29 letter was clear that the bonus fee should reflect managed improvement in the <u>HLR</u> <u>ERP's</u> three year loss ratio, not the Servicing Carrier's loss ratio. The intent of the bonus fee is to motivate carriers to address the varying causes of extremely high loss ratio results. In keeping with the objective of ensuring that the value of any claim settlement is not unnecessarily influenced by financial incentives to the company, any bonus incentive should be based exclusively on claim frequency for property damage liability and personal injury protection claims. Within the context of a three year transition, these coverages have the advantage of being quickly reported and thus simple to compare on a yearly basis. While we understand that CAR has not had sufficient time to prepare such a proposal, we offer the following principles for it to consider towards this end:

1. The baseline frequency against which subsequent performance will be measured for each HLR ERP, and whether that should be accident year or calendar year 2004;
2. The overall baseline frequency and subsequent year frequencies for each HLR ERP should be the weighted average of the actual frequencies by rating territory and driver class using the ERP's 2004 exposures as the weights. This will ensure that improvements are recognized for real reductions in frequency, and not changes in the composition of the producer's book of business;

3. A methodology should recognize relative improvement for each producer, and identify above average performance. The method should be able to identify better than average performance improvement in the presence of general trends affecting frequency which are driven by factors outside of the producer's control;
4. A means for estimating the proportion of the deficit that was eliminated as a result of the ERP's frequency improvement; and
5. A means for estimating the credit in deficit share that should accrue to the DSC.

The immediate objective of such a bonus plan is to provide HLR ERPs with the management resources necessary to improve their chances of obtaining voluntary contracts when the assigned risk plan is implemented. A potential benefit of such a plan is future containment of the deficit level within the pool during the transition. For this reason, CAR may consider guidelines for such a program as it may apply to all HLR ERPs during the transition, not just for those for which the DSC is operating as a third party carrier.

As to the costs of assuming additional HLR ERP assignments, it is reasonable for DSCs to expect to be compensated for any additional management costs they incur. During the transition, this process should be transparent to all Member Companies. In evaluating a process for this, CAR may want to consider how such a process will transfer to LADCs under an assigned risk system. The third party buy-out percentage in the formula often used for LADC services includes a service fee ranging from five to fifteen percent. The premiums used in this formula should be adjusted to reflect the subsidy within that premium based on the Subsidy Clearinghouse.

It is important that proper incentives be implemented to motivate companies to handle all claims in a disciplined and consistent manner, regardless of how the insured purchases his or her coverage or through what mechanism the coverage is provided. While the Proposal suggests that DSCs would be entitled to a higher ceding expense allowance than other carriers, the record does not offer a basis for this conclusion.

IV. Discussion and Analysis of Part II of the Proposal

Part II of the Proposal, consisting of new Rules 21-40, relates to the MAIP. CAR's Proposal fixes an effective date of January 1, 2006 for these rules.

Rules 21 through 40 address both issues of CAR governance and the structure and operation of the MAIP. The MAIP, however, will not be fully implemented until January 1, 2008. Changes to the current CAR Rules, set out in Part I of the Proposal, are intended to cover the interim transition period. In addition to administering the residual market, CAR is responsible for acting as the Commissioner's statistical agent. CAR must therefore be structured in a manner that enables it to perform all its duties. The Proposal does not explain whether adoption of the Part II Rules as of January 1, 2006, is intended to replace the current CAR Rules as of that date. In order to avoid confusion and ensure a smooth transition to the MAIP, CAR should reconsider the decision to replace all the current rules and take action to ensure that adoption of a new rule on January 1, 2006 will not conflict with anticipated operations during the transition period.

