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Commonwealth Automobile Reinsurers'

Proposed Changes to Rule of Operation 13.C

Docket No. C2007-02

Order on Proposed Changes

Introduction

On June 4, 2007, the Governing Committee of Commonwealth Automobile Reinsurers ("CAR") voted to amend Rule 13 of its Rules of Operation (the "Amendment"). Pursuant to Article X of the CAR Plan of Operation, CAR submitted the Amendment to the Commissioner of Insurance ("Commissioner") for her approval and also sent a copy to all its member companies. By letter dated June 7, the Arbella Mutual Insurance Company ("Arbella") requested a public hearing on the Amendment. On June 14, 2007 the Commissioner issued a hearing notice scheduling a hearing for July 25.

Eleven individuals representing insurance companies, trade organizations and CAR, offered statements at the July 25 hearing. In addition, the Division received, prior to the hearing; three written statements commenting on the Amendment. The record was kept open until July 27. Four insurers submitted post-hearing statements.

Historical Background

Rule 13 addresses a broad range of requirements for CAR members who are servicing carriers for the residual market. The Amendment changes only Rule 13.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] In June 2005, CAR submitted to the Commissioner a series of amendments clarifying the subscription methodology and revising procedures for obtaining relief for over- or undersubscribed servicing carriers. A stated goal of those amendments was to reduce the opportunity for manipulation of ERP subscriptions. The amendments stated that a "random selection" method would be used to select ERPs for reassignment in connection with subscription relief. After a hearing, held at the request of a CAR member, the Commissioner issued a decision on September 30, 2005 (the "*2005 Decision*") approving the changes to Rule 13, but ordering CAR, before implementing those changes, to complete a redistribution of ERPs that would first establish for all servicing carriers overall parity in the quantity and quality of their ERPs.[2]

The Commissioner also ordered CAR to revise the random selection methodology for choosing ERPs for reassignment to ensure that the methodology, in addition to balancing the ought-to-have number of ERP exposures for servicing carriers, addressed issues of business quality. After completing the redistribution mandated by the *2005 Decision*, CAR charged the Ad Hoc Subscription Methodology Committee that it had established earlier in 2005 with the task of devising a methodology for ensuring that future ERP reassignments would consider both the number of exposures in an ERP's book of business and the quality of that business. The Amendment at issue in this hearing is CAR's response to the Commissioner's order to revise the system for selecting ERPs for reassignment.

Summary of the Proposed Amendment

The Amendment changes the method for calculating a servicing carrier's ought-to-have subscription share from an exposure-based approach in which the carrier's share of total ERP exposures equals its percentage share of the total market for private passenger automobile business, to one based on the financial burden to a servicing carrier generated from business written through its ERPs relative to the industry's overall ERP financial

[1] Subscription shares are now determined on an exposure basis that matches the percentage of a servicing carrier's ERP business to its percentage of the total market for private passenger automobile insurance. A servicing carrier's "ought-to-have" share of ERP business, also referred to as its subscription level, varies with its share of the total market, and is also affected by business transactions affecting ERPs. A carrier whose ought-to-have share is over or under the calculated level is referred to as over- or under-subscribed.
[2] The quality of an ERP's book of business was measured using a three-year loss ratio methodology, adjusted to reflect the effect of rate subsidies.

burden. It prescribes a series of steps for calculating a servicing carrier's financial burden, looking at loss ratios calculated from earned premium and incurred losses, as well as expenses. Expenses are determined as a percent of earned premium in accord with the expense components in the approved rate for the most recent rate year included in the premium data. CAR also proposes to determine a servicing carrier's ought to have financial burden by multiplying its voluntary, rather than total, market share, based on property damage liability car years of exposure reported to CAR for the latest twelve policy effective months, by the industry total ERP financial burden.

Under the Amendment the primary consideration for determining subscription order and eligibility for relief is the servicing carrier's financial burden relative to the industry. The changes include specific rules relating to the allocation of exposures and financial burden as a result of transactions among producers, including purchases by voluntary agencies of ERPs or by ERPs of other ERPs or voluntary agencies, and of changes in the status of an ERP that receives a voluntary contract.

