Commonwealth Automobile Reinsurers'

Proposed ERP Redistribution Methodology

Docket No. C2006-01

Order on Proposed Methodology

Introduction

In a decision issued on September 30, 2005 (the "September 30 Decision") in Division of Insurance Docket No. C2005-04, the Commissioner of Insurance ("Commissioner") approved changes to Rule 13, Subsection C of the Commonwealth Automobile Insurers ("CAR") Rules of Operation that, in summary, revised the 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. The revisions, as approved, also prohibited transfers of ERP business among carriers through two- and three-party agreements, and rewrote the provisions for providing relief to oversubscribed carriers by reassigning exposures written by large ERPs by garaging town. The Commissioner concluded that CAR's proposed changes would be more effective if applied after making a qualitative assessment of all ERP business and physically redistributing ERPs to servicing carriers in a manner that would achieve both quantitative and qualitative parity among those servicing carriers. Therefore, although she approved CAR's revisions to Rule 13 effective immediately, she also ordered it to conduct no proceedings to address under- and oversubscription relief pursuant to Rule 13 C.2.b before implementing such a redistribution. The Commissioner further ordered CAR to complete a physical redistribution of ERPs so as to establish, for all servicing carriers, overall parity in the quantity and quality of their ERP exposures, within sixty days. The September 30 Decision, while it made no specific recommendations for a redistribution formula, commented on the challenges that achieving equity in the residual market presents, and observed that proposals to change the rules should both ensure that the residual market burden is fairly allocated to servicing carriers, and also consider such issues as the effect on producers and consumers.

At its November 16, 2005 meeting the CAR Governing Committee, pursuant to the Commissioner's order, approved a plan to redistribute ERPs (the "Redistribution Plan") that had been prepared by CAR staff.[1] Pursuant to Rule 20 of the CAR Rules of Operation, Plymouth Rock Assurance Company ("Plymouth Rock") and OneBeacon Insurance Company ("OneBeacon"), by letters dated, respectively, November 16 and November 18, appealed the Governing Committee's adoption of the Redistribution Plan to the Commissioner.

Plymouth Rock asserted that the Governing Committee's approval of a Redistribution Plan that required reassignment of ERPs to servicing carriers so as to equalize the subsidy-adjusted ERP loss ratios of all servicing carriers within a one percent tolerance level was inconsistent with the September 30 Decision. It contended that the concept of "overall parity" was not limited to equalizing loss ratios and that redistribution should, in addition to achieving equity and overall parity, minimize market disruption and promote good company management and fraud fighting efforts. Plymouth Rock asserted that the Redistribution Plan did not adequately balance the interests of ERPs and consumers, reflect individual company efforts to fight fraud, or recognize that differences in ERP loss ratios may result from differences in company procedures for managing their ERP business. Plymouth Rock asserted that CAR had not modeled alternative redistribution methodologies, including Plymouth Rock's proposal to determine ERP loss ratios at different cut-off points, to redistribute ERPs within those loss ratio groups among companies, and to rebalance the remaining ERPs based on exposure volume only, not loss

[1] Eleven members of the CAR Governing Committee voted in favor of the proposal; two opposed it.

ratio.[2] That methodology, it asserted, would move fewer exposures than would be required under CAR's proposal. Therefore, Plymouth Rock asked the Commissioner to re-examine CAR's Redistribution Plan and to order CAR to use a method that would achieve a more appropriate balance between the interests that would be affected by redistribution.

OneBeacon disagreed with CAR's proposed methodology for calculating ERP loss ratios, asserting that it did not address company differences in claim count development. As a result, OneBeacon asserted, the Redistribution Plan favored companies with lower claim count development factors and harmed those with higher factors. It also argued that basing redistribution on subsidy-adjusted loss ratios produces an inequitable result, because it artificially inflates loss ratios for ERPs with business in subsidy-paying categories, and therefore benefits companies with substantial amounts of such business. The true economic value of an ERP, it asserted, is measured by its actual loss ratio, unadjusted for subsidies, and the credits associated with its book of business that may affect the servicing carrier's CAR deficit share. OneBeacon offered suggestions for CAR to consider, including adjusting only subsidy-receiving ERP business, implementing a subsidy clearing house in place of matrix participation credits for 2006, and adding a new parameter to the redistribution plan methodology that would require each carrier to have the same percentage of subsidy-paying business. OneBeacon requested that the Commissioner order CAR to consider its suggestions as part of the Redistribution Plan.

