Decision and Order on Massachusetts Property Insurance Underwriting Association Rate Filings

R2005-14

I. Introduction and Procedural History

On September 9, 2005 the Massachusetts Property Insurance Underwriting Association ("MPIUA") submitted three rate filings to the Commissioner of Insurance ("Commissioner") for her approval pursuant to G. L. c. 175C, §5. The filings addressed three types of coverage: 1) Homeowners multi-peril, which includes policies issued to owners of residential property and condominiums, and renters; 2) Dwelling fire and extended coverage; and 3) Commercial fire and allied lines. The proposed overall rate effects were: 1) +12.5 percent for Homeowners Multi-Peril Insurance; 2) +6.4 percent for Dwelling Fire and Extended Coverage; and 3) 0.0 percent for Commercial Fire and Allied Lines. For each filing, the proposed effective date was December 31, 2005.

By notice issued September 13, 2005, a public hearing on these rate filings was scheduled for October 11, 2005, with a prehearing conference to be held immediately thereafter. The notice stated that the hearing would be conducted pursuant to the adjudicatory procedures set out in G.L. c. 30A. The Commissioner designated Jean F. Farrington, Esq. and Stephen M. Sumner, Esq. as presiding officers. Cameron Kerry, Esq., William Cowan, Esq., and Kenneth Sullivan, Esq., all of Mintz Levin, Cohn, Ferris, Glovsky and Popeo, P.C., and Robert C. Tommasino, Esq. of Tommasino & Tommasino, represented the MPIUA in this proceeding. The Attorney General ("AG"), a statutory intervenor in these proceedings, was represented by Thomas M. O'Brien, Esq. and Monica

Brookman, Esq. Thomas McCall, Esq. and Matthew Mancini, Esq. represented the State Rating Bureau ("SRB").

On September 20, the MPIUA submitted pre-filed written testimony from nine witnesses. Six individuals spoke at the October 11 public comment hearing. At the prehearing conference held thereafter, a preliminary cross-examination schedule was set.

On November 10, the first day of cross-examination, the MPIUA filed a motion for approval of a provisional premium endorsement to its policy forms that would allow it to renew policies at the current rates and then to recalculate those rates after the Commissioner approved new rates in this proceeding. It also filed a motion to strike a report prepared by Risk Management Services ("RMS") from its rate filings submitted on September 9 and to substitute a redacted version. A telephone conference among all the parties was held on November 14 to hear argument on the motions.[1] The AG and the SRB asked for and were granted time to file written responses to the motions; their responses were received on November 28. On November 30, we orally denied both motions, stating that written decisions would be issued later.[2]

Cross-examination of MPIUA witnesses took place on November 10, 21, 29, and 30, and December 1, 2 and 5, 2005. The AG and the SRB submitted advisory filings on, respectively, January 5 and 6, 2006. Their witnesses were cross-examined on January 26, 27, 30 and 31, and February 1 and 2.

The MPIUA submitted a rebuttal filing on February 13, 2006, and its witnesses were cross-examined on March 2, 3, 6 and 9. The AG submitted a surrebuttal filing on March 27, and its witness was cross-examined on April 3. Following the conclusion of the testimony on April 3, the parties agreed to admit into evidence all documents that had been marked for identification, with the understanding that arguments as to the weight to be given any exhibit could be set forth in their post-hearing memoranda. Briefs were submitted on May 8. On May 9, the AG submitted two corrected pages to its brief, and on May 15 the MPIUA filed 27 corrected pages. No party objected to either submission.

II. Historical Background of the MPIUA and the FAIR Plan

Following episodes of civil unrest in the 1960's that often resulted in extensive property damage, as well as loss of life, in several large metropolitan areas across the

[1] With respect to the motion to strike, Harvey Saperstein, Esq., in-house counsel for RMS, also participated in the conference.

[2] Our reasons for denying the motions have been incorporated into this decision.

United States, on August 1, 1968, Congress enacted the Housing and Urban Development Act of 1968.[3] Title XI of this Act was titled the Urban Property Protection and Reinsurance Act of 1968 ("UPPRA").[4] Finding that the vitality of many cities in the United States was being threatened by the deterioration of their inner city areas, one of the stated purposes of the UPPRA was to encourage and assist state insurance authorities and the property insurance industry to develop and carry out statewide programs so as to make property insurance coverage against fire, crime, and other perils more readily available for properties that meet reasonable underwriting standards. The UPPRA authorized, among other things, the establishment of Fair Access to Insurance Requirements Plans ("FAIR Plans"), based on the recommendation of the President's advisory panel that fair access to property insurance was a prerequisite for revitalization of urban America.[5]

Immediately prior to enactment of the UPPRA, on July 20, 1968, the Massachusetts legislature created an Urban Area Insurance Placement Facility ("UAIPF"), the precursor to the MPIUA.[6] As described by the Supreme Judicial Court, the Massachusetts FAIR Plan operated by the MPIUA exists pursuant to State and Federal law. *Cullen Enterprises, Inc. v. Massachusetts Property Insurance Underwriting Association*, 399 Mass. 886, 887, n. 3 (1987).

The MPIUA, like its predecessor, the UAIPF, is an association that, pursuant to G.L. c. 175C, operates and manages the Massachusetts residual market with the goal of providing "basic property insurance" to eligible applicants who otherwise are unable to obtain such coverage in the voluntary market.[7] Originally, the MPIUA offered such insurance only to those whose properties were located in "urban areas."[8] Today, however,

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[3] Pub. L. 90-448, 82 Stat. 476 (1968).
[4] Pub. L. 90-448, § 1102, 82 Stat. 555 (1968).
[5] Pub. L. 90-448, § 1211, 82 Stat. 558 (1968); codified as 12 U. S. Code § 1749bbb-3.
[6] 1968 Mass. Acts and Resolves, c. 731; codified as G.L. c. 175C.
[7] The Supreme Judicial Court reviewed the history of the MPIUA and the Massachusetts FAIR Plan in *Hudson v. Massachusetts Property Insurance Underwriting Association*, 386 Mass. 450, 452-454 (1982).
[8] The original legislation was titled "An Act Relative to the Placement of Fire Insurance in Certain Urban Areas." Chapter 175C, created by the 1968 legislation, was titled "Urban Area Insurance Placement Facility." From inception, G.L. c 175C has defined "urban area" as "any city or town, or streets or sections thereof, in the commonwealth so designated by the commissioner after appropriate hearing." The original definition of "Basic property insurance" read, in pertinent part, as follows (emphasis added): "insurance against direct loss to real or tangible personal property ***at a fixed location in an urban area in the commonwealth. . ."***. 1968 Mass. Acts, c. 731, §1.

this limitation no longer exists.[9] As the MPIUA filings show, in recent years, coastal property has become a larger component of the MPIUA's book of business.

The "basic property insurance" that the MPIUA offers is defined in c. 175C, §1 as follows:

> "Basic property insurance", insurance against direct loss to property as defined and limited in the standard fire policy and extended coverage endorsement thereon, filed with and accepted by the commissioner, and insurance against direct loss to such property from the perils of vandalism and malicious mischief and dwelling coverages and homeowners coverages, including the scheduled personal property endorsement and such other coverages as the commissioner after public hearing shall determine or the Secretary of the United States Department of Housing and Urban Development shall designate by rule made in accordance with the provisions of the Urban Property Protection and Reinsurance Act of 1968 (Public Law 90-448) but shall not include insurance on automobile or manufacturing risks except such classes of manufacturing risks as may, after proper hearing, be designated by the commissioner.[10]

The coverage that the MPIUA provides to owners of residential property is commonly known as "homeowner's insurance", which is designed "to protect homeowners from risks associated with the home and activities related to the home."[11] *Worcester Mutual Insurance Company v. Marnell*, 398 Mass. 240, 245 (1986).

III. Elements of the Commissioner's Review of MPIUA Rates

Chapter 175C, §5(c) ("§5(c)") states that the Commissioner *shall approve* MPIUA rates that satisfy the requirements of the General Laws and conform to specific requirements in §5(c). Because c. 175C, §5 requires the MPIUA to make its filings in accordance with the provisions of G.L. c. 174A, the Fire, Marine and Inland Marine Rate Regulatory Law, and G. L. c. 175A, the Casualty and Surety Rate Regulatory Law, the

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[9] 1996 Mass. Acts, c. 93, § 7, repealed that part of the 1968 Act, codified as G.L. c. 175C, §2, which related to plans of organization and operation of an urban area insurance placement facility. It also struck out the existing G.L. c. 175C, § 4, and replaced it with a new provision for a joint underwriting association "which shall provide basic property insurance to eligible applicants who are otherwise unable to obtain such coverage in the voluntary market." 1996 Mass. Acts, c. 93, § 9. The 1996 legislation also provided that the MPIUA as then organized and approved by the Commissioner was to be deemed to have been organized under G.L. c. 175C, § 4. 1996 Mass. Acts, c. 93, § 17.

[10] The current definition of "basic property insurance" was enacted in 1996. 1996 Mass. Acts, c. 93, §6.

[11] 7A J. A. Appleman, *Insurance Law and Practice*, § 4501.02 (Berdal ed., 1979) describes homeowners' policies as follows:

> The personal comprehensive liability policy occasionally is sold separately but it most frequently is found as a part of a package fire or home policy, popularly known as the homeowners' policy. This type of coverage is simply a combination of the many property and liability coverages desired by the average person. It is comparatively low in cost, and is primarily a non-business and non-automobile policy.

applicable requirements of the General Laws are those set forth in those statutes. The Commissioner, therefore, may not approve rates that are excessive, inadequate or unfairly discriminatory.[12] We will summarize, first, the statutory requirements and, second, review judicial interpretations of the statutes.

