Commonwealth Automobile Reinsurers'
Proposed Changes to Rule of Operation 13
Docket No. C2005-04

Order on Proposed Changes

Introduction

On June 15, 2005, the Commonwealth Automobile Reinsurers ("CAR") submitted to the Commissioner of Insurance ("Commissioner"), for her approval pursuant to Article X of the CAR Plan of Operation, proposed amendments to Rule 13 of its Rules of Operation ("Rule 13"). A copy of the proposed amendments was also sent to all CAR member companies. By letter dated June 16, the Plymouth Rock Assurance Corporation ("Plymouth Rock") requested a public hearing on CAR's proposal. The Exclusive Representative Producers of Massachusetts, Inc. ("ERPM") also submitted a hearing request, pursuant to Article X, by letter dated June 21. A hearing notice was issued on June 22, scheduling a hearing for July 15.

Ten individuals offered statements at the July 15 hearing. The record was kept open until July 29. On July 28, CAR submitted an additional statement from Michael Trovato, its executive vice-president and treasurer. Cara Blank, MAAA, FCAS, an actuary testifying on behalf of the Division of Insurance ("Division"), filed written testimony, in the form of an affidavit with attached exhibits, and a copy of an April 2004 report entitled *Analysis of Commonwealth Automobile Reinsurers* prepared at the request of the Division by the Tillinghast business of Towers Perrin (the "Tillinghast Report"). No other post-hearing statements were received.

Summary of the Proposed Changes

Rule 13 addresses a broad range of requirements for those CAR members who are servicing carriers for the residual market. CAR recommends changes only to Subsection C, which establishes procedures for assigning exclusive representative producers ("ERPs") to servicing carriers, including determination of a carrier's "ought-to-have" subscription share, provisions for subscription relief, and ongoing subscription modifications.[1]

Briefly summarized, CAR clarifies the subscription methodology by adding language specifying that it will develop subscription reports from statistical data reported to it for the latest 12 policy effective months. CAR also proposes to eliminate subsection C. 3, which allows servicing carriers, in certain circumstances, to enter into two- and three-party agreements with ERPs of other servicing carriers that result in the transfer of books of business from oversubscribed to undersubscribed servicing carriers. A new subsection C.1.d specifically prohibits such agreements, if entered into for the purpose of a change in ERP assignment. The proposed amendments also delete the provisions of C. 2 that address the transfer of exposures in connection with two or three party agreements.

The amendments also change the procedures for obtaining relief for carriers which are under- or oversubscribed. If a servicing carrier is undersubscribed by 25 percent and 1,000 or more exposures for three consecutive months, the amendments authorize CAR staff to initiate a process to correct the undersubscription by notifying the Governing Committee and all oversubscribed carriers. The Governing Committee will then determine whether to order a redistribution from oversubscribed carriers to the undersubscribed carrier; an oversubscribed carrier may notify the Governing Committee that it wishes to forego any redistribution of its ERPs. If the Governing Committee orders redistribution, CAR will randomly assign ERPs from the then most oversubscribed

[1] ERPs are assigned to servicing carriers based on the carrier's total market share. A servicing carrier's "ought-to-have" share of ERP business, also referred to as its subscription level, equals the servicing carrier's percentage of the total market multiplied by the sum of all servicing carrier ERP exposures. A carrier whose ought-to-have share is over or under the level calculated using this methodology is referred to as over- or under-subscribed.

servicing carrier until the undersubscribed carrier's subscription level approximates its ought-to-have share.

Under the amendments, a servicing carrier that has been oversubscribed at a level of 110 percent for three consecutive months may initiate the redistribution process by petitioning CAR for relief.[2] After validating the data, CAR staff will randomly select ERPs of the petitioner and reassign them to the most undersubscribed servicing carrier. If the first reassignment of a randomly selected ERP would reduce the petitioner's ought-to-have share below 100 percent or cause the most undersubscribed carrier to exceed 100 percent, CAR will make a new selection. After the reassignment of each individual ERP, CAR will recalculate subscription levels for all servicing carriers, and continue the reassignment process until the petitioner's subscription level is as close as possible to (but not below) 100 percent, and no more than 105 percent.[3] The process must also assure that no other servicing carrier becomes oversubscribed.