As a general overview, we note that CAR attempted to cover many principles of the MAIP in its Proposal. However, the individual rules and principles do not fully meet the objective for a fair and equitable distribution of the risks written through this Plan. Further, the Proposal does not provide the particularity necessary to ensure that that the Plan will achieve its desired goals. Examples of specific principles that we recommend be incorporated into the MAIP include:

1. The enhancement of consumer awareness. Such objective must be achieved through specific tools designed to promote such awareness and to facilitate consumer shopping. This objective is particularly important in the circumstances under which a consumer's ERP is not given a voluntary contract;
2. Distribution restrictions that affect policies maintained by households must be revisited to allow for the assignment of applicants to their existing carrier when coverage is already in place for a vehicle in the household. The rules should provide for the maximization of multi-vehicle and other such types of discounts; and
3. As part of the assigned risk plan, notably the "Clean in 3" rule recommended by the AG, CAR should consider including criteria with regard to retaining, or rejecting, certain policies that involve insureds who have not filed any personal injury protection ("PIP"), medical payment, or uninsured motorist claims as the result of an at-fault accident during the preceding three year period

or with regard to the number of accidents or violations recorded in the past five years for insureds who are accident and violation free for the three years preceding the policy effective date. The Proposal should also provide that risks who withdraw from it as a result of obtaining voluntary insurance will not suffer any financial penalties. Producers who can only place a risk through the MAIP should be required to notify the consumer of that result, and the reasons underlying that outcome.

Some of the unresolved issues relating to the MAIP may be addressed in the Uniform Automobile Insurance Plan developed by AIPSO and adopted, in some form, in other jurisdictions. The AIPSO plan provides some specific approaches to, among other things, the rights and responsibilities of consumers under an assigned risk plan, including cancellation and assignment provisions. Accordingly, we recommend, among other things, that CAR revise the Proposal using AIPSO's Uniform Automobile Insurance Plan as a model for the MAIP. Any departures from such model should be articulated and justified in detail.

4. The Subsidy Clearinghouse, as proposed in Rule 36, is established as part of the MAIP for policy years 2008 and subsequent. The Proposal as a whole is unclear on how the MAIP Subsidy Clearinghouse, MAIP quota share calculations, and overall MAIP credits will function relative to the residual market during the transition period. Because MAIP is expected to be implemented, in part, on January 1, 2006, the rules should provide specific guidance on the measures that will be in place from January 1, 2006 through December 31, 2007.

As with the rules in Part I of the Proposal, we note that the Part II rules require review to correct typographical errors and ensure that the language is consistent with current law. Such changes include replacing the term "agents" with "producers" and "fire and casualty insurance" with "property and casualty insurance". Other specific comments on the proposed rules follow.

Rule 21. General Provisions.

CAR Proposal. The purpose of the MAIP is to provide private passenger automobile insurance coverage to eligible risks who are unable to obtain such coverage in the voluntary market and to assure that the policies written through the MAIP are distributed equitably based on each member's quota share. The rules are to apply to all non-voluntary private passenger automobile motor vehicle insurance policies issued with the following effective dates: 1) as of January 1, 2006, new business from voluntary agents and Dual Status Producers may be place in the MAIP; 2) as of January 1, 2007, new and renewal business from those producers may be placed in the MAIP; 3) as of January 1, 2008, any business that is not to be written on a voluntary basis may be placed in the MAIP.

Discussion. As noted in our comments on Rules 13 and 14, provisions for the transition of business from the current system to MAIP should be revised. Rule 21 should therefore be revised to be consistent with changes to those rules.

Rule 22. Definitions.

CAR Proposal. Compared to the proposed Rule 2, Rule 22 adds definitions of the following terms: Assigned Risk Company ("ARC"), Assigned Risk Producer ("ARP"), Dual Status Producer ("DSP"), Limited Assignment Distribution Company ("LADC"), MAIP, and Quota Share. It revises the definitions of Eligible Risk, Household Member, Member, and Private Passenger Motor Vehicle. References to the MAP, the Plan of Operation, and the Rules of Operation are changed to refer to the MAIP, not to CAR. Definitions of Insurer, Newly Emerging Company, Principal Place of Business, Representative Producer and Servicing Carrier are omitted.