A. Quantitative Measures

Section 5(c) requires MPIUA rates to comply with different quantitative measures depending on the percentage of homeowners' business that the MPIUA writes in a particular territory.[13] A "large share territory" is determined by a statutory formula related to the percentage of homeowner's premium written by the MPIUA in the past three years compared to what it wrote in a period before 1996.[14] In any given year, the number of large share territories may not exceed thirteen. All territories that are not classified as large share territories are considered small share territories.

In addition to compliance with the General Laws, §5(c) provides that, in order to approve rates for large share territories, the Commissioner must find that:

> no rate for the territory in any calendar year increases over the lowest rate for that product charged by the association during the prior calendar year in the territory by more than the overall statewide average percentage increase in rates charged from December 31 of the year preceding the prior calendar year to December 31 of that prior calendar year for homeowners insurance by the 10 insurers with the largest market shares of such insurance written in the commonwealth on a statewide basis.

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[12] See, G.L. c. 174A, §§2, 5(a)(2); G.L. c. 175A, §§2, 5(a)(4).

[13] The MPIUA filing shows that it writes insurance in 27 territories. A territory may consist of all or part of a city or town or all or part of a county. Territories are identified by numbers that are not always sequential; the lowest number is 02 and the highest is 50.

[14] G.L. c 175C, § 1 contains the following definition of "large share territory:"

> "Large share territory", any territory in which at least 7 per cent of the homeowners premium averaged over the most recent 3 calendar years was written by the association, with the specific percentage to be determined annually, such that the total homeowners premium written by the association in the preceding 3 years in large share territories as a percentage of the total homeowners premium written by the association does not exceed the percentage of the total homeowners premium written by the association in territories in which market share of the association equaled or exceeded 4 per cent in the 3 years immediately preceding 1996, pursuant to section 5; and such that in no event shall there be more than 13 large share territories designated in any given year. A territory cannot be a large share territory if the market share of the association in the territory is less than the market share of the association in another territory that is not a large share territory.

A further restriction is that a territory cannot be a "large share territory" if the market share of the MPIUA in that territory is less than the market share of the MPIUA in another territory that is not a "large share territory."

The Commissioner must approve MPIUA homeowners' insurance rates for small share territories if she finds that:

> the proposed rates for the territories comply with the requirements of the General Laws; but, the commissioner may disapprove the rate upon a finding that it exceeds a rate equal to the ninetieth percentile of the rates then in use in the territory by the 10 insurers with the largest market shares of homeowners insurance written in the commonwealth on a statewide basis.

Chapter 175C, c. 174 A and c. 175A identify many other specific factors that are to be considered in connection with homeowners' insurance filings, including catastrophe hazards and the cost of catastrophe reinsurance. See, generally, G. L. c. 174A, §5 and c. 175A, §5.

In 2004, the legislature amended §5(c) to direct the Commissioner, in reviewing MPIUA rate filings, specifically to consider predicted hurricane losses and the cost of catastrophe reinsurance.[15] The third sentence in that section now provides that, for both large share and small share territories:

> Notwithstanding clause (2), the commissioner shall consider the effects of predicted hurricane losses and the cost of catastrophe reinsurance on the rates charged by voluntary market insurers and the cost of catastrophe reinsurance and the predicted hurricane losses on the association [when / in] approving rates for homeowners insurance in all territories.[16]

The 2004 legislation more specifically links to MPIUA rate filings for both large and small share territories consideration of two components, hurricane losses and the cost of catastrophe reinsurance that, as noted above, could before then be reviewed as general rate components, and subject to the statutory caps.

B. Qualitative Criterion

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[15] 2004 Mass. Acts, c. 436, §5

[16] Clause (2) of §5(c)(2nd sentence) of Chapter 175C of the General Laws provides as follows:

> The commissioner shall approve all rates for the association for homeowners insurance in large share territories only if the commissioner finds that: (1) . . . and (2) no rate for the territory in any calendar year increases over the lowest rate for that product charged by the association during the prior calendar year in the territory by more than the overall statewide average percentage increase in rates charged from December 31 of the year preceding the prior calendar year to December 31 of that prior calendar year for homeowners insurance by the 10 insurers with the largest market shares of such insurance written in the commonwealth on a statewide basis.

In addition to the quantitative measures for MPIUA rates, the legislature has articulated a qualitative criterion that the Commissioner is to apply in reviewing its rate filings. G.L. c. 175C, § 5(b) provides that:

> in reviewing the rates for the association, the commissioner shall give consideration . . . to the intent of this chapter to make basic property insurance available at reasonable cost to eligible applicants in large share territories.[17]

C. The Generally Applicable Statutory Standards

Compliance with the standards for property insurance rates as set forth in the General Laws means that rates must not be "excessive, inadequate or unfairly discriminatory". Over the years, the Supreme Judicial Court has issued a number of opinions addressing the meaning of those standards. It has also articulated a standard that rates must fall within a range of reasonableness.

(1) Non-discriminatory

The requirement that premium charges be nondiscriminatory when applied to different classes of risks means that they must be equitably adjusted and proportioned among the classes in accordance with the respective losses that reasonably are to be anticipated. *Century Cab Inc. v. Commissioner of Insurance*, 327 Mass. 652, 664 (1951) Accordingly, we must review the MPIUA's filing to determine whether the rates it proposes are ***unfairly*** discriminatory. *Workers' Compensation Rating and Inspection Bureau of Massachusetts v. Commissioner of Insurance*, 391 Mass. 238, 248-251 (1984) (Rates are permissible even if discriminatory, so long as they are not unfairly discriminatory).

The Supreme Judicial Court has applied a *Century Cab* analysis to claims that proposed rates are "unfairly discriminatory" in several cases since 1951. In *Westland Housing Corp. v. Commissioner of Insurance*, 352 Mass. 374 (1967), the plaintiffs objected to a rule of the workers' compensation experience rating plan which combined the

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[17] The current language dates from 2004. 2004 Mass. Acts, c. 436, §3. The 1996 enactment varied in its description of the scope of the requirement:

> in reviewing the rates for the association, the commissioner shall give consideration, in addition to all other relevant factors, to the loss experience of insurers in the voluntary market, as well as the experience of the association and to the intent of this chapter to make basic property insurance available at reasonable cost to eligible applicants in territories in which the market share of the association equals or exceeds four percent during the three most recent calendar years.

1996 Mass. Acts, c. 93, § 11.

experience of several commonly controlled corporations for the purpose of adjusting their premiums, contending that the rule was unfairly discriminatory, resulted in excessive rates, and therefore was contrary to G.L. c. 152, §52.[18] The Supreme Judicial Court held that the rule was not "unfairly discriminatory" and did not lead to "excessive" rates, but, rather was "simply a way of grouping employers according to the factor of common control which, like the type of work done by an employee, is related to the rate at which losses can reasonably be expected." *Id*. at 386. Therefore, in determining whether a given premium rate is "excessive, inadequate or unfairly discriminatory," the Commissioner may consider financial and other technical facts in making an overall judgment as to the "reasonableness" of a given rate structure. *Id*. at 385.

In *American Manufacturers Mutual Insurance Company v. Commissioner of Insurance*, 374 Mass. 181 (1978), the plaintiff motor vehicle insurers claimed that a statute that required them to rewrite certain automobile insurance contracts issued in 1977 retroactive to January 1, 1977, at reduced rates, was unfairly discriminatory because special treatment was afforded to two groups of policyholders based on their geographical territories (Chelsea and Revere). The Supreme Judicial Court concluded that the new statute was not unfairly discriminatory because there was a rational basis for singling out the two particular territories. It dismissed the plaintiffs' argument that some other communities were just as seriously affected, commenting that it did not constitute a ground for judicial relief. *Id.* at 197.

(2) Rate adequacy

To be considered adequate, an insurer's premium charges must be sufficient to produce enough revenue to pay losses and allow a reasonable profit. *Century Cab Inc. v. Commissioner of Insurance*, *supra*, 663. Rates might be considered inadequate if they ignored large aggregate losses for a prior year and probably greater losses for the rate year at issue. *Medical Malpractice Joint Underwriting Association of Massachusetts v. Commissioner of Insurance*, 395 Mass. 43, 52 (1985). When an insurance statute requires the Commissioner to determine whether a proposed rate is "adequate," it means that the

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[18] In *Workers' Compensation Rating and Inspection Bureau of Massachusetts v. Commissioner of Insurance*, 391 Mass. 238, 265-266 (1984), the Supreme Judicial Court stated that the standards of G.L. c. 152, §52 (since repealed) were similar to the standards set out in G.L. c. 174A, §5(a)(2) and G.L. c. 175A, §5(a)(4), which are applicable to FAIR Plan rates.

public through the Commissioner is concerned that an insurance plan be actuarially sound so that there will be assets to meet liabilities.

(3) Range of reasonableness

Over thirty years ago, the Supreme Judicial Court stated that the standards applicable to homeowners' rate filings are similar to the standards that the Commissioner applies in approving workers' compensation rates under G.L. c. 152, §52 (since repealed).[19] *Liberty Mutual Insurance Co. v. Commissioner of Insurance,* 366 Mass. 35, 41-42 (1974). In *Liberty Mutual*, the Supreme Judicial Court noted that these statutes require the Commissioner's approval before rates take effect but do not in terms authorize the Commissioner to "fix and establish" rates. *Id*. Although the Commissioner must approve or disapprove proposed rates, she may not require that they be fixed at figures that ***she*** finds to be reasonable:

> [The Commissioner] does not have power to fix rates; "he may not require that they be at the figures he finds reasonable. Necessarily there is a range of reasonableness and the statute permits disapproval only if the Commissioner finds "the rates" to be outside that range." *Massachusetts Medical Serv. v. Commissioner of Ins., supra* at 339.