If subscription relief cannot be obtained by reassigning an entire book of business written by an eligible ERP assigned to the petitioner, then relief will be granted by reassigning exposures written in specific garaging towns by the petitioner's eligible ERP. The current Rule 13 allows CAR to reassign exposures by garaging towns to an undersubscribed servicing carrier when the oversubscribed carrier has an ERP that represents more than 110 percent of its ought-to-have share. The proposed rule differs from the current rule in that it removes the 110 percent requirement and allows reassignment by garaging town whenever subscription relief cannot be obtained by reassigning an entire ERP book of business. If reassignment by garaging town is required, CAR will utilize the same random process to select the ERP whose business will be partially transferred that it proposes to follow when selecting ERPs whose entire book may be reassigned.

Summary of Presentations at the July 15 Hearing

Ralph Iannaco, President of CAR, and Mr. Trovato spoke on behalf of CAR at the July 15 hearing. CAR noted that its proposal is based on recommendations from an ad hoc Subscription Methodology Committee appointed by the Governing Committee in

[2] Under the current Rule, a servicing carrier may not petition for relief unless it is oversubscribed by 125 percent and 1,000 exposures for 12 or more consecutive months.
[3] The current rule sets the target for redistribution at 110 percent of the petitioner's ought-to-have share.

April 2005. It urged approval of its modifications that, it stated, are intended to enhance ERP subscription equity by making the subscription relief process more responsive for servicing carriers and less disruptive to the private passenger automobile insurance market. CAR also stated that the proposed Rule 13 streamlines the oversubscription process by deleting the current provision that requires the Governing Committee to approve a petition for relief from an oversubscribed carrier and adding language authorizing CAR staff to grant such relief. A second goal of its proposed amendments, CAR stated, is to minimize the opportunity for manipulation of ERP subscriptions. To that end, the proposed Rule 13 prohibits two- and three-party agreements and, according to CAR, promotes equity by creating a "truly random" assignment process that CAR will conduct. CAR identified the third goal of its proposal as market stability. It asserted that setting the threshold for subscription relief at 110 percent of the ought-to-have share reasonably balances the desire to provide prompt relief for oversubscribed carriers and the potential market disruption from reassigning ERPs too frequently. Similarly, CAR commented, while the subscription level target should be 100 percent, it is unrealistic to expect an assigned agency system to reach that level of precision without engaging in reassignments by garaging town. Therefore, it proposes 105 percent as a reasonable target. CAR stated that it is reluctant to reassign individual ERP exposures by garaging town and will not do so unless relief at the 105 percent level cannot be reached by reassigning entire books of ERP business. It believes that the new thresholds provide sufficient tolerance to ensure that reassignment by garaging towns will be required only for the largest ERPs. In response to questions from the presiding officers, CAR provided additional information on the random process that it would implement under the proposed amendments.

Representatives of five insurance companies made statements at the hearing. Two of the companies, Amica Mutual Insurance Company ("Amica") and the Liberty Mutual Insurance Company ("Liberty Mutual") support CAR's proposed amendments. Amica commented that it is unable to obtain relief from its longstanding status as an oversubscribed carrier under the existing CAR Rule 13.[4] The resulting cost to the

[4] Amica's ERP assignment consists of a single large insurance agency with multiple office locations and a book of business in excess of 60,000 exposures.

company is "substantial." Amica noted that the ERP assigned to it has a book of business with a higher loss ratio than the industry-wide average for ERP business. The costs to the company, Amica stated, include both the cost of servicing and handling the excess ERP business and an increase in Amica's share of the residual market deficit. It commented that these additional costs prevent it from offering greater discounts to good drivers. Addressing the putative effect of CAR's proposed amendments on its assigned ERP, Amica noted that it is a very large agency that, as a result of past redistributions of individual exposures by garaging territory, already works with multiple servicing carriers. Therefore, Amica concluded, that agency would not be harmed by the redistribution contemplated by the new rule. Amica urged approval of the proposed amendments, arguing that they would modify the current rule to ensure greater equity in the distribution of the residual market burden among servicing carriers.