Discussion. In our comments on CAR's Proposal relating to proposed Rule 2, we noted inconsistencies in the definitions throughout the Proposal, recommended that CAR define additional terms to improve the clarity of the Proposal, and urged it to review its proposal to achieve consistency and clarity. Those comments apply equally to proposed Rule 22. CAR should also determine whether a definition of Principal Place of Business is necessary in order to support placement and rating of insureds whose principal use of the vehicle is for business.

Rule 23. Member Obligations.

***CAR Proposal*.** In general, Rule 23 tracks current Rule 3, but eliminates the requirement that members pay an annual $500 fee to CAR, shortens the section relating to the effect of merger or consolidation of MAIP members, and omits the language that allows for the apportionment of any unsatisfied net liability of an insolvent CAR member to other CAR members. It additionally does not provide for a fee or conditions for becoming an inactive member of MAIP, conditions that currently exist in Rule 3A with regard to CAR members. In the event of mergers or consolidations, Rule 23 states that the quota share of the continuing Member will be adjusted to include the business attributable to the merged or consolidated Member. It also provides that "[a]ssigned risk policies of the transferring member shall not be subject to cancellation by the member to which said obligations have been transferred in accordance with the provision of Rule 29-Assignment Process; provided however, that nothing set forth herein shall prohibit the cancellation of an Assigned Risk policy pursuant to the provisions defining an eligible risk."

Discussion. G.L. c. 175, §22C sets out statutory reasons for policy cancellation. Rule 23 should not prohibit companies from exercising cancellation rights under that statute. **CAR may also wish to reconsider the elimination of annual fees.**

Rule 24. Governing Committee.

CAR Proposal. Rule 24 gives the Governing Committee of CAR responsibility for administering the MAIP, including preparation and filing of the Plan and Rules of Operation. The Governing Committee's specific powers are identical to those in current Rule 4, with the following exceptions: 1) it no longer has the authority to appoint servicing carriers or to apportion the underwriting results of CAR among members and to levy assessments or make such distributions as are appropriate for such apportionment; 2) the procedure requiring an majority vote to take binding action is omitted.

Discussion. The Rule 22 definitions of ARCs and ARPs state that they are appointed by the Governing Committee; Rule 38 addresses terminations of ARCs and ARPs and decertifications of ARPs by the Governing Committee. The Governing Committee's specific powers in Rule 24 should therefore include the powers to appoint, to terminate and to decertify ARCs and ARPs. The reason for separately incorporating the Rule 40 appeal right in Rule 24 is not clear; CAR should either explain its reason for including it or delete the sentence.

Rule 25. MAIP Officers.

CAR Proposal. Rule 25 provides for a single MAIP officer, the president, eliminating the positions of vice-president- claims, vice-president-administration and auditor that are specified in the current Rule 5. The Governing Committee may authorize additional officers. The duties of the president of MAIP are identical to those of the president of CAR, as set out in Rule 5.

Discussion. No objections were voiced to Rule 25, and we note no concerns.

Rule 26. Underwriting Guidelines.

CAR Proposal. Rule 26 specifies the underwriting practices that ARPs, ARCs and LADCs are to apply to risks assigned under the Plan. The practices relate to the forms that are to be used with assigned risks, the information that must be provided on new business applications, the timing of submitting applications, requirements for supporting documentation, and obligations to confirm data through the Registry of Motor Vehicles or other appropriate sources. Rule 26 also limits deferral or waiver of pre-inspection regulatory requirements if the vehicle has not been continuously covered for physical damage or is ten years old or older.

Discussion. Several of the practices incorporated into this rule parallel the recommendations relating to improvement plans for HLR ERPs in the MAP. Concerns addressed in our discussion of Rules 13 and 14, above, are equally applicable to Rule 26. CAR must also revise Rule 26 to ensure that the procedures it seeks to put in place comply with the regulations applicable to pre-inspection of vehicles.

Rule 27. Coverages.