Id. at 42, citing *Massachusetts Medical Service v. Commissioner of Insurance,* 344 Mass. 335, 339 (1962) [*Massachusetts Medical Service I*].

The Supreme Judicial Court often has cited its decision in *Massachusetts Medical Service I* as authority for the application of the "range of reasonableness" standard to other rate review proceedings. *Massachusetts Association of Older Americans, Inc. v. Commissioner of Insurance,* 393 Mass. 404; 407, n. 6 (1984). In addition to workers' compensation rates; *Workers' Compensation Rating & Inspection Bureau* v. *Commissioner of Insurance,* 391 Mass. 238, 245 (1984); *Liberty Mutual Insurance Co. v. Commissioner of Insurance,* 366 Mass. 35, 42 (1974); and noncompulsory automobile insurance rates; *Travelers Indemnity Co.* v. *Commissioner of Insurance.,* 362 Mass. 301, 305 (1972); the

[19] G.L. c. 152, §52, repealed by Mass. Acts 1987, c. 691, §13, provided in relevant part that "[W]hen any . . . company insures the payment of such [workers'] compensation it shall file with the commissioner . . . its classifications of risks and premiums relating thereto . . ., which shall not take effect until approved by said commissioner as not excessive, inadequate or unfairly discriminatory for the risks to which they respectively apply."

Furthermore, the Supreme Judicial Court in *Liberty Mutual, supra* at 42, held that §52 necessarily was to be read with G.L. c. 152, §52C, which in subsection (f) permits the Commissioner in approving rates under §52 to take into account the factors that §52(f) directs the workers' compensation rating bureau to consider in making rates. *Id*. at 42-43. The similarity between the factors that are relevant to developing for workers' compensation rates and those to be addressed in an MPIUA rate filing is striking.

Supreme Judicial Court also has employed a "range of reasonableness" standard in connection with the Commissioner's review of proposed rates for Medicare supplement insurance policies; *Bankers Life and Casualty Co. v. Commissioner of Insurance*, 427 Mass. 136 (1998); *Blue Cross & Blue Shield of Massachusetts v. Commissioner of Insurance,* 420 Mass. 707 (1995). The Court has stated that, because the Commissioner does not fix rates as is done under G.L. c. 175, §113B, the Commissioner may not disapprove an element of a filing simply because he or she would use a different one where both fall within a range of reasonableness. *Workers' Compensation Rating and Inspection Bureau v. Commissioner of Insurance*, *supra*, at 245, n.5, 265-266.

The applicability of a "range of reasonableness" standard to MPIUA rates is underscored by the specific provision in G.L. c. 175C that requires the Commissioner to determine that rates proposed by the MPIUA are harmonious with the intent of G.L c. 175C to make basic property insurance available at reasonable cost to eligible applicants in large share territories. However, we do not interpret this provision to require that the MPIUA offer insurance at rates lower than the going market rates. See *Massachusetts Medical Service v. Commissioner of Insurance,* 344 Mass. 335, 338 (1962) [*Massachusetts Medical Service I*] ("Low cost", expressed in the preamble to G.L. c. 176B, §4, governing the Commissioner's disapproval of a fee schedule for payment by a medical service corporation to participating physicians, does not require the fees to be fixed below prevailing rates.)

D. Burden of producing evidence

Implicit in a statutory requirement that proposed rates not be excessive, inadequate or unfairly discriminatory is the "fundamental requirement" that adequate evidence be made available to enable the Commissioner to establish a range of reasonableness. *Travelers Indemnity Co.* v. *Commissioner of Insurance,* 362 Mass. 301, 307 (1972); *Massachusetts Medical Service v. Commissioner of Insurance,* 346 Mass. 346, 348 (1963) [*Massachusetts Medical Service II*]. The burden of furnishing evidence to enable the Commissioner to find that its rates fall within a range of reasonableness in this proceeding is on the MPIUA. See, *e.g.*, *Bankers Life and Casualty Co. v. Commissioner of Insurance,* 427 Mass. 136 (1998); *Blue Cross & Blue Shield of Massachusetts v. Commissioner of Insurance,* 420 Mass. 707 (1995); *Massachusetts Association of Older Americans, Inc. v. Commissioner of Insurance*, 393 Mass. 404; 407, n. 6 (1984); *Workers' Compensation*

Rating & Inspection Bureau v. *Commissioner of Ins.*, 391 Mass. 238, 245 (1984) (burden of proof on insurers to show that workmen's compensation rates fall within range of reasonableness); *Liberty Mutual Insurance Co. v. Commissioner of Insurance*, 366 Mass. 35, 42 (1974) (burden of proof on insurers to show that workers' compensation rates fall within range of reasonableness.)

IV. Additional Issues Relating to the Commissioner's Review of the MPIUA Rate Filings

The parties raise two legal questions that relate to our review this year: 1) the Commissioner's authority to order specific revisions to the MPIUA filings; and 2) interpretation of the revised c. 175C, §5 as it relates to rate capping and consideration of hurricane losses and the cost of reinsurance. These preliminary legal questions will be addressed first.

A. The Commissioner's Authority to Approve or Disapprove Proposed Rates.

The MPIUA argues that the Commissioner's duty in this proceeding is to approve rates that are reasonable and nondiscriminatory, not to fix and establish rates for MPIUA policyholders. It asserts that SRB and AG recommendations for allegedly better methodologies or load factors are therefore of no consequence. The MPIUA argues that its proposed rates are a necessary response to market conditions, are actuarially sound, and are in line with those of voluntary market insurers writing risks in coastal territories. It contends that its proposed rates are within a range of reasonableness and must therefore be approved.

The SRB argues that the Commissioner has the "inherent" authority to reject the MPIUA filing and to adopt an alternative that she considers reasonable. The SRB proposes two alternative approaches: 1) setting rates according to a "coastal zone shore rate split;" and 2) revising the so-called "key factors." It also proposed a different methodology for calculating the non-hurricane catastrophe loss provision.[20]

[20] The MPIUA's rates include provisions for non-hurricane catastrophe losses to address relatively low frequency, high severity events that generate insurance claims. The MPIUA implemented a new methodology this year to calculate that adjustment, providing ISO with historical incurred non-hurricane catastrophe loss data beginning in 1985. ISO then excluded actual non-hurricane catastrophe losses during the most recent experience period and then calculated for each of the past twenty years the ratio of incurred non-hurricane catastrophe losses to normal losses. It averaged those values, producing a twenty-year average of 7.7 percent. The SRB's witness, agrees that such provisions are commonly developed using at least 20 years of claims experience, but recommends a different approach to calculating long-term average non-hurricane catastrophe losses, based on total insured values (TIVs). However, he testified, the data was

The AG proposes alternative methodologies to those used by the MPIUA, although he does not always recommend using the results of applying those methodologies. He argues that the Commissioner cannot approve the SRB's proposals, because the issue before her is approval or disapproval of the MPIUA's rate filings only. Because, the AG asserts, the SRB's proposals do not address a specific flaw in the MPIUA filing and do not correct an error in it, the Commissioner should not consider them.

Discussion and Analysis

Pursuant to G. L. c. 175C, §5, the Commissioner must review and approve, or disapprove, rates proposed by the MPIUA; but she does not "fix and establish" or set them, as she is required to do under laws pertaining to private passenger automobile insurance and as she was formerly required to for medical malpractice insurance. Contrast, *e.g.*, G. L. c. 175, §113B;[21] and G.L. c. 175A, §5A, repealed by c. 330, §5 of the 1994 Mass. Acts and Resolves.[22]

In 1984, the Supreme Judicial Court addressed the differences between the Commissioner's role in a proceeding to fix and establish rates and to approve proposed rates under the statutory standards applicable in this proceeding, in the context of an appeal from a *1982 Decision on Workers' Compensation Rates*. It considered the Commissioner's role in reviewing rates to determine whether they comply with the statutory standards and her authority to disapprove proposed rates. On the first issue, citing to a passage in the *1982 Decision*, the Court noted that "[t]he Commissioner serves as a rate reviewer, not as a rate maker. The Commissioner reviews the filing submitted.

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not available to develop a recommendation based on his preferred approach, and the MPIUA used an actuarially acceptable method to calculate this ratio. Although he concluded that the MPIUA's 7.7 percent provision is reasonable, we recommend that in the future, as more data become available, the MPIUA consider his approach to developing a rate provision for non-hurricane catastrophe losses.

[21] "The commissioner shall, annually on or before December 15, after due hearing and investigation, fix and establish fair and reasonable classifications of risks, including classifications of risks based on accident involvement and adequate, just, reasonable and nondiscriminatory premium charges including commission allowance to be used and charged by companies in connection with the issue or execution of motor vehicle liability policies or bonds, both as defined in section 34A of chapter 90, to become effective on April 1 of the ensuing year or any part thereof."

[22] "The commissioner shall, annually on or before December first, after due hearing and investigation, fix and establish fair and reasonable classification of risks and adequate, just, reasonable and nondiscriminatory premium charges on claims made and occurrence basis to be used to be used and charged by companies in connection with the issue or execution of medical malpractice insurance for the ensuing calendar year or any part thereof." See *Liability Investigative Fund Effort, Inc. v. Medical Malpractice Joint Underwriting Association of Massachusetts*, 409 Mass. 734, 737 (1991).