Liberty Mutual voiced its support for CAR's proposal, further noting that in the past it has brought proposals to CAR that involve financial redistribution of the ERP burden or a combination of financial and physical redistribution.

The Commerce Insurance Company ("Commerce"), Plymouth Rock Assurance Corporation ("Plymouth Rock") and Arbella Mutual Insurance Company ("Arbella"), while voicing support for the goal of CAR proposed Rule 13, to provide relief to oversubscribed servicing carriers, objected to its approval at this time, unless the Commissioner declines to approve changes to Rule 11 that CAR filed on March 29, 2005.[5] Because those changes, they pointed out, would set a different K-factor for ceded business produced by a high loss ratio ERP ("HLR ERP"), they would affect the ability of the proposed Rule 13 to satisfy the stated goal of achieving greater equity for servicing carriers.[6]

Arbella expressed support for reforming CAR to achieve a more equitable allocation of the deficit than occurs under the existing rules, but argued that any segregation of ERPs by loss ratio must incorporate a physical redistribution of those ERPs to servicing carriers. It asserted that CAR should also provide strong financial incentives to servicing carriers to ensure that they collect correct premiums, detect fraudulent

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[5] In a decision dated September 20, 2005, the Commissioner, in fact, declined to approve such changes.
[6] The "K-factor" is the penalty that a company must pay for ceding business to the residual market.

practices, and settle claims properly and cost effectively. Arbella, addressing proposed amendments to both Rules 11 and 13, recommended retention of a single K-factor for all ERPs and physical redistribution of ERPs with the highest loss ratios. If the Commissioner follows that recommendation, Arbella proposed two changes to the amendments to Rule 13 that would limit implementation of reassignment by garaging towns to cases in which reassignment of an entire ERP book of business could not attain a subscription level below 105 percent "or within 500 exposures of 100 percent." It recommended that the proscription against assigning an ERP with more than 300 exposures to a servicing carrier if that assignment will increase the carrier's subscription share to more than 105 percent of its ought-to-have share be changed to apply to ERPs with more than 500 exposures. Arbella asserted that the 500 exposure tolerance is appropriate because it is above the minimum exposure requirement for retention of an ERP appointment and will prevent the unreasonable assignment of very small ERPs to multiple servicing carriers.

Plymouth Rock also supported the goals of the proposed amendments, provided that all ERP business is subject to the same K-factor. Referring to its testimony on proposed CAR Rule 11, it asserted that CAR's proposal for different K-factors for different types of ERP business would create a significant financial advantage for companies with a larger share of HLR ERP business and a significant disadvantage for those with a lower share of such business. Therefore, if CAR's proposed Rule 11 is approved, Plymouth Rock argued, Rule 13 should provide for two subscription formulas, one for HLR ERPs and one for all other ERPs. Plymouth Rock argued, however, that the optimal situation involves a single K-factor and a physical redistribution of ERPs so each servicing carrier has its equitable share of HLR ERP business.