Consonant with the current Rule 13.C.2.c, the Amendment authorizes two approaches to correcting imbalances in the subscription share. A servicing carrier may petition for relief if it has been oversubscribed at a level of 110 percent or more of its relative financial burden for a period of four or more consecutive months. After validating the data, CAR staff will follow a series of rules relating to the selection of lower or higher loss ratio ERPs for reassignment that look first at financial burdens and then at whether the servicing carrier that is over- or undersubscribed by financial burden is also over-or undersubscribed by volume.

With respect to undersubscribed carriers, CAR staff is to notify the Governing Committee and all oversubscribed carriers if a servicing carrier has less than 75 percent of its financial burden relative to the industry and is at least $100,000 below its ought-to-have financial burden for four or more consecutive months. The Governing Committee then determines whether to order a redistribution of ERPs to achieve the appropriate level of financial burden. An oversubscribed servicing carrier may notify the Governing Committee that it wishes to forego any redistribution of its ERPs. CAR will then, at the Governing Committee's direction, assign ERPs to or from the most oversubscribed servicing carrier until the undersubscribed servicing carrier's financial burden approximates its ought-to-have level.

The rules require CAR to select lower loss ratio ERPs of the most undersubscribed servicing carrier for reassignment to an oversubscribed petitioner if the petitioner is undersubscribed by volume and the most undersubscribed servicing carrier is oversubscribed by volume. No ERP will be selected for reassignment if the reassignment would either reduce a petitioning servicing carrier's financial burden to less than 100 percent of the industry relativity or cause the undersubscribed servicing carrier's financial burden to exceed 100 percent of that relativity. Should an ERP that is reassigned under these relief procedures accept a voluntary contract before the effective date of the assignment, CAR will reassign additional ERPs as necessary to achieve the target subscription level.

If subscription relief cannot be obtained by reassigning entire books of business written by a petitioning servicing carrier's eligible ERP, final relief will be granted by reassigning financial burden to the most undersubscribed servicing carrier by utilizing garaging towns. Reassignment of ERP exposures by garaging towns if relief cannot be achieved by other means is consistent with the current CAR Rule 13.

Summary of Presentations at the July 25 Hearing

Virtually all the speakers at the July 25 hearing support adoption of a subscription share methodology that examines the financial burden of the residual market on servicing carriers, commenting that CAR's proposed approach would more fairly apportion that burden. General approbation, however, was not accompanied by a wholesale endorsement of the Amendment as approved by the Governing Committee. Several speakers expressed reservations about the details of the proposed methodology and its potential effect on some servicing carriers, and urged the Commissioner to order CAR to make specific revisions. The Plymouth Rock Assurance Corporation ("Plymouth Rock") asserted that the Amendment does not fairly measure the financial burden because it does not reflect differences in the way companies report financial information to CAR. Specifically, it asserts that some companies report to CAR, for liability claims that do not involve bodily injury, their reserves for both Incurred But Not Reported ("IBNR") claims and for Allocated Loss Adjustment Expenses ("ALAE"), while others report only IBNR reserves. Plymouth Rock argues that both ALAE and IBNR reserves contribute to a company's ERP burden, and that therefore, for companies, such as Plymouth Rock, that do not report ALAE reserves, the financial burden will appear to be lower than it actually is. Plymouth Rock asks the Commissioner to order CAR to ensure that its calculations of financial burden include a value for ALAE for all member companies.[3] Other companies argued that the methodology for calculating ERP loss ratios is flawed because it ignores recent improvements in those loss ratios and is overly sensitive to slight changes in company loss ratios.