On November 22, the ERPs of Massachusetts ("ERPM") sent a letter to the Commissioner. The ERPM stated that, while it had no direct interest in Plymouth Rock's appeal of the Governing Committee's decision, it agreed with Plymouth Rock's position that CAR's Redistribution Plan did not adequately balance achieving parity with minimizing market disruption. It asked that CAR be ordered to reexamine its decision to accept a 1.00 or lower tolerance level without first modeling the effects of other tolerance levels on market disruption.

On November 22, in response to the letters from Plymouth Rock and OneBeacon, the Commissioner sent a letter to CAR requesting that it provide her with additional information on the Redistribution Plan. She observed that CAR's adopted methodology

[2] Plymouth Rock suggested four cut-off levels, 90 percent, 100 percent, 110 percent and 120 percent.

was developed in the course of meetings of its various committees, and that the minutes of those meetings were silent on the specifics of the supporting data that the committee members had reviewed or the methodologies that they had considered. Noting that the sensitive process of arriving at a redistribution plan would be better served by greater transparency and disclosure, she ordered CAR to provide certain explanations and documentation relating to its adoption of the Redistribution Plan, including a description of the modeling it had conducted both for the method approved by the Governing Committee and other methods that any of the committees had considered. Recognizing the need to accomplish redistribution expeditiously in order to alleviate current market inequities, she asked that CAR submit its materials to her by December 16.

The Norfolk & Dedham Group ("Norfolk & Dedham"), by letter to the Commissioner dated November 28, 2005, expressed concern that the Governing Committee had not adopted changes to Rule 13 that would address on-going subscription relief. It asked that, before implementing the Redistribution Plan, CAR be required to expand Rule 13 to include language relating to the methodology for considering quality and quantity in the process for providing ongoing subscription relief after the initial ERP redistribution. It made no specific recommendation for such rule changes in this letter..

By letter dated December 1, augmented with copies of transcripts of meetings of the CAR Actuarial Committee, its Ad Hoc Subscription Methodology Committee ("Ad Hoc Committee"), and the Governing Committee, CAR responded to the Commissioner's November 22 order and reviewed the deliberative process it had followed.[3] Its letter described the affiliations of members of the Ad Hoc Committee and stated that, although that committee had thoroughly considered the issues raised in the Plymouth Rock and OneBeacon appeals, it had determined that the time constraints placed upon it by the September 30 Order and the complexity of the project would not allow it to model all such alternatives. CAR indicated that the Ad Hoc Committee's goal was to establish parity while minimizing market disruption, and chose the one percent tolerance margin because exact parity might not be an achievable goal. It asserted that the final model balanced exposure movement and loss ratio parity to acceptable levels.

[3] CAR also established an Ad Hoc Subscription Methodology Subcommittee to develop standards for transferring ERP business, in an effort to minimize market disruption.

CAR noted that the Ad Hoc Committee had relied on an ERP redistribution model that, at the request of Safety Insurance Company ("Safety") had been previously modeled for the Actuarial Committee. That model had balanced servicing carrier loss ratios to within one percent of the overall ERP loss ratio by moving less than 200,000 exposures, a result that the Committee considered acceptable because it represented only 17 percent of the entire ERP exposure population. It also considered the reasonability of that level in light of the historical movement of ERP books of business, including the 1991 redistribution ordered by the then Commissioner that affected 200,000 exposures, and the high percentage of ERP business that moves annually as a result of marketplace operations and consumer choices. Although the Ad Hoc Committee had not modeled a proposal to reassign ERPs within loss ratio bands, CAR's letter notes that CAR staff had attempted to distribute ERP books of business by three loss ratio bands (lowest 25 percent, middle 50 percent and highest 25 percent), producing an outcome that would require movement of about 240,000 exposures. CAR considered that result less desirable than its chosen model because it would affect too many policyholders.

CAR also stated that the Ad Hoc Committee concluded that choosing a loss ratio tolerance greater than one percent would not be appropriate, noting that even a one percent tolerance could have a significant effect on carriers' financial results. It reported that CAR staff had estimated that, based on 2004 ERP reported premium, a single point of loss ratio tolerance could impact a company's financial results by up to $140,000 per point of market share. Selection of a loss ratio tolerance as high as plus or minus 2.5 percent would therefore have a maximum effect of as much as $700,000 per point of market share.[4]

CAR also addressed Plymouth Rock's concerns about the effect of redistribution on company fraud fighting efforts. It noted that neither any member of the Ad Hoc Committee nor Plymouth Rock could propose a way to distinguish company ERP management efforts from other reasons for improvements in ERP loss ratios.[5] Further,

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[4] I note that CAR, in its statement submitted on January 23, estimated the financial effect of a single point of loss ratio tolerance at least $100,000.