Commerce supported efforts to provide more timely relief to oversubscribed servicing carriers, but took the position that, until pending changes to Rules 11 and 12 are resolved, the proposed amendments to Rule 13 are premature. Commerce expressed concern that, if approved now, physical redistributions undertaken pursuant to the revised rule would need to be reversed or amended after Rules 11 and 12 are changed. It also asserted that CAR's proposal should be corrected to ensure that the subscription relief process functions smoothly. Like Arbella, Commerce recommended utilizing exposure tolerances in Rule 13 to avoid splitting ERPs among multiple servicing carriers by garaging town. It suggested allowing a servicing carrier to petition for subscription relief only when it has been oversubscribed by over 110 percent "and 400 or more exposures" for a period of three months. Commerce also recommended adding a 300-exposure tolerance to Rule 13 C.2.b (1), which addresses the reassignment of ERPs to servicing carriers when the reassignment would decrease the petitioning servicing carrier's ought-to-have share to less than 100 percent or increase the undersubscribed servicing carrier's share to more than 100 percent. In addition, Commerce suggested that CAR allow servicing carriers to exchange ERPs. Such a process would, for example, allow a servicing carrier oversubscribed by 300 exposures to move an ERP with 800 exposures to another servicing carrier and to receive back an ERP with 500 exposures. These modifications, Commerce asserted, would reduce the need to split up an ERP's business among multiple servicing carriers.

Commerce also recommended that Rule 13 provide for review of an oversubscribed servicing carrier's petition for relief by an appropriate CAR committee, a process that will, it asserted, allow CAR to provide necessary guidance in situations that could negatively affect CAR or ERPs. It noted that Rule 13 currently provides for such review, and expressed concern that, without it, CAR will lose the ability to manage this aspect of the residual market. Finally, Commerce asserted that proposed Rule 13 conflicts with CAR Rule 14, specifically the section that allows an ERP assigned to an oversubscribed servicing carrier to file a written request to CAR to be reassigned to an undersubscribed servicing carrier, under certain circumstances. It asserted that, if Rule 13 is approved, Rule 14 must be updated to be consistent with the ban on two- and three-party agreements.

While the EPRM supports an equitable distribution of the CAR deficit, it opposed CAR's proposed amendments, asserting that it is unclear how the current changes to Rule 13 coordinate with proposed changes to Rules 13 and 14, previously submitted to the Commissioner, that have not been approved. It asserted that CAR's proposal equalizes subscription levels by physically redistributing ERPs, either in response to a petition from an oversubscribed servicing carrier or by the CAR Governing Committee. It argued that such involuntary redistribution has, in the past negatively affected both ERPs and the public. The ERPM asserted that proposed Rule 13, by lowering the threshold for defining oversubscription, makes it easier for physical redistribution to occur, thus increasing the likelihood of damage to ERPs and the public. Furthermore, it argued, elimination of two- and three-party agreements, which have moderated disruption when an ERP has moved from one servicing carrier to another, and allowing only involuntary transfers does not protect ERPs or their customers.

As support for its position that physical redistribution is not an appropriate solution for the problem of equitable apportionment of CAR premiums, losses and expenses, the ERPM pointed to comments from former Insurance Commissioner Doughty and to a recent memorandum of decision by the Suffolk Superior Court in *Commerce Insurance Company v. Commissioner of Insurance*, Docket No. 05-0032. It noted, as well, that although proposed Rule 13 retains the reimbursement rate of $15 per exposure for ERPs whose books of business are redistributed, it is not clear that such rate is rationally related to the actual costs and losses that the ERP may incur. Further, it argued, the ERP's property (policy expirations) may be unlawfully taken.[7] Characterizing CAR's proposal as a "quick fix," it argued that CAR should go back to the drawing board to develop a solution that does not redistribute ERPs or their customers.

Ms. Blank raised a number of additional questions about CAR's proposal. She noted that the proposed amendments would permit an oversubscribed carrier to request relief after three months but that Rule 13 also provides for the immediate transfer of exposures to a servicing carrier when an ERP purchases another ERP's book of business. She pointed out that the transfer of a substantial ERP book of business could quickly leave the servicing carriers of both ERPs in an over- or under-subscribed position. Ms. Blank questioned whether the three-month period is a realistic time frame within which those servicing carriers could, on their terms, correct their subscription levels to their ought-to-have shares, but proposed no specific alternative time periods. In addition, she raised the issue of "random" reassignment by place of garaging, particularly for customers of Amica's assigned ERP, A-Affordable, further questioning whether it is reasonable to

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[7] Although the EPRM did not expand on this point, we infer that it is alleging that its members have some "property rights" in the policies they write.

characterize an insurance agency such as A-Affordable that, because of geographical reassignments, represents several insurance companies, as an ERP.