CAR Proposal. Rule 27 is derived from Part A of current CAR Rule 6, which relates to coverages available on policies issued through the residual market. It differs from Rule 6 in two ways: 1) omits language stating that the rule applies to private passenger vehicles registered in MA or owned by a person which has its principal place of business in MA, regardless of the state of registration; and 2) substitutes in subsection (8) the words Assigned Risk Company or Limited Assignment Distribution Company for "Servicing Carrier."

Parts B and C of the current CAR Rule 6 relate to commercial coverage, and are therefore omitted from the MAIP rules.

Discussion. CAR should review its Proposal to ensure that the rule includes all risks insured under private passenger motor vehicle policies.

Rule 28. Application Process.

CAR Proposal. Rule 28 requires producers to submit applications electronically to MAIP which, once the application is certified as complete, assigns it to an ARC or LADC based on the carrier's quota share. MAIP notifies the producer of the assignment; the producer must, within two working days, provide the insurer with the original signed application form and the deposit premium. The rule also provides premium deposit and payment requirements, including installment plans, prescribes the terms of installment plans, including installment charges, and sets various fees for returned checks, etc.

Discussion. G.L. c. 175, §113H requires the residual market plan to include guidelines for installment payment plans that servicing carriers provide. Unlike the analogous portions of current Rule 13 that require servicing carriers to provide an installment plan which has been filed with and approved by the Commissioner, Rule 28 prescribes a single standard payment plan for business written through the MAIP. CAR should reconsider the Proposal to ensure that its installment plan is comparable to the average charges in the marketplace. We agree that it is appropriate for CAR to develop installment plan differentials for risks which are cancelled for non-payment.

Rule 29. Assignment Process.

CAR Proposal. Rule 29 specifies procedures for assigning applicants to members, based on their individual quota shares. It includes the process for determining quota shares, arrangements for servicing quota shares through LADCs, restrictions on quota distributions, quota share adjustments, and time limits on the assignment periods. CAR states that it will discuss additional details relating to Rule 29 at future CAR committee meetings.

Discussion. Because the procedures for becoming an LADC are set forth more fully in proposed Rule 30, a cross-reference to that Rule should be included in Rule 29. Rule 29 should also be reviewed to ensure the consistent use of accurate terminology; *e.g.*, it refers to assignments to "Members," rather than to ARCs and LADCs, and uses the terms "application", "applicant" and "risk", all apparently referring to a person who is to be insured through the Plan. Consistent with our position on other incomplete sections of the Proposal, CAR must provide additional detail on the assignment process and the determination of quota shares, particularly as they will be measured during the transition period, including an explanation of the circumstances that would warrant adjustment of quota shares more frequently than quarterly. We note that AIPSO's Uniform Plan includes sections on quota share measurement and its alignment to credits.

Rule 30. Assigned Risk Company and Limited Assignment Distribution Company Requirements.

CAR Proposal. Rule 30 sets out the requirements for appointment as an ARC or LADC and the responsibilities of those entities. In large measure, it tracks the requirements in current CAR Rule 13, adjusting the Rule 13 section on installment payment plans to conform to Rule 28 and requiring reports to be made to MAIP rather than CAR. It continues the Rule 13 requirement that companies use policies and other forms mailed to policyholders that are the same as those used for non- ARC or non-LADC business. Rule 30 omits the requirements that the ARC or LADC confirm operator driving licenses and records in order to administer the SDIP and those sections of CAR Rule 13 that relate to contracts with ERPs. It adds two requirements: 1) that the the Underwriting, Claims and SIU of any ARC/LADC communicate and promptly document and share any discrepancies in information; and 2) that the ARC/LADC keep and forward to MAIP copies of any written complaints itreceives about ARPs. The Rule further requires ARCs and LADCs to notify MAIP of any ARP "infractions" that may result in revocation of the producer's MAIP certification. The "infractions" track the grounds for termination of an ERP contract contained in the current CAR Rule 13.