Two insurers objected to the Amendment on the ground that it does not provide appropriate incentives for effective company management of its ERP business. Arbella and Plymouth Rock argued that it will take poorly performing ERPs away from companies that do not manage them and give them to companies that manage their ERPs well.[4] Plymouth Rock proposed freezing ERP loss ratios after a distribution has been made to establish financial parity. One company pointed out that the Amendment does not cap the number of exposures that could be reassigned to a servicing carrier as part of the process for equalizing the financial burden, noting that a smaller company might not be able to service a large increase in exposures. It recommended that the rule expressly limit reassignments to an undersubscribed servicing carrier if the assignment would cause the carrier's exposure volume to exceed 105 percent of its ought to have exposure share.

Arbella and Plymouth Rock raised concerns about the process for developing the Amendment, asserting that the process was flawed because CAR had refused to model proposals they presented to the Ad Hoc Subscription Methodology Committee. Arbella criticized the decision to examine the issue of improving parity in the apportionment of the residual market burden through an ad hoc committee, rather than assign it to CAR's Actuarial Committee.

Arbella opposed the Amendment for several other reasons. It argued that the Amendment does not comply with the September 2005 Order, which did not suggest a

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[3] Plymouth Rock offered two alternatives: 1) that CAR assign the industry average reserve level to companies that do not set their own ALAE case reserves; or 2) that CAR substitute the industry average for all companies.

[4] Arbella, the company that, according to CAR's analysis, is undersubscribed in terms of financial burden, asserted that it has invested time and work to improve its ERP results and has gone from being a carrier with some of the worst ERP results to a carrier with some of the best. It characterized the prospective receipt of ERPs with high loss ratios as punishment for its investment in ERP management.

wholesale change to the subscription process. The Amendment, Arbella asserted, will produce a second physical redistribution of ERPs utilizing loss ratios calculated on a basis that is inconsistent with the methodology used to calculate those loss ratios for purposes of the 2006 redistribution.[5]

Arbella also questioned whether it is necessary to change the subscription formula now, when the new Massachusetts Automobile Insurance Plan ("MAIP") is being implemented, and instead recommended retaining the current exposure-based formula. It argued that the Amendment would create substantial market disruption and frequent reassignment of ERPs and risks, outcomes that will create instability and uncertainty during the MAIP transition period. Arbella pointed out that CAR did not model the number of consumers or producers that might be reassigned, because it was not sure how many would request redistribution.

Supporters of the Amendment also recognized that any allocation system that is based on the assignment of ERPs to servicing carriers is inherently flawed because, in a fluid marketplace, it will be stable for only a brief time. Achieving a continuous fair and equitable allocation of the residual market burden requires periodic adjustments in response to market dynamics. As stated by the Property and Casualty Insurers ("PCI"), imbalance is a permanent fixture in the current residual market system and more than a one-time redistribution is necessary. The 2006 redistribution was unable to provide a long-term solution.[6] Amica Mutual expressed the opinion that the system will stay out of balance until the MAIP is implemented. Encompass Insurance, while characterizing the Amendment as a "less than adequate solution to the dilemma of addressing the statutory requirement that the residual market burden be shared equally," concluded that while the Amendment may be flawed, it is the best that could be achieved under the ERP assignment structure. In its opinion, even if the system is rebalanced in 2007 under a financial burden standard, additional redistributions may be necessary before the residual market pool mechanism is converted to the MAIP.

[5] The ERP loss ratios used as a basis for the 2006 redistribution were adjusted by subsidy; the Amendment eliminates those factors from the measurement.
[6] The *2005 Decision*, which mandated the 2006 redistribution, recognized that "achieving equity for a residual market in which the values of the relevant parameters constantly change presents significant challenges."

Participants in the hearing also recognized the difficulties of accurately assessing the financial burdens associated with ERP business. One speaker pointed out that differing business practices make exact comparisons of agencies impossible. OneBeacon Insurance, describing the system as fairer, but not perfect, acknowledged the difficulty of calculating an ERP's profit, noting that the process requires many simplifying assumptions. CAR's calculations do not take into account the impact of recent rate changes on ERPs, for different loss development among carriers, except for bodily injury claims, to the expenses related to managing ERPs, or the credit value of ERP business. Speakers disagreed on the extent to which these issues should be considered in developing a formula for calculating a carrier's financial burden. Whether to recognize servicing carrier expenses relating to the management of their ERPs in the calculation of their financial burden is also controversial. Developing a methodology for measuring the relative costs and effectiveness of particular management practices is difficult; one carrier questioned the accuracy of claims about the superiority of some companies' practices.