The concept of random assignment Ms. Blank testified, should be adjusted to consider such facets as the number of consumers that would be affected by the physical redistribution of an ERP's book of business, the expected financial impact of the reassignment on the new servicing carrier, and the effect of the ERP's market share on the servicing carrier's total market share.

The Post-Hearing Submissions

CAR argued that its proposed amendments to Rule 13 address only the provisions regarding oversubscription, and therefore should not be tethered to the Rule 11 revisions. It pointed out that, other than concerns about the effect on carriers if the Commissioner approves CAR's proposed revisions to both Rules 11 and 13, the companies that testified at the hearing generally support the Rule 13 amendments, with minor revisions.

Ms. Blank's written testimony corrected some of the numerical values reported in her statement at the July 15 hearing, but in large measure reiterated that statement. She noted that although the stated goal of CAR's proposed Rule 13 amendments is to bring all carriers closer to 100 percent of their ought-to-have subscription level, it fails to not address achieving parity among them in terms of financial and management effects. Ms. Blank stated that the rule does not consider incentives to improve effective management of ERPs by individual companies, to encourage the formation of voluntary relationships between companies and ERPs, or to provide more underwriting outlets for independent agents. She questioned whether the proposed rule would generate a major reassignment of ERPs in connection with subscription relief, commenting that it did not clearly state how reassignment would achieve equity.

As noted above, two carriers expressed a preference for physical redistribution of HLR ERPs as a starting point for reallocating residual market losses. Ms. Blank agreed that such a one-time reassignment has merit, but asserted that the entire subscription process, as well as standards for agency management, needs to be approached as a long-term issue. She recommended that any one-time reassignment consider the number of customers that would be moved, the competencies needed to manage agencies of a certain size or performance level, and the market share impact of reassignment on a servicing carrier. Ms. Blank proposed that no company, without its express consent, should be assigned an ERP if the assignment would constitute more than ten percent of its total market share. Reassignment, she further noted, should have reasonably identical financial effects on each servicing carriers; companies should also be required to develop agency management plans with their ERPs.

Discussion and Analysis

1. The Equitable Distribution of ERP Business

CAR's proposed revisions to Rule 13 are an additional facet of its attempt to achieve a more equitable distribution of the CAR deficit among member companies. The amendments to Rule 13, which focus on changes to the system for assigning ERPs to servicing carriers, spring from the Tillinghast Report which determined, among other things, that the quality of ERP books of business, as measured by loss ratios, differs widely.[8] That Report concluded that the uneven distribution of HLR ERPs among carriers, combined with CAR rules that penalize cessions to the residual market, made it virtually impossible for carriers with a relatively high share of HLR ERPs to earn a profit writing private passenger automobile insurance in Massachusetts.

CAR asserts that its proposed changes to Rule 13 make the subscription relief process more responsive by establishing lower tolerance limits for what is considered "oversubscription," allowing a servicing carrier to obtain relief within a shorter time frame, and streamlining the procedures for seeking relief, and thereby will enhance ERP subscription equity among servicing carriers. CAR further asserts that the amendments will promote equity by creating a truly random assignment process that CAR will conduct.

At the hearing, no objections to CAR's stated goal were expressed. However, the speakers raised a number of questions as to whether CAR's proposed amendments to Rule 13, particularly if viewed in the context of its other proposed rule changes, would improve the current system.