[5] That there is no agreement on the question of the effect of company fraud-fighting efforts on ERP loss ratios is apparent from the statement made by Safety at the January 23 hearing. He commented that the differences in ERP loss ratios among carriers might result simply from the geographical location of their

some committee members questioned whether the current loss ratio inequities among carriers result from differences in ERP management or from rules that do not ensure a random ERP distribution. The committee determined that achieving parity is more important that attempting to compare company management efforts by adopting a wider loss ratio tolerance. In response to Plymouth Rock's concerns about disrupting relationships between carriers and producers, CAR stated that its Redistribution Plan model minimizes market disruption, so that current relationships will be maintained, to the extent possible.

CAR's letter reported that the Ad Hoc Committee had also considered OneBeacon's concerns about basing ERP redistribution on subsidy-adjusted loss ratios, and the three options it had proposed. It had concluded that it did not want to increase market disruption by adding an additional constraint of balancing average subsidies to the redistribution, and that any methodology other than one that adjusted loss ratios for both subsidy-paying and subsidy-receiving business would not comply with the September 30 Decision. CAR noted that at this time the Actuarial Committee had recommended continuation of the credit matrix approach for 2006, and that members of that committee were not persuaded that the use of subsidy-adjusted ERP loss ratios is inconsistent with such a system.

CAR stated that the Actuarial and Ad Hoc Committees had both expressed concern about the effect of differences in servicing carrier reserving practices on the loss ratios to be used in the ERP redistribution and discussed various methods to adjust for this disparity. Ultimately, the Ad Hoc Committee selected an average case reserve method, which allows for variation in frequency but neutralizes the effect of the severity of bodily injury losses. Committee members concluded that averaging, even though based on estimates, was adequate for purposes of measuring equity and that introducing a variable of claim count development would add an unnecessary and misleading perception of exactness to the system and over-complicate the process.

Plymouth Rock responded to CAR's December 1 letter by letter to the Commissioner of the same date. It asserted that the Governing Committee, when it voted

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ERPs, noting that carriers that do not have to manage urban ERP exposures did not achieve their ERP loss ratios by fighting fraud.

to adopt the Redistribution Plan, had no information before it on the Plan's effect on the public or CAR members companies, particularly the number of consumers who would be moved, or the impact on fraud fighting. It requested that she either: 1) order CAR to perform a full analysis and modeling of all proposed redistribution methods and to hold a special meeting to reconsider its approval of the Redistribution Plan, based on that full analysis; or 2) hold a public hearing on Plymouth Rock's November 16, 2005 appeal.

The Commissioner, on December 8, 2005, in response to Plymouth Rock's December 1 letter, and pursuant to Rule 20 of the CAR Rules of Operation, ordered CAR to reconsider its November 16, 2005 decision adopting the Redistribution Plan and to consider other methods and proposals suggested by member companies. She specifically directed CAR: 1) to review redistributions based on various loss ratio cut-off points, as recommended by Plymouth Rock; 2) to review redistributions that would classify ERPs by loss ratio bands, such as low, middle and high, and assign them to servicing carriers so that each carrier would have a proportionate share of ERP exposures within each band, a method supported by the Amica Mutual Insurance Company ("Amica") and One Beacon at the Ad Hoc Committee meeting held on November 2, 2005; and 3) to model and compare redistributions using two different loss ratio tolerances: +/- 0.75 percent and +/-1.75 percent, as requested by the Arbella Mutual Insurance Company ("Arbella") at that same Ad Hoc Committee meeting. She also asked CAR to state its intent regarding the fixing of deadlines by which servicing carriers must offer voluntary contracts to ERPs before implementation of redistribution.

Norfolk & Dedham Group ("Norfolk & Dedham"), by a second letter to the Commissioner dated December 9, 2005, again expressed concern that the Governing Committee, before approving the Redistribution Plan, had not changed Rule 13 to address on-going subscription relief. It submitted specific language for proposed Rule 13 changes.

On December 13, CAR staff submitted to the Governing Committee a report that included the additional models that it had prepared in response to the Commissioner's December 8 letter. At a special meeting on December 14, the Governing Committee, after considering the staff report on these models and comments made by CAR members at the meeting, voted again to adopt the Redistribution Plan previously approved at its

November 16 meeting.[6] In a letter to the Commissioner dated December 15, the Governing Committee reported that, in response to the Commissioner's December 8 letter, it had considered alternative redistribution models, explained the reasons for its decision to adopt the plan developed by CAR staff, and requested the Commissioner's approval of the Redistribution Plan.