Discussion. As drafted, Rule 30 requires all CAR members to be ARCs; it is inconsistent with the definition of an ARC in Rule 22 and should be corrected to conform to that definition. It should also clarify the question of responsibility for confirming the information needed to apply the SDIP to applicants.

Rule 31. Assigned Risk Producer Requirements.

CAR Proposal. Rule 31 provides that, as of January 1, 2006, all voluntary producers who have contracts with a Member, or have been appointed to a Member as an ERP, will be determined to have met the requirements for certification as an ARP and may submit business to the Plan. It then outlines the requirements that an ARP must meet after January 1, 2006, to satisfy MAIP's producer certification requirements. The rule describes the responsibilities of ARPs, addresses service fees, and identifies the circumstances that render a producer ineligible for certification as an ARP or allow revocation of such certification. It adds to the ARP responsibilities fraud training for customer service representatives ("CSRs") within the first two years of MAIP, and prohibits ARPs and their employees from accepting fees or tangible property for referring an insured or the parties to an accident to any glass, repair or rental facility, or to any legal or medical provider.

Discussion. Rule 31 is analogous to current CAR Rule 14 and, in large measure, adopts its language. It requires revisions to ensure that it accurately reflects the desired goals of a marketing system based on ARPs, rather that ERPs. Rule 31 A, paragraph 1, should limit automatic certification to those who hold a property and casualty producer license, have experience placing motor vehicle insurance with an ARC, and can satisfy the requirements for electronic access to the MAIP (see Rule 28). Other producers who seek to place business with the MAIP should be required to satisfy the requirements in Rule 31 A, paragraph 2. The fraud training requirement should not be limited to ARP CSRs who are working during the first two years of the MAIP, but should also apply to employees who are hired thereafter. We recommend that such training be completed for all current employees within six months of the initial implementation of the MAIP and that, for new employees, the rule set a similar time frame for completion of the training that relates to the date of hire. We note, as well, that the rule refers to courses approved for continuing education credit by the Division, but not to the training that ARCs and LADCs are required to offer producers. The rule should also make clear that ARPs may provide referral information to consumers consistent with company practices under regulations relating to motor vehicle repairs. The terminology in Rule 31 F, relating to the revocation of ARP certification, is inconsistent with the Rule 38, which refers to decertification. As noted above, the Governing Committee's powers should be amended to reflect its authority to take such action.

Proposed Rules 31 C and D relate to production criteria and market need criteria for ARPs and, for both, state that further details will be discussed at CAR. Both these criteria have been controversial, and CAR should revise the Proposal to include specific information on production and market need criteria.

Rule 32. Claim Practices.

CAR Proposal. Rule 32 incorporates revisions to Rule 10, set out in Part I of the Proposal, and also establishes additional requirements for claims handling practices. It specifically enlarges the responsibilities of carrier Special Investigation Units to investigate suspicious circumstances surrounding underwriting, rating and premium issues.

Discussion: Our comment on proposed Rule 10 applies equally to Rule 32.

Rule 33. Statistical Data.

CAR Proposal. Rule 33 is essentially identical to current CAR Rule 8, but omits the reference to the Merit Rating Board contained in that Rule.

Discussion. No objections were voiced to Rule 33, and we note no concerns.

Rule 34. Audit Review.

CAR Proposal. Rule 34 is analogous to current CAR Rule 9 and is consistent with the revisions to that Rule in Part I of the Proposal. It also substitutes MAIP for CAR and "determination of quota share" for "deficit sharing."

Discussion.: Our comment on Rule 9 is equally applicable here.

Rule 35. Assessments.

CAR Proposal. Rule 35 provides for the allocation of MAIP expenses to MAIP members. It adds text specifying that during the transition to the MAIP in policy years 2005 through 2007, written premium from HLR ERPs will be excluded from the calculation of a Member's expense ratios, and notes that CAR will develop further details about potential data exclusions from the expense ratio calculation for policy year 2008 and thereafter.