As several speakers observed, CAR also proposes to amend Rule 11 to provide a different K-factor for ceded business produced by an HLR ERP. They expressed concern that, absent a single K-factor for all ceded business, carriers with a high proportion of HLR ERPs would be able to cede such business without incurring costs. Any segregation

[8] The term "high loss ratio ERP" was coined in that report.

of HLR ERP business, they argued, should also include a physical redistribution of those ERPs. To resolve such concerns, these carriers recommended that CAR maintain a single K-factor and redistribute HLR ERPs so that each servicing carrier has an equitable proportion of that business. It was also suggested that, if multiple K-factors are approved, separate subscription formulas should be implemented, one for HLR ERPs and one for all others. In her decision addressing CAR's proposed revisions to Rule 11, the Commissioner declined to approve dual K-factors for HLR ERP and other ERP business. [9] Objections to CAR's proposed Rule 13 based on its interface with proposed Rule 11 are therefore mooted.

CAR anticipates that improving the match between actual and ought-to-have subscription levels will improve residual market equity, even though its proposed ERP subscription process does not directly address the quality of business assigned to servicing carriers. It emphasizes that under its proposed rule it will implement a random system to select the ERPs that would be reassigned to maintain servicing carriers at their ought-to-have shares. As explained by CAR, the random system will target the size of the book of ERP business that must be transferred in order to match the ought-to-have number, but not the quality of that book. However, under both the current and proposed Rule 13, the ERP assignment system focuses exclusively on the number of exposures that a company ought to have based on its total market share.

As drafted, Rule 13 refers to random selection of ERPs but, except for the recalculation of subscription shares, does not otherwise address the mechanics of the selection operation. It fails to address equalization of the residual market burden by reassigning ERPs to servicing carriers in a manner that is designed to ensure that their ought-to-have shares reflect both the quantity and quality of ERP exposures. Reassigning books of business by size alone may help reduce market disruption resulting from transfers; nevertheless, we are not persuaded that a rule that addresses only the quantitative aspect of the ERP subscription system is adequate to alleviate the broader problems with the residual market identified in the Tillinghast Report.

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[9] See, *Order on Proposed Changes to Rules 11 and 12 of the Commonwealth Automobile Reinsurers Rules of Operation*, Docket No. C2005-02.

The statutory requirements of fairness and equity in the allocation of the residual market deficit cannot be achieved absent an ERP subscription system that accomplishes those goals. We are persuaded that a prerequisite to attaining equity in the residual market is the establishment of a baseline subscription level that reflects numerical and qualitative equity for all servicing carriers, and that the most reasonable approach to establishing that baseline level is a physical redistribution of all ERPs. While carriers have proposed such a redistribution, the ERPM argues that physical redistribution is not a solution to ERP oversubscription. We are aware that physical redistribution of ERPs, while it has occurred in the past, is not without controversy. Nevertheless, it appears that the ERP subscription system has produced effects that are not consistent with the fair and equitable distribution of the residual market among servicing carriers.[10] As noted above, a principal finding of the Tillinghast Report was the effect of the uneven distribution of HLR ERPs among servicing carriers. Uneven distribution, it found, results in disproportionate distribution of residual market losses among carriers. Correcting inequity in the allocation of the residual market deficit is critical if the health of the residual market is to improve. However, reassignment only of HLR ERPs would not address disproportionate differences resulting from the inequitable distribution of books of ERP business whose loss ratios do not rise to the 125 percent level.

We conclude that CAR's proposed changes to Rule 13, while they may help to correct some inequities in the current system, will be more effective if applied after a qualitative assessment has been made of all ERP business and ERPs have been physically redistributed to servicing carriers in a manner that will achieve both quantitative and qualitative parity. Such redistribution will equalize the overall quality of each carrier's ERP exposures, as measured by the three-year loss ratio methodology utilized in the Tillinghast Report, and will establish a level playing field for the industry. Once that basic step toward overall fairness is completed, the proposed changes to Rule 13 will assist in maintaining balance in the system. However, CAR's random selection process for reassigning ERPs must be revised to incorporate consideration of the ERP's loss ratio, adjusted to reflect the effect of rate subsidies, in addition to the size of an ERP's book of business.