On December 15, Plymouth Rock wrote to the Commissioner to address CAR's use of the modeling that it had completed in response to the Commissioner's December 8 letter. It observed that the modeling was important so that ERP redistribution could be done with full knowledge of its likely effects on consumers, ERPs, and company fraud fighting efforts. Plymouth Rock asserted, however, that despite the importance of considering these effects, the Governing Committee had voted to adopt its original methodology which, according to Plymouth Rock, is heavily weighted toward the goal of achieving equity among companies and places little weight on the concern of reducing market disruption. It reiterated its concerns that a +/-1.75 percent tolerance margin would allow carriers to maintain more of their ERP relationships, a result that will aid their fraud fighting efforts. Plymouth Rock now requested that the Commissioner order CAR to redistribute the ERPs based on a model that permitted a +/- 1.75 percent loss ratio tolerance, rather than a +/- 0.75 percent loss ratio tolerance.

By letter dated December 21, OneBeacon asserted that the CAR Governing Committee, at its December 14 meeting, had reviewed modeling that focused on loss ratio tolerance margins and loss ratio bands, but did not address any analysis relating to OneBeacon's issues of claim count development and subsidy adjustments. It stated that the Governing Committee had not asked CAR staff to perform further modeling addressing OneBeacon's concerns, and requested that the Commissioner direct CAR to complete additional modeling related to the redistribution that would specifically relate to the financial impact of its decision on loss development and subsidies.

On December 30, the Commissioner directed CAR, in addition to loss ratio calculations, to calculate the credit eligibility of ERP books of business, and to calculate that credit eligibility at both +/- 0.75 and +/-1.75 percent loss ratio tolerances. In addition,

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[6] Again, eleven members of the Governing Committee voted to adopt the Redistribution Plan, and two opposed it.

she asked CAR to provide a direct answer to her question about deadlines for offering voluntary contracts to ERPs before redistribution. Correspondence exchanged between CAR and the Commissioner on January 4 and January 6, 2006 clarified the methodology for calculating the credit eligibility of ERP books of business.

On January 6, The Premier Insurance Company ("Premier") raised an additional issue about the physical redistribution of ERPs, specifically questioning the application of the Redistribution Plan to a single very large ERP which because of its size, for purposes of applying CAR's subscription methodology rules, has received special treatment. The Redistribution Plan provides that exposures written by that ERP will be redistributed by individual garaging towns, as necessary to achieve equity, and that an effort will be made to redistribute exposures and garaging towns to the servicing carriers now serving the ERP's business, but using others as needed. Premier requested that the Commissioner order CAR to remove the limitations in the Redistribution Plan relating to the assignment of exposures written by that large ERP.

In light of the concerns expressed by CAR member companies, and their requests that the Commissioner order changes to the Redistribution Plan approved by the Governing Committee, the Commissioner decided to hold a hearing to enable all interested persons to comment on the proposed Redistribution Plan. A hearing notice was issued on January 13, setting a hearing date of January 23. The notice was sent to all those who have requested that the Division send them such documents, published in the Boston Globe on January 16, 2006 and posted on the Division's web site. CAR distributed it to its members, and posted it on its website on January 13.

CAR made an extensive presentation at the hearing, and submitted documents including the Redistribution Plan and copies of its December 2005 and January 2006 correspondence to the Commissioner. Ralph Iannaco, President of CAR, indicated that if the Commissioner approved the plan by January 27, CAR was prepared to move forward on a timetable that would allow redistribution to take effect for new policies as of March 1, 2006 and renewal policies as of May 1. Representatives of eight CAR members made statements at the hearing. Speakers also appeared on behalf of the Independent Property and Casualty Insurers of Massachusetts ("IPCIM")and the Massachusetts Association of Insurance Agents ("MAIA"). Two ERPs made statements. The record was left open until

12:00 noon on January 24. Two additional submissions were received, from an additional member of CAR, United Services Automobile Association ("USAA") and the Pioneer Valley Insurance Center, Inc., an ERP in Springfield.

Discussion and Analysis

Of the nine CAR members who made written or oral statements in this proceeding, Amica, Arbella, Fireman's Fund Insurance Company ("Fireman's Fund"), Liberty Mutual Insurance Company ("Liberty Mutual"), Safety, and USAA fully support the Redistribution Plan as adopted by the Governing Committee. MAIA and IPCIM also support it. Plymouth Rock does not object to the basic plan methodology, but urges the Commissioner to approve the model that incorporates a loss ratio tolerance of +/- 1.75 percent, rather than the lower tolerance,+/-0.75 percent, approved by the Governing Committee. One Beacon argues that the Redistribution Plan does not adequately measure the economic value of ERPs, because the subsidy-adjusted loss ratio is not a true indicator of an ERP's value, and also leads to an inequitable result because it fails to take into account differences in company claim count development practices.