Balancing the residual market burden of servicing carriers through the redistribution of ERPs is further complicated by the historical response of servicing carriers to the prospect of losing their low loss ratio ERPs. In the 2006 redistribution, CAR expected to reassign 133 ERPs. Ultimately, only 54 were actually reassigned, because the remainder received voluntary contracts.[7] Under the current exposure-based subscription rules, carriers retain profitable producers as ERPs to satisfy their subscription share; retention of those producers as ERPs would no longer benefit them in a system based on financial burden. Several participants observed that the amendment is expected to further the salutary goal of increasing the number of ERPs who receive voluntary contracts. No participant, however, attempted to quantify the number of ERPs that might be given voluntary contracts if the amendment is approved or to predict the effect of such a change on the calculation of servicing carriers' financial burdens.

Discussion and Analysis

CAR proposes an entirely different basis for determining subscription shares, instead of modifying the exposure-based methodology in the current Rule 13.C to provide for the targeted, rather than random, selection of ERPs for reassignment in the

[7] Amica Mutual questions whether ERPs with low loss ratios should continue to be ERPs.

subscription relief process. That CAR takes a broader approach than that mandated in the 2005 Decision to the issue of achieving equitable distribution of the residual market burden is not, in itself, a reason to reject the Amendment, but does require careful analysis to ensure that the Amendment achieves the desired result in the current marketplace. After considering the Amendment, the written statements and the testimony at the July 25 hearing, I conclude that the articulated goals for the Amendment respond appropriately to the *2005 Decision* but that the Amendment itself should be remanded to CAR to address the issues discussed below.

The context in which the residual market will operate has changed since CAR approved the Amendment on June 4, 2007. On July 16, the Commissioner issued two decisions, one approving new CAR Rules 21-40 that establish the MAIP and setting a timetable for its gradual implementation, and the other allowing competitive rating for Massachusetts private passenger insurance for policies with effective dates of April 1, 2008 or later. Those substantive changes to the market for private passenger automobile insurance do not obviate the need for examining the procedures for allocating the residual market deficit. Carriers will be able to cede some risks to the residual market pool through March 31, 2009. Allocating the financial burden of the ceded residual market pool will continue after the MAIP is fully implemented.

The residual market burden, as several participants observed, is also a factor affecting the expense loading that a carrier incorporates into its rates. Equitable distribution is therefore essential to establish an equal footing for all carriers in the marketplace. For those reasons, it is inadvisable to maintain the status quo pending full implementation of the MAIP. At the same time, it is reasonable to consider the potential impact of the Amendment in a defined transition period, to ensure that it does not exacerbate any disruption associated with changes to the market, and that it appropriately balances the interests of all participants in the insurance transaction: carriers, consumers and producers.

A stated goal of the Amendment is to establish a process that will address oversubscription relief. Participants in the hearing disagree on the extent of market change that would be generated by adoption of the Amendment. As under the current rule, oversubscribed servicing carriers drive the system for relief. CAR estimated that giving subscription relief to one company that has requested it would require four to six ERPs to be reassigned. It acknowledged that seven or eight companies would be eligible to request subscription relief, but could not estimate the effect if all oversubscribed companies petitioned for such relief, or predict how many might initiate a request for relief. In Liberty Mutual's opinion, some companies that, under CAR's analysis, are eligible to apply for relief might not do so because of the transition to the MAIP. Arbella, however, thought it likely that every carrier that is eligible for relief would request it. Their statements demonstrate the lack of consensus within the industry on company utilization of the Amendment's procedures for oversubscription relief, an issue that is further complicated by the dual approaches that the Amendment provides for initiating subscription relief.