[10] No single reason for the disparity in loss ratios among ERPs has been identified.

2. ERP Reassignment After Physical Redistribution

A major cornerstone of the Massachusetts residual market, as created by the CAR Plan and Rules, is the system for appointing ERPs to servicing carriers. As a servicing carrier's share of the voluntary market and the number of exposures written by its assigned ERPs change, the carrier's ought-to-have share may fluctuate. Achieving equity for a residual market in which the values of the relevant parameters constantly change presents significant challenges. In addition to ensuring that the residual market burden is fairly allocated to servicing carriers, public policy also mandates that recommendations to change the rules consider such issues as the effect on producers and consumers.

No speaker at the hearing objected to reducing the level at which a servicing carrier is defined as oversubscribed from 125 percent to 110 percent, or to setting 105 percent as a reasonable cap when reassignment of an entire book of business cannot achieve a 100 percent subscription level. CAR argues that its proposed rule balances the need to provide responsive oversubscription relief and the potential market disruption that could result from too frequent reassignment of ERPs. CAR's new standard for oversubscription may have an effect on the number of ERP exposures that are transferred as a result of changes in the marketplace. However, because business transfers are inherent to the ERP subscription process, in its normal course of operations some consumers will inevitably find that, on renewal, their policies will be written by a different carrier. We conclude, nevertheless, that CAR's new definition of oversubscription reasonably balances concerns for improving equity in the system and limiting the number of policy transfers.

To help ensure that Rule 13 will balance achieving equity and minimizing market disruption in circumstances where it is possible to transfer entire books of ERP business, Arbella and Commerce both proposed to add tolerance limits to the subscription process. Arbella would limit reassignment of ERP business by garaging towns to cases in which reassignment of an entire book of business would attain a subscription level that was neither below 105 percent nor within 500 exposures of 100 percent. It also suggested that CAR revise Rule 13.C.c.(5) to provide that no ERP with more than 500 exposures will be assigned to a servicing carrier if the assignment would bring the Servicing Carrier's subscription level to over 105 percent of its ought-to-have share.[11] Arbella supports its choice of a 500 exposure tolerance on the ground that it exceeds CAR's minimum ERP production requirement, and will prevent the application to very small ERPs of reassignment through garaging. Commerce would allow a servicing carrier to petition for relief only when it has been oversubscribed by over 110 percent and 400 or more exposures for three months, and would add a 300-exposure tolerance to Rule 13.C.b. As noted above, we have concluded that, as a first step to achieving fairness and equity in the allocation of the residual market deficit, it is essential to implement a physical redistribution of all ERP books of business. In light of that undertaking, we are not persuaded that at this time additional parameters in the form of numerical tolerance limits should be incorporated into the reassignment process.

Commerce also suggested that, in order to reduce the need to split up ERP business among servicing carriers by garaging territory, companies be allowed to achieve their ought-to-have shares by exchanging ERPs.[12] While exchanges might improve arithmetic precision, allowing insurers to negotiate among themselves about residual market business without CAR supervision would potentially perpetuate a practice that has contributed to the inequities in the allocation of the residual market deficit. Further, it is not clear what effect exchanges would have on the number of ERP books of business that would be subject to transfer. For those reasons, we are not persuaded that Rule 13 should incorporate Commerce's suggestion.

3. Administering the ERP Subscription Process

Proposed Rule 13 eliminates the provisions for two- and three-party agreements that now allow carriers to manage their ERP subscription levels independently of CAR, and transfers complete control of ERP reassignments to CAR. No company voiced objections to this specific change.[13] However, the ERPM argued that such agreements

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[11] As proposed by CAR, the rule would proscribe assigning an ERP with more than 300 exposures to a servicing carrier if the assignment will increase its subscription rate above 105 percent.