He (or she) does not accept or reject other proposals, but rather uses them as an aid in judging the filing." *Workers' Compensation Rating and Inspection Bureau v. Commissioner of Insurance*, 391 Mass. 238, 245, n. 5, 265-266 (1984).[23]

For these reasons, we conclude that the Commissioner's sole authority in this proceeding is to approve or disapprove rates after a hearing, rather than to substitute alternative methodologies and results offered by the intervenors, as she may do in proceedings to fix and establish rates. However, the Commissioner's practice has been, in other proceedings where she disapproves rate filings, to advise the filing party of the provisions that she would find reasonable and to permit the permit it to submit a revised filing. See, e.g., *Blue Cross and Blue Shield of Massachusetts Proposed 1998 Rates for Direct Pay Medicare Supplement Products*, Docket Nos. R97-41 and R97-44.[24]

B. Capping and "Consideration"of Reinsurance Costs and Catastrophe Losses

The second principal legal issue underlying the MPIUA's filing for 2006 rates is the extent to which the 2004 legislation removed the §5(c) large share territory cap. Under the quantitative formula in that statute, the 2006 MPIUA rates for large share territories would be allowed to increase no more than 5.9 percent.[25]

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[23] The SRB has suggested two changes to the MPIUA's methodologies: 1) territory definitions and 2) key factors). Because this is a proceeding to approve or disapprove the MPIUA's proposed rates, rather than a proceeding to fix-and-establish property insurance rates for the residual market, we will not discuss these suggestions other than to state that, on this record, we find merit in proposals intended to support territorial definitions, at least for purposes of evaluating hurricane risks, that may permit more accurate rating of exposures depending on their location relative to the coastline. We point out that in order to effectuate such changes, the MPIUA would need to develop appropriate definitions that will allow consistent territorial assignments of risks. Similarly, we find some merit in the SRB's proposal to change the key factors within territories with the goal of ensuring reasonable proportional relativities between premiums and the value of the insured property, although we are not clear why the SRB proposes to change key factors only for Territory 37. We urge the MPIUA to cooperate with the other parties to study these issues more closely.

The MPIUA rates currently do not differentiate between seasonal and year round properties, although Mr. Golembeski testified that some companies do surcharge for seasonal properties. He indicated that the ISO rating manual utilized by the MPIUA does not provide for such a factor. We are cognizant of the MPIUA's obligation to make basic property insurance available at reasonable costs, as well as statements about the median income of year-round Cape Cod and Island residents. Assuming, *arguendo*, that seasonal properties present a higher risk of loss than similar exposures that are characterized as year-round, a surcharge with a related off-balance factor might help mitigate across-the-board rate increases for year-round residents of Territory 37.

[24] Furthermore, in decisions approving or disapproving rates she has made suggestions with respect to future filings.

[25] Clause (2) of Section 5(c)(2nd sentence) of Chapter 175C of the General Laws provides as follows:

> The commissioner shall approve all rates for the association for homeowners insurance in large share territories only if the commissioner finds that: (1) . . . and (2) no rate for the territory in any calendar year increases over the lowest rate for that product charged by the association during the prior calendar year in the territory by more than the overall statewide average percentage increase in rates charged from December 31 of the year preceding the

The MPIUA argues that the 2004 legislation recognized a need to reexamine ratemaking for the FAIR plan to reflect the impact of hurricane risks in coastal areas of Massachusetts, and to provide relief from the statutory capping that was the basis of previous annual MPIUA rate filings. It asserts that the legislation reflects that MPIUA rates need to be adequate and reasonable to enable it and its members to absorb hurricane losses without disruption. The MPIUA argues that the legislature recognized the potential for substantial rate increases, and put no ceiling on rate changes resulting from predicted hurricane losses or costs of reinsurance. It also requires the Commissioner to take into account the losses and costs of voluntary insurers. The MPIUA asserts that the statute seeks to narrow the gap between its rates and those of the voluntary market and to include in MPIUA rates provisions for the same factors that have increased rates in the voluntary market. It argues that the statute gives the Commissioner no discretion, but states that she "shall" consider hurricane losses and the cost of reinsurance.

The SRB has taken no formal position on the issue of capping, but recommends rates for Territories 33 and 37 that exceed the statutory caps. It points out that because of the capping mechanism the MPIUA rates may be lower and more affordable than those generally prevailing in the voluntary market.

The AG points out that the MPIUA fails to apply the §5(c) rate cap to the proposed rates for three of the thirteen large share territories. He contends that the 2004 legislation did not eliminate the statutory capping provision or allow the commissioner to exceed it. Even if it were within the Commissioner's discretion to do so, the AG argues, she should not do so, because the MPIUA has failed to show that its rate request otherwise complies with the law. He also asserts that increasing rates above the cap is inconsistent with making property insurance available at reasonable cost. The AG argues that the MPIUA also proposes to exceed the cap for homeowners' policies in three small share territories, noting that the Commissioner has authority to reject those rates. He contends that approving increases above the small share territory cap would be contrary to the purpose of the MPIUA and impose a significant burden on homeowners.

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prior calendar year to December 31 of that prior calendar year for homeowners insurance by the 10 insurers with the largest market shares of such insurance written in the commonwealth on a statewide basis.

Discussion and Analysis

The parties disagree about the interplay between the language in §5(c) requiring the Commissioner, in pertinent part, to consider the effects of predicted hurricane losses and the cost of catastrophe reinsurance on the MPIUA when approving homeowners' insurance rates in all territories and the language establishing what we have previously referred to as a quantitative capping measure. The MPIUA argues that the 2004 legislation authorizes and empowers the Commissioner to approve rate increases for territories that exceed the capped rates, because it "recognized the need to reexamine FAIR Plan ratemaking to reflect the impact of hurricane risks in coastal areas of Massachusetts," which "risks have changed the property insurance market as a whole, and the MPIUA's book of business and its role as the insurer of last resort." The MPIUA argues that the 2004 legislation specifically provided relief from statutory caps that were the basis of the MPIUA's previous annual rate filings. In contrast, the AG argues that the 2004 legislation does not release the MPIUA from conforming to that quantitative capping measure.

In evaluating the parties' arguments, our starting point is a careful review of the 2004 legislative changes to §5(c). We note, first, that the legislature did not simply "amend" §5(c) by adding language to it. It made a wholesale change, striking out §5 in its entirety and inserting in its place the revised provision. Thus, a single legislative provision incorporates the current formulas limiting rate increases and the language instructing the Commissioner to "consider" both predicted hurricane losses and the cost of catastrophe reinsurance in setting MPIUA rates.

Second, the statute sets different measures for MPIUA rates, depending on whether they are applicable to small share or large share territories. For each group of territories, the measure is expressed as a numerical formula. The revisions to §5(c) did not change the capping formulae. Further, they did not change the directive requiring the Commissioner to approve the MPIUA rates if they comply with the general laws, including c. 175C.

For small share territories, the legislature has stated a legally sufficient, but discretionary, basis upon which the Commissioner "may disapprove" proposed rates. The statute does not, as the AG sometimes suggests, "cap" proposed MPIUA increases for such territories. Rather, it provides a "safe harbor" for disapproving rates that are proposed by the MPIUA, mandating that the Commissioner's disapproval will be legally sufficient if she, in her discretion, decides to disapprove a proposed MPIUA rate for no reason other than that the rate “exceeds a rate equal to the ninetieth percentile of the rates then in use in the territory by the 10 insurers with the largest market shares of homeowners insurance written in the commonwealth on a statewide basis.” Rather than impose a rate cap, the statute establishes a legal basis for a decision disapproving a proposed MPIUA rate for a small share territory.

We find that the revisions to §5(c) have no material effect on the standards applicable to the Commissioner’s approval of rates for small share territories. Because no cap is mandated for those territories, any issue related to the legislature’s intent, in the revised statute, to remove a statutory cap is not relevant to them. We find that the Commissioner’s discretionary safe harbor for disapproval of rates for small share territories remains in effect despite the revisions to §5(c). Therefore, our discussion will address the applicability of those revisions to approval of rates for large share territories.

For large share territories, §5(c) limits the Commissioner’s ability to approve MPIUA rates, requiring disapproval if they do not comply with a mandated capping formula.[26] Even if a proposed rate otherwise complies with the requirements of the General Laws, the Commissioner ***cannot*** approve it unless she also finds that “no rate for the territory in any calendar year increases over the lowest rate for that product charged by the association during the prior calendar year in the territory by more than the overall statewide average percentage increase in rates charged from December 31 of the year preceding the prior calendar year to December 31 of that prior calendar year for homeowners insurance by the 10 insurers with the largest market shares of such insurance written in the commonwealth on a statewide basis.”

With respect to proposed rates for large share territories, the statutory language initially appears opaque. The mandatory command (“shall”) modifies a discretionary act (“consider”). However, the statutory language makes sense if the legislature is delegating discretion to the Commissioner and intends to signify that consideration is mandatory,

[26] The 2004 legislation also provided that: Whenever the average market share of the association during the most recent 3 years shall reach a level which newly qualifies a territory as a large share territory, the association shall analyze the rates of companies in that territory and shall file a report with the commissioner who shall, in turn, either re-certify the current rate or approve a revised rate for the territory filed by the association which bears a relationship to the rates in the voluntary market in the territory which is consistent with the average relationship between the rates charged by the association in all territories in which it has a similar market share and the rates in the voluntary market in those territories.

although the final decision of the Commissioner, following such consideration, is subject to her discretion.