Equitable distribution of the financial burden is unlikely to be achieved unless relief is also implemented to address undersubscription.[8] Under both the current Rule 13.C and the Amendment, CAR may take action to redistribute ERPs to undersubscribed carriers; the Amendment allows CAR to initiate a reassignment if a servicing carrier is undersubscribed by 75 percent of its financial burden and at least $100,000 below its ought to have financial burden for four or more consecutive months. Although CAR has authority under its rules to initiate relief in appropriate circumstances, the testimony does not suggest that it anticipates doing so. CAR should consider the adoption of a more specific policy for determining when to reassign ERPs to undersubscribed carriers. In addition, both the Amendment and the current Rule 13.C allow an oversubscribed company to decline to participate in redistributions initiated by CAR. CAR should consider whether, in light of its stated goal to maintain an equitable balance of the residual market burden, it is still appropriate to allow oversubscribed companies that option.

CAR should also consider other approaches to ensuring that the Amendment satisfies the goal of responsiveness to changing conditions. In order to minimize market disruption the Amendment, as submitted, reasonably sets time frames that require over- or undersubscription to occur for a period of time before relief can be granted. Because of the importance of equalizing the residual market burden in a competitive rating

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[8] The *2005 Decision* noted that the reassignment methodology did not address disproportionate differences resulting from the inequitable distribution of books of ERP business with lower loss ratios.

environment, carriers, consumers and producers will all benefit if CAR ascertains whether other approaches, such as different triggers for periodic reviews of the market, are needed to ensure that the allocation of the residual market burden is regularly equalized during the transition period.

The Amendment does not consider the anticipated effect of the transformation of ERPs into voluntary agents, an occurrence that the industry considers a likely (and positive) outcome of the Amendment.[9] The 2006 redistribution was, as Amica Mutual noted, far less disruptive than anticipated because of the number of voluntary appointments of ERPs. No participant, however, addressed the effect of that exodus on the process for planning and implementing equitable distribution of the residual market burden in 2006. Implementation of the Amendment without first recognizing the effect of realistic expectations of change in the number of ERPs will occur skews any assessment of its ultimate ability to resolve imbalance in servicing carriers' financial burdens. A reasonable analysis of the effect of implementing the Amendment should make adjustments for the recurrence of a significant reduction in the number of ERPs because of offers of voluntary contracts.

The record includes no analysis of the effect of the Amendment using current market data. CAR developed a subscription order and calculated financial burdens based on data from December 2006, but agrees that if the Amendment is approved implementation will be made on the basis of more current data. No participant attempted

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[9] It is reasonable to expect servicing carriers to preserve their relationship with ERPs with profitable books of business rather than risk losing them to competitors. Encouraging servicing carriers to offer voluntary contracts to ERPs before undertaking a redistribution plan would also minimize the effect on producers and consumers, an outcome that is consistent with the statement in the *2005 Decision* that, "[I]n 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." That Decision further observed that

> "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 predict the extent to which that analysis might change subscription order or financial burden. Effective review of the Amendment requires a model based on the most recent available information.

Although CAR expects the Amendment to improve the equitable allocation of the residual market burden, its analysis of the residual market standings as of December 2006 demonstrates that inequities exist whether the subscription share is calculated on the basis of exposure distribution or financial burden. Implementation of an entirely new approach to the subscription methodology during a transition period to the MAIP may be unnecessary if adequate relief is available through less dramatic means. Under either the current rule or the Amendment, a number of carriers are in a position to petition for subscription relief. Because CAR has provided no comparative analysis of the effect of applying the Amendment or the existing rule to the current market, it is not possible to determine whether the Amendment produces a more equitable outcome, or the effect of either approach on producers or consumers.

The Amendment also adopts an approach to calculating ERP loss ratios that differs from that employed in the 2006 redistribution.[10] The *2005 Decision* concluded that the process for reassignment of 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. CAR has performed no comparative analysis of the outcome of applying the current and revised subscription share methodologies utilizing the approach taken in 2006 for calculating ERP loss ratios. Absent modeling of the potential outcomes, it is not possible to determine whether the Amendment represents a significant improvement over the existing procedures.