[12] Commerce's suggestion appears to be inconsistent with its objection to CAR's proposed relaxation of the CAR Governing Committee's oversight of oversubscribed carriers' petitions for subscription relief. Proposed Rule 13 would allow such requests to be handled by CAR staff without prior approval of the Governing Committee.

[13] It is not entirely clear whether Commerce's suggestion that companies be permitted to exchange ERPs was offered as an alternative to two-and three-party agreements.

have moderated disruption when ERPs have moved from one servicing carrier to another, and that eliminating them will not protect ERPs or their customers.

Under a system that estimates residual market shares based on the source of exposures that carriers write, recalibration will always require ERPs to move between servicing carriers. Transfer of ERP business from one servicing carrier to another, whether it results from an agreed-upon inter-company transfer or a CAR decision on a petition to remedy oversubscription, affects the marketplace in multiple ways. ERPs are required to forge a new relationship with a servicing carrier, a process that may require some changes in its day-to-day operations; their customers may choose to continue coverage with the new servicing carrier or seek to stay with the former company, albeit through a different producer. Absent changes to the current system, ERPs face the inherent risk of the transfer of all or part of their books of business to satisfy carrier's ought-to-have shares. To ameliorate the effect of transfers, the CAR Rules provide for compensation to ERPs to offset the costs of transfers, and incorporate time frames to reduce the possibility of frequent transfers.[14] CAR's stated reason for eliminating two- and three-party agreements is to reduce manipulation of the system that has helped create the inequities identified in the Tillinghast Report. We are not persuaded that the elimination of such arrangements will incrementally increase the level of disruption that occurs whenever an ERP's book of business is transferred and, on balance, conclude that it will significantly assist in reducing market manipulation.

Commerce pointed out that Rule 14 F now permits ERPs, under certain circumstances, to negotiate for reassignment to an undersubscribed servicing carrier. CAR's proposed Rule 13 establishes a single centralized administrative process for addressing transfers of ERP business to undersubscribed servicing carriers. Rule 14 F should be revised to make it consistent with that process.

Commerce also suggests that petitions for relief from a servicing carrier should continue to be reviewed by a CAR committee, as they are under the existing Rule 13, on the ground that such oversight will allow CAR to provide necessary guidance and prevent it from losing the ability to manage the residual market. The grounds for Commerce's

[14] The ERPM argues that the $15 fee included in the CAR Rules has not been shown to be reasonably related to actual costs that ERPs incur. If ERPs believe that the value is incorrect, it would be appropriate to raise the issue at CAR.

concerns are unclear. It is reasonable to expect CAR staff to follow policy decisions from the Governing Committee and to seek guidance when appropriate. We are therefore not persuaded that any change is required to those portions of proposed Rule 13 that streamline the review of petitions from oversubscribed servicing carriers.

Conclusions

We approve CAR's proposed Rule 13. Its provisions, including but not limited to the prohibition on two- and three-party agreements, are to take effect immediately. However, we hereby order CAR to conduct no proceedings pursuant to Rule 13 C.2.b to address under- and oversubscription relief before it has physically redistributed all ERPs in accordance with this order. CAR is directed to complete, within 60 days, a physical redistribution of all ERPs that will establish for all servicing carriers overall parity in the quantity and quality of their ERP exposures. Because the Tillinghast Report was based on 2003 data, some ERP loss ratios may have changed. CAR is to recalculate ERP loss ratios using data for the three calendar/accident years ending December 31, 2004. Further, CAR is to expand its random selection methodology referred to in Rule 13 C, including, but not limited to, sections C.2.b.(1) and 13 C.2.b. (3) a and d, to ensure that the Rule 13 reassignment process addresses both the quality and quantity of ERP exposures. Within ten days of this order, CAR is also directed to submit revisions to Rule 14 to make it consistent with these changes to Rule 13.

September 30, 2005

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