Under general rules of statutory construction, all parts of legislation are to be given effect and none are to be considered meaningless. See, *e.g*., *Bankers Life and Casualty Company v. Commissioner of Insurance*, 427 Mass. 136, 140 (1998) (A basic tenet of statutory construction is that a statute must be construed "so that effect is given to all its provisions, so that no part will be inoperative or superfluous."); *Commonwealth v. Mercy Hospital*, 364 Mass. 515 (1974) (A statute should be construed in such a way as to make it an effective piece of legislation, and in that connection every phrase should be given some effect.)

We must consider what the legislature intended to accomplish by its revision of §5(c). While the legislative direction is only that the Commissioner "shall consider," this requirement would be meaningless if we were to construe the statute as requiring the Commissioner to engage in a futile exercise. See *Hein-Warner Corp. v. Jackson Industries, Inc*., 364 Mass. 523 (1974) (Construction of a statute that would effectively nullify or make it impossible to administer is not to be favored.). We note that before enactment of the 2004 legislation, the general laws applicable to MPIUA rate filings allowed the Commissioner to consider catastrophe hazards, projected losses, and the cost of catastrophe reinsurance but, whatever the rate effect, capped rate increases in large share territories. If the legislature did not intend, in revising §5(c), to allow the Commissioner, in consideration of the cost of reinsurance and potential hurricane losses, to approve rates for large share territories in excess of the cap, the revisions would have no operation.

We note, further, that catastrophe hazards and the cost of catastrophe reinsurance are factors that the Commissioner is already authorized to consider in reviewing rates. For that reason, authorizing the Commissioner to consider the "cost of catastrophe reinsurance and the predicted hurricane losses on the association when approving rates for homeowners insurance in all territories," if a proposed rate does not exceed the statutory cap for large territories, would not reasonably be stated as being done "notwithstanding" that cap.

We find that the language in §5(c) relating to rate caps for large share territories and to consideration of the cost of catastrophe reinsurance and predicted hurricane losses can be meaningfully reconciled.[27] See generally *Massachusetts Commission Against Discrimination v. Liberty Mutual Insurance Co*., 371 Mass. 186 (1976) (Where there is contradiction in a statute, it should be interpreted so as to make it an effectual piece of legislation in harmony with common sense and sound reason.). We construe §5(c) as authorizing the Commissioner to approve, in her discretion, a proposed rate for a large share territory that exceeds the statutory cap (5.9% for purposes of this proceeding), ***but only to the extent that the amount of the increase in excess of the cap of clause (2) is based solely on "the effects of predicted hurricane losses and the cost of catastrophe reinsurance on the rates charged by voluntary market insurers and the cost of catastrophe reinsurance and the predicted hurricane losses on the association.***" Thus, if the MPIUA has proposed rate increases in excess of the statutory cap for any large share territory, the increase in excess of the cap for that territory must be based solely on two factors, predicted hurricane losses and the cost of reinsurance.

We conclude, in summary, that freedom from the statutory cap on rate increases for large share territories must be based, by the terms of the statute, solely on the effects of predicted hurricane losses and the cost of catastrophe reinsurance on the rates charged by voluntary market insurers and the cost of catastrophe reinsurance and the predicted hurricane losses on the MPIUA.

V. Review of the MPIUA's Indicated Rates

In 2005, as it has in prior years, the MPIUA submitted separate filings seeking the Commissioner's approval of rates for each of the three types of coverage it offers. This proceeding represents the first full evidentiary hearing on MPIUA rate requests, and the first since passage of the 2004 legislation revising c. 175C, §5.

The MPIUA's rate filings include rate level analyses prepared by the Insurance Services Office ("ISO") actuarial consulting services. The MPIUA offered as a witness in support of those filings Paul Ericksen, FCAS, MAAA, a member of ISO's consulting department. It also presented testimony from Katherine Barnes, FCAS, MAAA, John DeMartini, and John Golembeski, president of the MPIUA. The MPIUA also offered two witnesses from AIR Worldwide International Corporation ("AIR"), Karen Clark, its founder and president, and David Lalonde, FCAS, its senior vice-president, and two

[27] Although the MPIUA in its brief discusses legislative bills that were not passed, we do not rely on these asserted matters because they are not in the record.

witnesses from Risk Management Solutions ("RMS"), Robert Muir-Wood, Ph.D., head of its research group, and Mitchell Sattler, a vice-president in charge of its public sector strategy. The SRB offered as witnesses Mark Brannon, FCAS, MAAA, CPCU, a consulting actuary, and Caleb Huntington, a mathematician for the SRB. Witnesses for the AG were Stacey Gotham, FCAS, MAAA, and Allan I. Schwartz, FCAS, MAAA.

The exhibits to the MPIUA's rate level analyses address specific aspects of ratemaking. The parties do not dispute the MPIUA loss, expense or premium data that underlie any aspect of the rate calculations. No party objects to the methodologies used in those portions of the MPIUA filings that address premium on-level factors, premium trend factors, loss trend factors, loss development factors, and provisions for general and variable company expenses, or contests the results generated by applying those methodologies.[28]

The MPIUA's filing incorporates two sets of rates, a set of ***indicated*** rate levels and a set of ***proposed*** rate levels which, for the large-share territories for which the rates have not been capped, are lower than the indicated rates. We note that the evidence in this proceeding in large measure addresses the methodologies that the MPIUA employs to calculate its ***indicated*** rate levels, including hurricane loss loads, and reinsurance load. The SRB and the AG each challenge some aspects of the MPIUA's methodology for calculating ***indicated*** rate changes, including its provisions for expected hurricane losses, the net cost of reinsurance, loss adjustment expense ("LAE") ratio, loss and LAE ratios for non-hurricane losses, and the long-term provision for non-hurricane catastrophes. They did not specifically analyze the MPIUA's proposed rates.

A. Hurricane Loss Load

To develop its indicated rates, the MPIUA includes hurricane loss loads based on the results of applying mathematical models developed for the purpose of estimating hurricane losses to data on its book of business. It includes in each filing reports from two modeling firms: AIR (the "AIR Report") and RMS (the "RMS Report"). Although the models vary in some specific ways, the MPIUA argues, they simulate hurricanes and develop loss estimates in essentially the same manner. Both, it states, incorporate components for hurricane generation (event frequency), windfield generation and speed,

[28] See Internal Exhibits 6, 7, 8, 9 and 26, pages 1 and 2 of the Homeowners Filing, Exhibit 2. The MPIUA states that this year it has changed its methodologies for classifying general and other acquisition expenses and selecting loss development factors.

damage calculations (vulnerability) and insured losses. Both rely on historical data on hurricanes compiled by the National Hurricane Center in a data base known as HURDAT. For purposes of this filing, each model was run on the same set of data on the MPIUA's book of business. The MPIUA points out that a comparison of their results for Massachusetts shows that the AIR model produces higher losses than RMS for inland territories, while RMS produces higher losses than AIR in coastal areas. To develop its indicated rate recommendations, the MPIUA averaged the results produced by the two models.

The AG disputes the MPIUA's decision to base its proposed hurricane loss load on model results, rather than historical data. He argues that the MPIUA has not met its burden of showing that its hurricane load estimates are reasonable. The AG complains that the MPIUA has not disclosed its models fully to all parties for review and evaluation although, as the proponent of a model, it is obligated to do so. The MPIUA, he asserts, did not provide its models in response to discovery requests and has not permitted them to be placed on the public record. The AG contends that the testimony does not address how the models were built or provide data sufficient to test their performance. Noting Mr. Muir-Wood's testimony that models incorporate proprietary information, he argues that the record is insufficient to allow a reasonable analysis of them.[29]

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[29] Throughout this proceeding, the parties have raised questions relating to the confidentiality of documents and exhibits, responding to some discovery requests only under the terms of a confidentiality agreement among them. We note, as well, evidence that RMS has a practice of marking documents as "confidential" even when they are distributed in public settings.

As noted above, on November 10 the MPIUA moved to strike the RMS report as submitted with its rate filing and to substitute a redacted version, arguing that it had inadvertently included the report in its September 9 filing without consent from RMS or under a non-disclosure agreement, both of which are required under the contract that governs the MPIUA's use of the RMS report. It asserted that RMS considers the loss results it produced for the MPIUA as competitively sensitive intellectual property and a valuable trade secret. The MPIUA characterized the loss results as the "product of an enormous amount of research and development time and costs involved in developing the proprietary software, methodologies, data, assumptions and formulas used to calculate such results." It asserted that inclusion of the unredacted report in its filing could enable an RMS competitor to compare its results to those of RMS, using the latter as a benchmark for its own product. The presence of witnesses from AIR, described as RMS's largest competitor, the MPIUA argued, made concerns about the RMS proprietary information reasonable. The SRB and the AG participated in a telephone conference to address the MPIUA's motion, but neither filed a written opposition.

Our reasons for denying the MPIUA's motion are grounded in the facts that this rate proceeding, like other rate approval hearings, is a public proceeding, and that we have previously stated that, in such proceedings, any person proposing a model must be prepared to disclose it fully to all parties for review and evaluation. It is essential that a rate filing, which initiates the public hearing process, be sufficient to enable any person who might seek to challenge the proposed rates to evaluate the information and methodologies that underlie the filing. That the MPIUA inadvertently included a copy of the RMS report in its filing

The SRB objects to the MPIUA's averaging of the results of the AIR and RMS reports, arguing that the RMS model is less reliable than the AIR model and that the MPIUA should base its rate request solely on the AIR recommendations.