Of particular concern is CAR's proposal to institute radical changes to the basis for allocating the Residual Market Burden during a finite period of transition to the MAIP during which the industry anticipates a significant reduction in the number of ERPs. The changes, further, are framed in terms of the financial losses associated with business written through ERPs. Because not all such business is ceded to the residual market, an allocation methodology that is based on the volume of business written by all ERPs does not reflect the financial losses associated with a subset of that business. Eventually, the

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[10] CAR did not explain the reason for the change.

MAIP will achieve a more equitable allocation because individual risks will be randomly assigned to insurers based on their quota shares. Until the MAIP is fully implemented, it is preferable to develop a system that effectively reflects the transition from a producer-based system of assigning risk to a risk-based system. The interests of all participants in the insurance transaction, insurers, consumers and producers will be best served by a system that focuses on the sources of financial loss, minimizes disruption and maximizes the likelihood that ERPs will obtain voluntary contracts.

CAR's analysis of ERP loss ratios as of the end of September 2006 demonstrates that the loss ratio results for ERPs have dropped substantially in recent years.[11] The appropriate focus for allocation of the financial burden of ERP business is that portion of the business that is written in rate-subsidized classes rather than the entire range of business written through ERPs. That analysis begins with consideration of each servicing carrier's market share in the rate-subsidized classes relative to its total market share by exposure. For purposes of transition, subscription is more fairly measured in terms of the degree to which a company is insuring its fair share of rate-subsidized business regardless of whether the business is produced by an ERP or a voluntary agent. Basing the subscription share on exposures, but limiting it to subsidized business targets the segment of the market that has the most potential to generate high financial losses and reduces incentives to game the system for both companies and producers. In order to determine the effect on the marketplace of an analysis based on the equitable sharing of rate-subsidized business, the number of companies that would qualify for subscription relief and the number of exposures that would potentially be transferred should also be modeled.[12]

To that end, we are ordering CAR to develop a baseline model for allocating the residual market burden based on subscription shares of rate-subsidized business. The model shall first calculate for each servicing carrier the following components:

1. The total (for all CAR ID codes) exposure based market share based on data for the twelve most recent policy effective months.
2. The total exposure based rate-subsidized market share as the sum of:

[11] The relative range of those ratios has also narrowed considerably.
[12] A preliminary analysis of the data suggests that these numbers would not significantly disrupt the market.

a. Total exposures (all CAR ID codes) for exposures in premium towns with codes 2, 300, 303, 400, 401, 403, 601-603, 717, 802, 803, and 815-824;

b. Total exposure in operator class codes 17, 20 and 25 that are not already included in a., above; and

c. Total exposures with SDIP points 9 and above that are not already included in the totals for a. and b. above.

3. The ought-to-have rate-subsidized market share shall be calculated by multiplying the total market share by the statewide total number of exposures in the rate-subsidized markets.

4. The over- or undersubscribed subscription position in the subsidized market shall be measured as the difference between the number of exposures actually written in the rate-subsidized market and the ought-to-have share.

CAR should then consider retention of the current Rule 13.C.2.a relating to eligibility to request subscription relief (i.e., the length of time for which the servicing carrier has been oversubscribed and the percentage of oversubscription). Servicing carriers eligible to provide subscription relief will be those companies whose total subscription in rate-subsidized markets is less than 95 percent for a period of three or more consecutive months.

As a second step, CAR is instructed to model a system to provide relief based on ERP written exposures by calculating for each servicing carrier eligible for such relief the following:

a. The exposures in rate-subsidized markets that are produced by ERPs (CAR ID Codes 1 and 5);

b. The ratio of ERP-produced exposures to Total exposures in rate-subsidized markets; and

c. A comparison of the ratio of a servicing carrier's ERP to Total exposures in rate-subsidized markets to the statewide average ratio of ERP exposures to Total exposures in rate-subsidized markets.