Premier asks the Commissioner, as part of the Redistribution Plan, to change the procedure now in place for assigning exposures written by a large ERP to a number of insurance companies based on where the vehicle is garaged, but does not otherwise oppose the plan adopted by the CAR Governing Committee. Concerns were also expressed about the effect of offers of voluntary contracts to ERPs on the Redistribution Plan and the need to control that effect, whether through a moratorium on offering voluntary contracts to ERPs or setting an "appoint by" date before redistribution. In addition, the IPCIM reiterated the concern earlier expressed by the Norfolk and Dedham Group about the need for a methodology to address future ERP subscription relief.[7] Two of the ERPs who spoke objected, in general, to using ERP redistribution to solve problems with the residual market; the third urged that the chosen plan redistribute the least possible number of ERPs and, in deciding which ERPs to redistribute, consider the number of years that a producer has been with its current carrier**.**

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[7] No representative of the Norfolk & Dedham Group submitted a written or oral statement in this proceeding.

The companies expressed hope that a decision would be reached quickly to enable the redistribution process to proceed expeditiously to bring fairness to the residual market. No objection was voiced to CAR's proposed implementation timetable.

1. The choice of a tolerance level

As its baseline for distributing ERP exposures on an equitable basis, the Redistribution Plan looks at the loss ratios of ERP books of business, adjusted to reflect subsidies incorporated into the fixed-and-established rates. Recognizing that **exact** loss ratio parity is not achievable, it proposed a loss ratio tolerance margin of plus or minus one percent. As applied, the Redistribution Plan produced a loss ratio tolerance of less than one percent. The Plan approved by the Governing Committee thus includes a loss ratio tolerance of +/- 0.75 percent. Application of the model at that level, CAR estimates, will require movement of approximately 133 ERPs and 171,000 ERP exposures (vehicles), and produce a subsidy-adjusted loss ratio range by company of 89.1 percent to 90.2 percent. The exposures that would be moved represent approximately 15 percent of the total number of ERP exposures.

Plymouth Rock, acknowledging that the choice of a redistribution methodology is within the Commissioner's discretion, asks her to substitute a loss ratio tolerance of +/- 1.75 percent for CAR's recommended value, on the ground that implementation at the higher level would require movement of only 114 ERPs and 144,235 exposures, while producing a loss ratio range by company of 88.1 percent to 91.4 percent.[8] It argues that the higher tolerance margin would reduce inconvenience to ERPs and consumers, while still improving the ERP loss ratio range of 70 percent to 150 percent that the current system has produced. Further, Plymouth Rock asserts, because it would change fewer relationships between servicing carriers and their ERPs, it would reduce the adverse effect of such changes on company fraud-fighting efforts.[9]

CAR's testimony indicates that the question of loss ratio parity was addressed by the Ad Hoc Subscription Methodology Committee and considered by the Governing

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[8] CAR, in response to directives by the Commissioner, modeled Plymouth Rock's proposed alternative approaches to ERP redistribution, including redistribution at various levels of loss ratios and by loss ratio band. In its statement at the hearing, Plymouth Rock did not recommend adoption of either of these alternatives.

[9] CAR's analysis indicates that Plymouth Rock would fare better, in terms of ERP assignments, under a +/- 1.75 percent tolerance ratio than under a +/- 0.75 tolerance ratio.

Committee at its December 14 meeting. A majority of the Governing Committee members agreed that the lower loss ratio tolerance most equitably accomplished the Redistribution Plan goal of achieving loss ratio parity among companies. It concluded that the disparity in loss ratios resulting from using a +/- 1.75 percent loss ratio tolerance was unacceptable. CAR's Redistribution Plan results in a tolerance level that with a spread of 1.50 percent, while a +/- 1.75 percent tolerance level results in an overall 3.50 percent spread. CAR noted, in its testimony, that a one percent loss ratio difference could have a significant effect on a servicing carrier's financial results, pointing out that the impact was estimated to be at least $100,000 per point of market share. A wider tolerance level would therefore be less effective at achieving equity among servicing carriers. We agree that it is preferable to utilize model parameters that produce a narrower range of loss ratios by company and for that reason, conclude that CAR's chosen loss ratio tolerance margin produces a more equitable result for all carriers and is therefore preferable to the +/- 1.75 percent recommended by Plymouth Rock.