Discussion and Analysis

In the aftermath of Hurricane Andrew in 1991, insurers discovered that rates based on historical data can seriously underestimate hurricane losses. Since then, in both the voluntary or residual market, insurers have changed from reliance on historical data to the use of mathematical models to estimate hurricane losses.[30] The evidence demonstrates that insurers extensively use models to develop rate filings, although that use follows no single pattern.[31] The MPIUA's witness, Mr. Ericksen, testified that he knows that many companies rely only on results produced by the AIR model, some on both AIR and RMS models, and at least one on RMS only. His review of 15 rate filings made by the larger insurers writing homeowners insurance showed no consistent model use in that group.[32] Mr. Brannon, testifying for the SRB about his observations on the use of models by insurers making homeowner's filings in other states, also identified no single pattern of such use. We are persuaded that it is appropriate to use mathematical models to develop rates, but that there is no single preferred approach to doing so.

The MPIUA's approach is consistent with that of other insurers. Mr. Golembeski, president of the MPIUA, testified that it included hurricane models in its filing for the past four years. For the first three of those years, it used the AIR model exclusively, and for the fourth year, blended AIR and RMS results.[33] On this record, we find that it is not *per se* unreasonable to utilize multiple model results to develop rates. Nor do we find it

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without complying with its contractual obligations is not sufficient to overcome the public interest in having access to the report in the form that the MPIUA relied on to develop its rates.

[30] The impetus for change includes the limited number of hurricane observations, either by insurance companies or states, and the changes in exposure base between observed events and the current period.

[31] ISO, in its filings, uses AIR results only. However, AIR is an ISO subsidiary.

[32] Mr. Ericksen testified that found that five filings did not provide enough information to allow him to determine if a model had been used. Of the remaining ten, three used RMS only, one used AIR only, one combined results from both, one used Equicat and one an undisclosed model. Three others relied on a hurricane load that is incorporated into ISO loss costs rather than run a model on their own books of business; that load is .developed from the AIR model.

[33] Mr. Golembeski testified that Guy Carpenter may have run the models for the MPIUA, and that the MPIUA chose to utilize two models last year because it understood that reinsurers would require it to look at RMS as well as AIR. He further testified to a general perception that RMS is the better model for the high-risk adverse selection book of business in coastal areas close to the water, but stated that the MPIUA did not look at any comparative documents showing differences in credibility between the two modelers. Because the MPIUA's prior rate filings were resolved by stipulation, without an evidentiary hearing, there is no prior testimony relating to its decision to use models.

unreasonable to utilize an averaging methodology to develop rates, as the MPIUA has done.[34]

We find that the reasonableness of using the AIR and RMS models is manifested by their widespread acceptance by the insurance market. As Mr. Brannon testified, hurricane modelers have an economic incentive to try to predict hurricanes as accurately as possible. Sellers of reinsurance will rely on the models only if they are convinced that the models' predictions are not understated; otherwise they will not charge enough for the reinsurance. Primary insurers, the potential buyers of reinsurance, on the other hand, will use the models only if they believe that their predictions are not overstated; otherwise they will keep excessive reserves or pay too much for reinsurance. The market, therefore, exerts pressure on hurricane modelers to be as accurate as possible. Furthermore, although the record includes limited information on the models, we are not persuaded that the information is inadequate to support a conclusion that it is reasonable for the MPIUA to have relied on them.

The SRB and the AG question, in particular, the approach that RMS has taken to developing vulnerability functions for Massachusetts. We find merit in their positions that a model should consider both specific provisions in the Massachusetts building code relating to wind loading in various regions of the state, as well as building practices in areas where the exposure base includes a significant volume of new construction that must comply with local guidelines that are stricter than the state code. Further, we find it appropriate, in assessing vulnerability, to consider the characteristics of buildings that have withstood past hurricanes, even though built before the enactment of building codes. We do not find credible Mr. Muir-Wood’s testimony that few buildings from 1938 remain in Massachusetts, and that, even if they did, they would not be viewed as informative for developing vulnerability standards because the effects of deterioration would likely increase their vulnerability. Nevertheless, even if the AIR and RMS hurricane models may not be perfectly calibrated to the characteristics of Massachusetts, we are persuaded that they are evidence of the range of predicted hurricane losses.[35] Thus, we find that it is

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[34] The MPIUA uses a straight average of the outputs from the AIR and RMS models. The AG proposed to hurricane load factor based on a weighted average of the AIR model results with historical loss data. We note, as well, Mr. Brannon’s testimony that he has reviewed homeowners’ rate filings that average two or even three model results.

[35] We particularly note some issues about vulnerability.

reasonable for the MPIUA to use the AIR and RMS models as predictors of hurricane losses, and to average the two models to develop a range of predicted hurricane losses.

B. Net Cost of Reinsurance

The MPIUA incorporates into its rate filing $13 million representing the estimated cost of purchasing reinsurance to cover catastrophe losses greater than $520 million.[36] The AG and the SRB object to including any provision for the cost of catastrophe reinsurance in the rates, pointing out that the MPIUA has not actually bought any reinsurance and that inclusion in prospective rates of an expense item for such a purchase would result in excessive rates. Therefore, they argue, the Commissioner should disapprove the MPIUA filing.

In support of its proposal, the MPIUA argues that there is no dispute about its estimated cost for reinsurance, and that the only basis for rejecting its factor for that cost is that it did not actually incur this expense. It contends that the MPIUA did not purchase reinsurance because there was no premium in the current rates to cover the cost, arguing that the statutory language and sound actuarial principles establish that failure to purchase is not a basis for denying a reinsurance load in the rates. Further, the MPIUA argues, its management intends to purchase reinsurance and that including a reinsurance factor in the premiums it charges will allow it to do without incurring losses or assessing MPIUA members.

The MPIUA asserts that, in accordance with the 2004 legislation, the Commissioner should allow the reinsurance load in the MPIUA proposed rates. It argues that inclusion of a factor for the cost of reinsurance, even if the MPIUA did not incur the expense, is consistent with the actuarial principle that ratemaking is prospective. Because insurance is the transfer of future costs and risks, the MPIUA asserts, both public policy and actuarial principles support inclusion of a reinsurance load representing a prospective cost.

The MPIUA argues that the breadth and language of the 2004 legislation indicate that the MPIUA need not have purchased reinsurance in order to include a load for it in its prospective rates, because it directs the commissioner to consider the cost, not the

[36] In developing its indicated rates, the MPIUA allocated the $13 million statewide by line of business, by territory, and by policy form, based on its estimate of the distribution of recoverable hurricane losses by line, territory and policy form. $12,085,72, (93 percent of the total) is assigned to Homeowners, $891,661 to Dwelling, and $22,615 to Commercial Property. Approximately two-thirds of the amount allocated to the homeowners line is then allocated to Territory 37.

expense, of such coverage. The customary meaning of "cost," it asserts, includes the price of a planned future purchase. The MPIUA argues that the legislature, if it intended the reinsurance load to include only actual incurred expense, would have so stated. Further, it asserts, the statute requires the Commissioner to consider the cost of reinsurance in the voluntary market and therefore does not necessarily require that the MPIUA itself incur such an expense.

The reinsurance load, the MPIUA argues, is an alternative to incorporating into its rate request a risk charge equal to the net cost of reinsurance. Its actuarial witness, Mr. Ericksen, testified that the MPIUA did not classify the net cost of reinsurance as an underwriting expense or in the profits and contingencies portion of the rates. He further stated that the voluntary market, which backs the MPIUA, has a risk of future assessments if the MPIUA has to assess members when the next major hurricane strikes New England. Therefore, inclusion of the net cost of reinsurance in the rates can be viewed as a risk charge that would indirectly compensate the voluntary market for assuming risk. The MPIUA contends that the legislature recognized that the risk of loss that would be covered by reinsurance has an economic impact on MPIUA members, regardless of whether the MPIUA purchases catastrophe reinsurance.

The SRB points out that §5(c) does not require the Commissioner to approve a rate that includes reinsurance, but only to consider the cost of obtaining such coverage. It notes that the statutory requirement that she consider the cost of catastrophe reinsurance on the rates charged in the voluntary market is fulfilled because that cost is included in the rates of the top ten insurers whose rates are used to calculate the caps applied to the rates for large share territories, and the relationship between voluntary and residual market rates in small share territories. Its witness testified that it is not actuarially correct to include in rates an incurred fixed expense that the MPIUA did not incur, because there is no actual risk transfer. In response to the MPIUA's position that the net cost of reinsurance included in the MPIUA rate filing is considered to be reflective of the risk load that the MPIUA and its members carry, Mr. Brannon testified that risk load is traditionally considered part of an underwriting profits provision in rates. The SRB notes that the MPIUA did not include any underwriting profit provision in its filing this year, although it has in the past.

Similarly, the AG argues that because the MPIUA's actual expense for reinsurance is zero, no cost for that item should be passed on to consumers. He notes that the $13 million that the MPIUA seeks contributes 8.9 percent of its total indicated premium, and 22 percent of the indicated premium in Territory 37. Further, he asserts, inclusion of a provision for a non-existent expense is contrary to actuarial standards and wholly unreasonable. The AG notes that the MPIUA has not shown that any other insurer loads phantom reinsurance costs into its rates. Regardless of the reasons for the decision not to purchase reinsurance, he argues, the MPIUA cannot charge for an expense it did not incur. The AG also asserts that no weight should be given to the testimony on the estimated cost of reinsurance, citing to the testimony of actuarial experts for the SRB and the MPIUA that neither recalls reviewing a rate filing where an insurer filed a net cost of reinsurance based solely on quotes for coverage.