ERP exposure-based relief is appropriately limited to eligible servicing carriers whose ratio of ERP to Total exposures exceeds that ratio for the state as a whole. For servicing carriers that satisfy that criterion, CAR should model the ought-to-have exposures from ERPs in rate-subsidized territories as the product of the statewide average ERP to Total exposure ratio and the company's total exposures in rate-subsidized markets. The amount of exposure a relief a servicing carrier may receive is the smaller of the difference between its actual and ought-to-have share of the rate subsidized market and the difference between its actual and ought-to-have share of ERP-produced business in rate subsidized markets.

If oversubscription relief requires physical redistribution of ERPs, it is appropriate to limit redistribution to ERPs who, for the past twelve months, have written over half their business in rate-subsidized markets. CAR should also place appropriate limits on the effect of reassignment of an ERP on the total exposures attributable to the company providing relief. CAR is to model the number of ERPs who would be reassigned and the number of consumers who would be affected by implementation of an approach based on equitable distribution within the rate-subsidized market.

As an alternative to the physical redistribution of ERPs during the transition period, CAR also should consider how the financial information in the proposed rule might be used to facilitate a financial resolution to any inequity identified through the market share positioning determined as a result of the above analysis of rate-subsidized business. In that process, we find it appropriate for CAR to apply the financial information on page 2 of exhibit 2 to its testimony presented on July 25, on an exposure basis, as a reasonable measure to estimate the cost of a financial reallocation.[13] For the purposes of modeling the cost and effect of such a solution, CAR is to provide the following calculations:

1. For all companies that are eligible to ***provide*** ERP relief, calculate each company's market share of total rate subsidized business within the group.
2. Calculate the statewide average financial loss for ERP business using the calculations shown in column (11) on page 2 of Exhibit 2 in the CAR testimony.
3. Compute the statewide average financial loss per ERP exposure using the corresponding total ERP exposures (see column (3) on page 2 of Exhibit 2 in the CAR testimony.)

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[13] Objections to CAR's calculation of the financial burden were based on specific issues that affect the calculation of ERP loss ratios. An approach that focuses on subsidized business written through ERPs avoids the need to calculate such loss ratios. In any event, with respect to those specific issues raised, we agree that company management practices can affect their ERP loss ratios, but that it is difficult to separate the effect of such practices from the other factors that have contributed to the recent industrywide reduction in ERP loss ratios. Both the current CAR Rules and the MAIP explicitly address the obligations of servicing carriers and producers. CAR's expressed preference for addressing agency management practices through performance standards represents a reasonable approach to establishing uniform expectations for insurers and producers.

4. The total amount of financial relief for a qualifying company will equal the statewide average financial loss per ERP multiplied by the number of exposures the company is qualified to have relieved.
5. The share of financial relief born by each company eligible to provide relief shall be its market share as computed in 1 above by the value calculated in 4 above.
6. Companies that provide financial relief will be credited with ERP produced exposures in rate subsidized markets equal to their payment share (5 above) divided by the average cost per exposure (3 above). Such exposure credit shall be fully attributed immediately to the relief providing carriers and fully deducted from the relief seeking company.

CAR should also establish a schedule for monitoring the market share in rate-subsidized territories to ensure the continued fairness and integrity of the process.

Conclusions

CAR's proposed amendment to Rule 13.C is a far reaching revision of the rules relating to calculating subscription shares. It does not, however, address the myriad issues and incorporate calculations that have arisen as a result of the imminent introduction of the MAIP. We therefore remand it to CAR to develop a model as described in this decision and to revise the Amendment to address the issues raised in the decision. CAR is to present the baseline model to the Commissioner within three weeks, and to submit a revised Rule within 60 days.

September 24, 2007

Jean F. Farrington
Presiding Officer

Elisabeth Ditomassi
General Counsel

Affirmed:

Nonnie S. Burnes
Commissioner of Insurance