At the same time, we are cognizant that redistribution of ERPs affects both producers and consumers and that evaluation of any plan must include an analysis of its effect on the marketplace. We have considered the estimates provided by CAR and Plymouth Rock of the number of ERPs and exposures that would be redistributed under the two proposed tolerance margins. While the use of +/-1.75 percent tolerance level, as recommended by Plymouth Rock, would move about 19 fewer ERPs and 26,750 fewer exposures, we are not persuaded that, viewed in the context of the total number of ERP exposures and historical data on the changes that routinely occur in the marketplace, the difference between the two outcomes is so significant that it outweighs the greater success of the lower tolerance margin at achieving equity in loss ratio parity.

CAR's December 1 letter to the Commissioner notes that a past physical redistribution of ERPs involved 200,000 exposures. Testimony from both MAIA and Safety observed that over the past five years some half a million ERP exposures have been transferred from one servicing carrier to another as a result of company withdrawals from the marketplace or efforts to reduce their books of Massachusetts private passenger automobile insurance business. Movement of ERP exposures routinely occurs in the marketplace, and we are not persuaded that the effects of this redistribution will excessively burden a system that is accustomed to change.[10] Further, we note that 26,750 exposures represent only about 2.6 percent of total ERP exposures.

For those reasons, we approve the Redistribution Plan model that uses a loss ratio tolerance margin of plus or minus 0.75 percent.

2. Other modeling issues

One Beacon argues that ERP's subsidy-adjusted loss ratios, that are the basis for achieving residual market parity under the redistribution plan, do not adequately measure the quality of ERP books of business, and that the Redistribution Plan should also incorporate parameters that would equalize the distributions based on the credit eligibility of ERP books of business and reflect differences in company claim development practices. The Commissioner, in her December 30 letter to CAR, instructed it, in addition to calculating loss ratios to also calculate the credit eligibility of ERP books of business, and to calculate that credit eligibility at both +/- 0.75 and +/-1.75 percent loss ratio tolerances.[11] The results of that analysis were presented to the Commissioner on January 17.

OneBeacon argues that the spread between the percentage of credit-eligible business, before and after applying the Redistribution Plan at a +/- 0.75 tolerance level, does not change. While that is correct, OneBeacon does not acknowledge that CAR's analysis also shows that, after implementing the Redistribution Plan, the percentage of credit-eligible exposures, for 17 of the 18 companies in the analysis, falls between 20 and 30 percent. The only company that falls outside that range is OneBeacon. Pre-

[10] The two ERPs who made statements at the hearing object in principle to balancing the residual market by redistributing ERPs. The methodology for adjusting company subscription levels, however, has always been based on the transfer of ERPs. Further, we note that the Redistribution Plan ameliorates the effect of the one-time distribution by providing payments of $25 per in-force exposure to compensate ERPs whose books of business are moved in the one-time redistribution. That rate is $10 higher than the payment required under Rule 13 for transfers effected to resolve over- and under-subscription positions. With respect to selecting ERPs for transfer, the Redistribution Plan notes that, consistent with the CAR Rules, ERPs who have been with their current servicing carrier for less than thirty-six months, will not be redistributed unless equity cannot be achieved without reassigning them. On this record, it cannot be determined whether CAR, in making its decisions, utilizes other guidelines, such the total length of time an ERP has been with the current servicing carrier. We note, however, CAR's statement in its December 1 letter that, to the extent possible, current relationships between carriers and producers will be maintained. Proposals to adopt policies to consider specific factors, such as the length of such relationships, are appropriately brought to the attention of CAR.

[11] In allocating the residual market deficit, carriers receive credits for retaining exposures written in class/territory cells that receive rate subsidies. "Credit eligibility" refers to the potential that an exposure has for earning credit for the carrier that writes the business voluntarily rather than cede it.

redistribution, the percentage of credit-eligible exposures for 12 of the 18 companies is between 18 and 28 percent; six others are between 30 and 43 percent.[12] Under both analyses, OneBeacon is at the high end of the range. It thus appears that, for a majority of companies, the Redistribution Plan narrows the differences among them in the percentage of credit-eligible exposures in their books of ERP business, a result that again moves toward parity and equity among servicing carriers. OneBeacon did not express any opinion on that outcome, or identify at the hearing a target value that it would consider a reasonable measure of parity as evidenced by credit-eligibility of ERP business.

I note, further, that OneBeacon has not addressed the relationship between credit eligibility and company cession decisions. The CAR rules do not require that a company retain or cede all credit eligible risks. Therefore, an individual company's perceived value of an ERP book of business, measured by credit eligibility, will vary depending on its chosen cession strategy. Consequently, absent some evidence of a generally accepted range of variation, there is no basis on which to determine whether credit eligibility is a significant parameter.[13] For these reasons, I am not persuaded that the Redistribution Plan should be modified to include an additional parameter for credit eligibility. OneBeacon offered no explanation for its high percentage of credit-eligible ERP business, and identified no plans to effect a change its business practices that might affect that percentage.