Discussion and Analysis

The MPIUA has considered, and rejected, the purchase of reinsurance, stating that it is reluctant to incur such an expense unless it could be certain that the expense would be covered in its rates. Its decision was made even when it was apparent that the MPIUA's book of business had produced an operating profit in fiscal year ("FY") 2004 and anticipated a profit for FY 2005.[37] The record does not indicate that at any time following its filing the MPIUA reconsidered its decision, or took affirmative steps to commit itself to the purchase of reinsurance if its approved rates included an allowance for such expense.[38]

We agree with both the SRB and the AG that we should not include in rates a prospective expense absent evidence that the insurer has, or will in fact incur that expense during the period in which the requested rates will be in effect. The MPIUA's assertion that an expense may include a planned future cost does not resolve the issue in this case: that the record does not include a vote from the MPIUA Board of Directors approving the purchase of reinsurance for a date certain and for a stated sum.[39] We note Mr. Ericksen's

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[37] However, overall the MPIUA has accumulated a deficit, for which it has not assessed its members.

[38] We note Mr. Welch's testimony that, in his opinion, it would be wise for the MPIUA to purchase reinsurance, if the cost could be covered through premiums, because it cannot control the decisions that individual companies make about reinsurance. Similarly, John DeMartini, a catastrophe risk practice manager for Towers Perrin and a reinsurance intermediary, opined that it would be prudent for the MPIUA to purchase reinsurance.

[39] Definitions of cost do not unequivocally support the MPIUA's position. *Black's Law Dictionary* 345 (6th ed., 1990) defines "cost" as follows: "Expense, price. The sum or equivalent expended, paid or changed for

testimony that he has not loaded a net cost of reinsurance that has not been purchased into rates for voluntary or other residual market carriers and that, to his knowledge, ISO did it for the first time in this filing for the MPIUA.

For the reasons stated above, we are persuaded that it is unreasonable to include in a rate a component for reinsurance that has not actually been purchased. We therefore will not approve a filing that incorporates such a component. However, on this record, we find that the value of $13 million for the net cost of reinsurance falls within a range of reasonableness, and would approve its inclusion in the rates if it were purchased.

C. Loss Adjustment Expense (LAE)

Loss adjustment expenses are variable expenses associated with claims adjustment; for ratemaking purposes insurers typically calculate historical ratios between paid LAE and paid losses as a basis for projecting the LAE ratio for future rate periods. As part of its rate filing, the MPIUA estimates its LAE for 2006, expressed in the form of a ratio of LAE to losses. Its requested 13.8 percent LAE averages the LAE ratios from fiscal years 2002, 2003 and 2004.[40] The SRB supports the MPIUA's methodology, characterizing it as a standard actuarial approach, and considers the result to be reasonable.

The AG recommends a lower value of 12.3 percent. He argues that the MPIUA's projected LAE ratio is inflated and ignores the MPIUA's historical loss data and growth projections. The AG performed a regression analysis on historical loss ratios; his trending methodology produced lower predicted LAE ratios than averaging. Ultimately, the AG recommends an LAE ratio of no more than 12.3 percent, which matches the latest (2004) data point.

The parties agree that the MPIUA has used a standard actuarial procedure to calculate its non-hurricane LAE factor. The parties do not disagree that LAE ratios decrease in years when the MPIUA has incurred catastrophe, as well as normal losses, or that LAE ratios differ because of random variances in losses from year to year. We find

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something," implying that it is an item that must have been incurred. *Webster's New World Dictionary of American English* 314 (3rd college ed., 1989) defines "cost" as follows: "1a) to be obtained or obtainable for (a certain price); be priced at b) to cause or require the expenditure, loss, or experience of [victory *cost* him his health]."

[40] Loss adjustment expenses include expenses generated to service claims for "normal" (i.e., non-catastrophe) losses and claims for events, other than hurricanes, that are categorized as catastrophes (non-hurricane catastrophes.)

the MPIUA's methodology is reasonable and that it produces an LAE ratio that is within a range of reasonableness.

D. Non-Modeled Losses

In calculating its hurricane loss load, the MPIUA adds 17 percent to the loss estimates produced by the models to account for losses that are, it argues, not reflected in the modeling process.[41] The SRB rejects that value, characterizing it as excessive and unreasonable. Non-modeled losses, it argues, should be estimated using reasonable actuarial methodologies that do not double count loss provisions already in the rates. The AG argues that the MPIUA has not demonstrated that it is appropriate to include a value for non-modeled losses in its proposed rates. He asserts that the MPIUA's recommendation on non-modeled losses is based on the testimony of an unqualified witness whose testimony should be given little weight.

(1) Demand Surge

The MPIUA argues that its ten percent adjustment to modeled losses to account for demand surge is within a range of reasonableness, and is neither unfair nor excessive. It relies particularly on the testimony of Mr. DeMartini and on testimony that the AIR model, if run with a demand surge function turned on, would have produced a demand surge between 5 and 15 percent.

The AG argues that there is no general agreement that demand surge exists and, if so, that the circumstances that might generate demand surge are not well understood. He notes that even if a demand surge was observed following Hurricane Andrew, it has not been documented in smaller storms, commenting that demand surge for weak hurricanes will be implicitly reflected in industry experience, and have no separate rate effect. The AG concludes that the MPIUA has not demonstrated that demand surge has ever occurred historically in Massachusetts or that it has affected insurers' loss payments.

The SRB recommends a factor of no more than five percent for non-modeled demand surge; its witness believes that a one to two percent factor would be at the lower end of the range of reasonableness.[42] It agrees that severe shortages of labor and materials after a major catastrophic event can impact claim costs, but argues that the MPIUA's

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[41] Its recommended value was developed by Mr. DeMartini and includes ten percent for demand surge, two percent for debris removal, and five percent for "all other factors."

[42] The SRB views the five percent maximum as an average, noting that some storms might not produce any demand surge.

request is excessive. The SRB points out that the RMS model, when run on MPIUA data with the demand surge function on, produced a factor of 3.2 percent, much lower than the MPIUA's request. Further, it notes, the MPIUA's estimate is based on testimony relating to claim costs in Florida during 2004 and 2005, when that state experienced seven hurricanes in fifteen months. The SRB argues that the MPIUA has not shown that a demand surge value based on Florida experience is reasonable for Massachusetts, and concludes that a lower value would be appropriate for the Commonwealth.

(2) Debris Removal

The SRB and the AG object to including a load for debris removal in non-modeled hurricane losses. Both argue that because debris removal is a covered loss under homeowners' policies, the models already reflect such losses, and adding another provision would double-count this expense.[43] Further, the AG argues, undocumented observations on the experience of insurers in have not been shown to apply to Massachusetts loss estimates.

(3) Other Expenses

The MPIUA seeks to include as non-modeled losses additional loss adjustment expense, damage to structures such as decks and sheds, damage to property from trees, power outage claims, food spoilage claims, coverage erosion and understated values.

The SRB agrees that it is appropriate to include a five percent load for this general category, solely to address the issue of understated property values. It argues that it is inappropriate to include a factor, noting Mr. Brannon's testimony that the ratio of LAE to losses is lower for large catastrophes than for normal losses, and evidence that the MPIUA's LAE ratio has gone down in years when it had significant catastrophe losses. With respect to damage to decks and sheds, and damage to property caused by falling trees, the SRB points to Mr. Golembeski's testimony that the MPIUA policy covers such losses, and Mr. Lalonde's statement that they are included in the AIR hurricane model.[44] The SRB comments that losses such as food spoilage are more likely to occur on commercial policies and that, if covered under a homeowners policy will be considered as additional living expenses and, therefore, will be included in the loss data used by the

[43] The SRB notes that the AIR model made no adjustment to historical loss data to remove actual debris removal expense.

[44] The SRB also comments that the MPIUA homeowners' policy covers tree damage and removal, even when there is no structural damage, in certain circumstances, such as driveway blockage.

modelers. The SRB recommends that no load be included for coverage erosion, arguing that there is no support in the record to suggest that the MPIUA is actually paying losses that are not covered under their policies.

The AG argues that the MPIUA has not provided evidence that any of these "other expenses" should be added to modeled losses, noting that some of these elements are already included in the models or represent expenses that should not be paid. He notes that the AIR model includes losses involving tree damage to structures. Like the SRB, the AG points out that claims for losses because of power outage and for food spoilage are generally paid under commercial, not homeowners' policies and, if paid under the latter, are generally classified as "additional living expense," a category that is already included in the models. The AG argues that coverage erosion is not a factor in MPIUA losses, noting that there is no evidence that the MPIUA has ever paid for non-insured events, such as flooding, or expects to do so in the future.

With respect to underinsured values, the AG argues that the MPIUA's witness did not analyze the issue, nor did the witness for the SRB. The only evidence in the record, the AG contends, is the statement that it is possible that some properties may be undervalued because the MPIUA has found it challenging to pursue its home inspection program. However, the MPIUA has also stated that it is reasonably confident that new business and high value properties are accurately valued.

Discussion and Analysis

To ensure that rates are not excessive, a filer must demonstrate that its provisions for non-modeled losses are reasonable. We are not persuaded that it is reasonable for the MPIUA's hurricane load to include a 17 percent charge for non-modeled losses. Reviewing the testimony as a whole, we note that there is little agreement among the parties on the extent of demand surge and the circumstances under which it becomes relevant for insurance claims. Estimates that rely on data from Hurricane Andrew and earthquakes, and on multiple Florida hurricanes during the past two years are not a reliable basis on which to estimate demand surge in Massachusetts.[45] Mr. Ericksen testified that demand surge is not a fixed number, but could span a wide range depending

[45] Mr. DeMartini's estimate is based entirely on his review of Florida claims data for 2004.

on the size of the event.[46] He had no specific information on demand surge in connection with category one storms, and based his statement that ten percent is reasonable on a comparison to numbers ranging from 20 to 30 percent in Louisiana and Florida. However, the numbers from Louisiana are too recent to be reliable, and the Florida data results from several sequential events. Mr. Brannon testified that the possibility of multiple events is lower in Massachusetts than in Florida. In addition, we note Mr. Lalonde's testimony that coverage limitations affect the potential for demand surge, because demand surge will not affect losses that are capped at a particular limit.