Discussion. The Proposal generally follows the expense allocation provisions in current CAR Rule 11, section A. The additional text relating to the premium exclusion for policy years 2005 through 2007 is properly included in the first section of the Proposal and appears redundant here; CAR should also provide additional details about anticipated premium exclusions for policy year 2008 and later years.

Rule 36. Credit Provisions.

CAR Proposal. Rule 36 describes the Subsidy Clearinghouse that is to replace the current system for allocating the CAR deficit.

Discussion. Comments on the operation of the Subsidy Clearinghouse are incorporated into our discussion of Part I of CAR's Proposal. As noted in that discussion, the clearinghouse methodology should support the objective that no driver class or territory is disproportionately represented in the plan. To improve clarity, the "year" which will be used as the basis of the clearinghouse should be defined.

Proposed Rule 36, however, does not totally address the issue of credit for voluntary take-out or the writing of certain classes of business. Sections 44 and 45 of the Appendix to AIPSO's Uniform Plan provide guidance on the type of credits offered in assigned risk plans as well as their value. CAR should additionally consider other types of credits that would support the goal of controlling the size of the plan.

Rule 37. Commissions.

CAR Proposal. Rule 37 states that ARPs will be paid the same average commissions for MAIP business as are paid for voluntary retained risks, in accordance with the commission rates approved by the Commissioner, and that ARPs who do not operate under the American Agency System will be paid the same average commission as those who do operate under that system.

Discussion. Rule 37 preserves the principle, set out in current CAR Rule 18, that commissions paid on business placed in the pool shall equal the average commissions on voluntary business.

Rule 38. Terminations.

CAR Proposal. Rule 38 addresses the termination of ARCs and LADCs, the decertification of ARPs, and the obligations of withdrawing MAIP members.

Discussion. The sections of Rule 38 that relate to ARCs and LADCs incorporate portions of current CAR Rules 11 and 16. However, it omits language in Rule 16 that relates to determinations of whether existing servicing carriers have the capacity to absorb the business of a terminated servicing carrier. The rule requires revisions to clarify the sequence of the review process for withdrawing companies. CAR should also provide greater detail about the methodology for determining a withdrawing member's financial obligations to MAIP. The terminology relating to decertification of ARPs is inconsistent with the use of the term "revocation" in Rule 31. The rule also should be more specific about the appeal rights of an ARP who is "decertified."

Rule 39. Indemnification.

CAR Proposal. Rule 39 provides for the indemnification of individuals and MAIP members who are made a party to any legal proceeding as a result of their participation in MAIP.

Discussion. Rule 39 is essentially identical to current CAR Rule 19, substituting MAIP for CAR. No objections were voiced to Rule 39, and we note no concerns.

Rule 40. Hearings and Review.

CAR Proposal. Rule 40 provides for appeals to the Governing Committee and then to the Commissioner.

Discussion. Rule 40 is essentially identical to current CAR Rule 20. No objections were voiced to Rule 40, and we note no concerns.

V. Order

We have carefully reviewed the testimony and written materials submitted in this proceeding. We conclude that CAR's Proposal, while it is, in part, a sound step toward achieving the objectives identified in the Commissioner's April 29 letter, requires further revisions and development. Such revisions are necessary to ensure that the Proposal fully addresses necessary consumer protection issues and that it incorporates sound methodologies for sharing the CAR deficit and the burden of the residual market, during the transition period and upon implementation of the MAIP. These revisions must be designed to limit the size of the residual market and to be fair to companies and to consumers. To assist CAR in its revision process, we have identified a number of specific problems with the Proposal and have recommended approaches that may help solve those problems.

We hereby remand the Proposal to CAR, to be revised in accordance with this Order. CAR is ordered to submit its revisions by September 24, 2004. A hearing on the revised Proposal will be held at the Division on October 4, 2004, at 10:00 a.m.

Dated: August 27, 2004

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Julianne M. Bowler Commissioner of Insurance	Jean F. Farrington Presiding Officer