On the second issue, OneBeacon argues that the Redistribution Plan does not take into account differences in bodily injury claim count development among carriers. OneBeacon concedes that it has the highest development factor in the industry and that their ERP loss ratios are therefore understated. In a December 1 letter to the Commissioner, CAR commented that, were it not for OneBeacon's mix of business and its reserving patterns with respect to claim count development, OneBeacon would support the Redistribution Plan. OneBeacon generally agrees with CAR's observation but considers that, because the Redistribution Plan does not address OneBeacon's situation, it fails to achieve overall parity and is therefore flawed.

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[12] The cited values have been rounded to the nearest whole number.

[13] The record suggests that there is no consensus on the meaning of differences in the percentage of credit eligible business in a carrier's book of ERP business. I note Arbella's statement at the January 23 hearing that such differences are neither unexpected nor inequitable, and its comment that treating credit eligibility as a parameter would increase market disruption with little gain in terms of overall equity.

The Redistribution Plan submitted by CAR states that, in order to minimize the impact on loss ratio results of differences in servicing carriers' reserving practices, CAR will uniformly apply an average case reserve to each open bodily injury claim, while using paid losses for closed bodily injury claims and incurred losses for all other coverages. CAR, in its testimony, notes that the Ad Hoc Committee considered that the averaging methodology, while based on estimates, would be a sufficient measure of equity. The Redistribution Plan will be applied to all CAR members which act as servicing carriers for private passenger automobile insurance. For an industry-wide application, we conclude that it is appropriate to utilize an industry-wide case reserve average to develop loss ratios. OneBeacon is undisputedly at the top of the range from which the average is calculated, but has offered no persuasive argument that averaging is an inappropriate methodology, or offered any formula for adjusting the subsidy-adjusted loss ratios to address its concern.[14]

We therefore will not order CAR to modify the Redistribution Plan by adding specific provisions relating to credit eligibility or claim count development.

3. Application issues

Premier asks the Commissioner to address the treatment in the Redistribution Plan of business written by the A-Affordable Insurance Agency, an ERP whose large book of business is now divided among several servicing carriers. Premier has two particular concerns: first, that the carrier with the largest market share in the state is not assigned A-Affordable business; and second, that the agency's growth will mean that all carriers servicing its exposures will soon become oversubscribed.[15]

Because ERP subscription levels are determined as a percentage of a servicing carrier's total business, expansion or contraction of ERP books of business may change a carrier's status to over- or under-subscribed. The CAR rules include a procedure for assigning ERP exposures by garaging town when the transfer of the entire book of business would result in oversubscription. With respect to the one ERP whose book of business is assigned to multiple servicing carriers, CAR proposes to follow the procedures now prescribed by Rule 13 during the one-time redistribution. In its testimony at the hearing, it stated that following the current method will minimize disruption as a result of

[14] We note, further, that because each company sets its own reserving and claim development practices, each company has the capacity to change those practices.
[15] The largest carrier is the Commerce Insurance Company.

physical redistribution. Further, CAR points out that any change to that methodology would require specific direction on the allocation of garaging towns among servicing carriers. In addition, CAR stated that the current allocation of business from the large ERP, except for the one carrier to which it was initially assigned, has been done through voluntary two- and three-party agreements, not through an involuntary assignment by CAR.

The effect of the Redistribution Plan on any particular ERP, large or small, cannot be determined at this time. Neither the ERPs who may be transferred nor the companies that will lose or acquire their books of business have been identified in any submission to the Commissioner. The Commissioner has been asked only to approve a Redistribution Plan. Nothing on this record provides an adequate basis for ordering changes to the Redistribution Plan that would address the assignment of particular ERP exposures to individual companies.

Further, to the extent that the procedure for assigning business written by large ERPs is addressed in CAR Rule 13, proposed changes to the Rule, including its elimination, should first be addressed at CAR. I note also that Rule 13, as approved in the September 30 Decision, has been revised to provide more prompt relief to oversubscribed carriers, which should help to allay Premier's concern. Although Premier is concerned that CAR will be unable to resolve issues arising from A-Affordable's potential growth, no determination as to the effectiveness of the CAR Rules should be made before CAR has had an opportunity to utilize its own procedures and analyze relevant data. Market transactions that affect the number of vehicles serviced through an ERP such as the sale of all or a portion of the existing renewals or the purchase of all or a portion of the renewals of another agency or company should be monitored by CAR. To this end, we direct CAR to prepare monthly trend reports of the vehicle growth rates for each ERP on a three month and six month moving average basis. The number of ERPs with a growth rate in excess of the industry average shall be reported to all member companies. Any ERP with a growth rate greater than two times the industry average shall be identified to all member companies.

Concerns were also expressed about the possibility that the Redistribution Plan would be affected by last-minute decisions by servicing carriers to offer voluntary contracts to their ERPs. CAR takes the position that it has no authority to regulate offers involving voluntary contracts; the carriers assert that a carrier which offers a voluntary contract to its ERP immediately after that ERP has been transferred to another carrier would throw off the loss ratio of the recipient carrier. Offering such contracts would also remove the producer from the roster of ERPs. CAR indicated at the hearing that it would establish a date whereby any transactions between carriers and ERPs would not affect the redistribution and stated that, if the Commissioner approved the Redistribution Plan by January 27, that cut-off date would be January 30.[16]

Although the methodology under consideration in this hearing relates to a one-time ERP redistribution, a few speakers expressed concern about the methodology that will apply to future reassignments of ERPs through the subscription relief process and the possibility of future physical redistributions to correct imbalances. The September 30 Decision ordered CAR 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. IPCIM and the Norfolk and Dedham Group seek reassurance that the random selection process will, in the future, conform to the Commissioner's order. IPCIM suggests that the Commissioner issue a directive requiring CAR to fairly reapportion the ERP burden on a periodic and regular basis. Plymouth Rock's statement suggests additional revisions to Rule 13, and asks that CAR strengthen Rule 13 by adding "anti-gaming" provisions to it. CAR's December 1 letter to the Commissioner stated that the Ad Hoc Committee had considered Norfolk & Dedham's request for ongoing rules relating to ERP distribution, and was committed to addressing its issue at future meetings.

After considering these matters, on this record, I decline to issue any directives specifically addressing the methodology for future ERP redistributions. Based on the Commissioner's September 30 Decision, the CAR Governing Committee's decision, and the record of this hearing, the only issue to be decided at this time is the methodology for implementing a one-time redistribution. Further, as yet there has been no opportunity to evaluate the effectiveness of the revisions to Rule 13 that are designed to improve CAR's

[16] Post-redistribution, of course, any effect on a carrier's subscription level resulting from changing an ERP relationship to a voluntary relationship would be governed by the Rule 13 provisions for subscription relief.

response to over- and under-subscription positions. CAR's testimony indicates that its goals for 2006 include reviewing and possibly enhancing ERP subscription procedures, and close monitoring of all market activities affecting ERP subscriptions in order to evaluate any future imbalances. Our directive to CAR to collect certain types of information should not be considered a limit on the information that it considers necessary to collect in order to evaluate the operation of the residual market adequately. As noted above, any changes to the rules relating to ERPs and servicing carrier subscription levels should be developed first at CAR before submission to the Commissioner.

Conclusion

CAR is to be commended for its prompt responses to the Commissioner's inquiries throughout this process. We agree with Plymouth Rock's characterization of that process, in its statement submitted at the January 23 hearing, as long and thorough. The additional modeling that CAR performed has contributed to our understanding of the issues, as has commentary from companies, producers and members of the public. CAR has provided explanations for its choices that have enabled us to evaluate the reasonableness of its recommended model.

The Redistribution Plan for ERPs, as adopted by the CAR Governing Committee on November 16 and December 14, 2005, is hereby approved. Implementation is to proceed in accordance with the timetable proposed by CAR at the hearing on January 23, 2006, *i.e.*, March 1, 2006 for all new business and May 1, 2006 for all renewal business.

January 27, 2006

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Jean F. Farrington
Presiding Officer

Affirmed: __________________________
Julianne M. Bowler
Commissioner of Insurance

Amendment and Clarification of Order on Proposed Methodology

After the order in this matter was issued, CAR pointed out that at the end of the January 23 hearing it had revised the last date on which it would recognize transactions with ERPs that would affect implementation of the Redistribution Plan from January 30 to the day before an order issued approving the Redistribution Plan. That statement was inadvertently omitted from the order. Therefore, we are inserting the following text after the sentence on page 17 of the order that refers to CAR's proposed timetable: At the end of the hearing, CAR revised the January 30 date, stating that the cut-off date for recognizing transactions relating to ERPs would be the day before an order issued approving the Redistribution Plan.

Therefore, the reference on page 19 of the order to "implementation in accordance with the timetable proposed by CAR at the hearing on January 23" incorporates a cut-off date of January 26 for recognition of transactions that affect the implementation of the Redistribution Plan.

January 27, 2006

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Jean F. Farrington
Presiding Officer

Affirmed:

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Julianne M. Bowler
Commissioner of Insurance