Mr. Brannon noted that demand surge is an immature area of research and that in states where he has reviewed rate filings he has found a provision of zero to five percent reasonable. He noted that he was not aware of any studies of demand surge in the Northeast, and that his five percent estimate is based in part on the geography of the exposed area in Massachusetts and in part on uncertainty, because no one knows what would happen in Massachusetts. Mr. Brannon further noted that one to two percent for demand surge would be at the lower end of the reasonable range.

Although the MPIUA categorizes demand surge as a non-modeled loss, both AIR and RMS provide clients with an option to run their models with a demand surge function. However, both Mr. Muir-Wood and Mr. Lalonde testified that validation of demand surge for modeling purposes is difficult because very few data points are available. The result of running the RMS model with the demand surge function on produced a 3.2 percent demand surge, a value considerably below the estimate offered by Mr. Muir-Wood. In future filings, the MPIUA must limit any provision for a demand surge factor to a reasonable value. On this record, we conclude that a reasonable range for demand surge is between one and five percent.

With respect to debris removal, adding to non-modeled losses a factor for losses that are already covered under MPIUA policies and are reflected in its historical loss experience is unreasonable and could produce excessive rates. The model results are based on losses that the MPIUA has paid; adding a second factor to non-modeled losses would double-count those payments. Any special provisions in future rate filing to reflect the costs of debris removal must be carefully supported.

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[46] Mr. DeMartini agreed that the percentage impact of demand surge is not the same for 10-year and 100-year storms, and that it would be more significant at the 100-year loss level.

We are not persuaded that all of the MPIUA's provisions for other expenses in non-modeled losses are reasonable. The SRB supports inclusion of a non-modeled loss factor of no more than five percent for undervaluation, and we find it reasonable to include such a factor for 2006. However, we are persuaded that proposed non-modeled losses should not provide for additional LAE or for losses, such as tree removal, that are covered under the MPIUA policy and therefore are already included in the modeled losses. On the issue of coverage erosion, we note Mr. Golembeski's testimony that, in his opinion, the MPIUA has not paid claims for losses that are not covered under the policy for business reasons or political or regulatory reasons. He recalled no cases where flood damage was treated as wind damage, but pointed out that, when a property suffers both wind and water damage, it may be difficult to determine what damage is caused by flood and what by wind. He noted that the MPIUA resists paying uncovered losses, but that he would not be surprised if there were cases where it had paid for some flood damage. Based on Mr. Golembeski's testimony, we are not persuaded that the MPIUA has justified including coverage erosion as a component of non-modeled losses. To the extent that the MPIUA has paid claims in the past that included some flood damages, those losses will be included in its historical data provided to the modelers and be reflected in their estimates.

Further, insurers are not expected to pay losses that are not covered under the terms of the policy and are ultimately responsible for claim payment decisions. Public policy considerations do not support inclusion of a factor in rates to compensate insurers should they effectively choose to ignore the terms of a policy and pay claims for uncovered losses.

We do not find it unreasonable to include non-modeled as well as modeled hurricane losses to develop a hurricane loss load rate component. However, on this record, the MPIUA has not demonstrated that its 17 percent factor for non-modeled hurricane losses is reasonable. For that reason, we disapprove inclusion of that proposed factor in its rate calculations. We would find reasonable provisions for non-modeled losses that do not exceed the range of values previously discussed.

E. Loss Ratios for Non-hurricane Losses (including Losses and LAE)

The MPIUA calculates its loss and LAE ratio, *i.e.*, that portion of the premium that represents non-hurricane losses and LAE, at 0.726 percent, applying a weighted averaging methodology to five years of historical data. The MPIUA first calculated the non-hurricane loss ratio on a statewide basis, an approach that Mr. Ericksen described as a common actuarial practice, but concluded that it did not adequately reflect loss ratios by territory.[47] It therefore took another actuarially acceptable approach, based on territory groupings, a methodology first utilized in its last year's filing.

The purpose of this aspect of its analysis, the MPIUA explains, is to allocate costs by territory, but implementation is complicated because individual territories do not always have enough experience to be fully credible or reliable. For that reason, the MPIUA combined territories that are geographically similar into four groups. Loss ratios are then calculated for each territory group; a credibility weighting process is applied for territories that do not have enough experience to be fully credible. The MPIUA calculates the ratio for each of four territorial groups for the five years from 2000 through 2004 and averages those values, giving 10 percent weight to 2000, 15 percent to 2001, 20 percent to 2002, 25 percent to 2003 and 30 percent to 2004. It argues that its recommendation is reasonable, actuarially sound and accounts for its changing mix of business. It criticizes the AG's proposed territorial mix factor on the ground that it does not give the greatest weight to the MPIUA's recent history. The MPIUA notes that Ms. Gotham agrees that weighting is a "pretty standard procedure."

The AG, however, argues that the standard procedure is appropriate in a relatively static market, but that an alternative approach is preferable when there are significant changes to a book of business. He asserts that the MPIUA's methodology produces inaccurate and excessive results because of the geographical shift in the MPIUA's book of business. He points out that, as a result of its expanding market share in coastal areas, particularly Cape Cod and the Islands, the MPIUA now has more exposures with loss experience that is relatively good compared to its historic experience. The AG comments that newer properties have lower expected loss ratios and that the MPIUA, by not adjusting to reflect that difference, overestimates its loss ratio. To address that issue, his actuary developed a territorial mix factor to be applied to the most recent three years of experience losses, rather than the more standard five-year period. She also performed exponential regressions on statewide weighted average projected loss and LAE ratios, and also separate regressions on Territory Group 3 loss experience and statewide minus

[47] This weighting methodology was not applied to non-hurricane catastrophe losses, which were loaded on a statewide basis.

Territory Group 3. She then calculated loss and LAE ratios for individual territories within Territory Group 3, resulting in a .623 five-year average for those territories. For the remainder of business written by the MPIUA, Ms. Gotham combined its methodology with the AG's selected LAE of 12.3 percent, thus reaching a recommended 0.68 percent.

The parties do not dispute that the MPIUA has used an actuarially acceptable approach to developing its non-hurricane loss and LAE ratio. The AG's proposed application of a territorial mix factor was derived from methodologies used in other rate approval proceedings, notably for workers' compensation insurance. However, Ms. Gotham testified, in this case the calculation is complicated because the rates from which the loss ratios were developed included hurricane provisions and were in some instances capped. She also, in her calculations, employed a loss ratio lower than that selected by the MPIUA and approved for use in an earlier section of this decision. In light of that, as well as the difficulties in determining whether consistent data underlie the regression analysis, we are not persuaded that the AG has identified a reason to support rejection of the MPIUA's approach. The MPIUA's methodology, by giving more weight to data for more recent years, effectively acknowledges changes in its book of business. Further, on this record, we are persuaded that the result produced by the MPIUA's calculation is not outside the range of reasonableness.

VI. Review of the MPIUA's Proposed Rates

The MPIUA has included in its rate filings provisions for reinsurance costs that it did not incur and for some non-modeled losses that we find to be unsupported.[48] The reinsurance costs and the hurricane loading are allocated to all territories and all policy forms, and therefore affect both the MPIUA's indicated and the proposed rates for all coverages. Both these factors have the effect of increasing rates throughout the Commonwealth. At the same time, we acknowledge that the MPIUA has both complied with the statutory rate cap for ten of the thirteen large share territories and has tempered its indicated rates in the other three. In those territories where it has exceeded the statutory rate cap, the MPIUA's proposed rates reflect the impact of predicted hurricane losses and the cost of reinsurance.[49] Based on a comparison of calculations in the SRB's advisory

[48] Although the evidence has focused on homeowners' coverage, the MPIUA used the same methodologies to develop the rates for Dwelling and Commercial form. Therefore, our stated reasons for disapproving the MPIUA's rates apply equally to all three filings.

[49] See testimony of John Golembeski, Tr. VII, pp. 892-893.

filing, which omit the cost of reinsurance and hurricane loads from its rate indications, and the MPIUA's indicated rates, we find that the provision for hurricane losses justifies the percentage increase above the statutory cap.[50]

On this record, notwithstanding that the MPIUA has demonstrated that many of the elements underlying its proposed rates are reasonable or fall within a range of reasonableness, we must disapprove the MPIUA's rate filings. Our practice has been, in other proceedings where the Commissioner disapproves rate filings, to advise the filing party of the provisions that she would find reasonable and to permit the permit it to submit a revised filing. See, e.g., *Blue Cross and Blue Shield of Massachusetts Proposed 1998 Rates for Direct Pay Medicare Supplement Products*, Docket Nos. R97-41 and R97-44. We are persuaded that it is appropriate to adopt that procedure with respect to the MPIUA's filing. We will therefore permit the MPIUA to submit revised filings that are consistent with this decision.[51] If the MPIUA can demonstrate that it has purchased premium of a dollar amount at least as great as $17.5 million, as evidenced in Exhibit 1 to the pre-filed testimony of Katharine Barnes, it may include in its rates the $13 million net cost of reinsurance as initially filed. We would also find reasonable inclusion of a factor for non-modeled losses that includes components that fall within the ranges of reasonableness as found above. We further find, however, that the MPIUA's proposed rates for uncapped large share territories, to the extent that they have been tempered to a level below its indicated rates, are rates that will be adequate and reasonable for 2006.

VII. Rate Effective Date

The MPIUA filing sought new rates for policies effective on or after December 31, 2005. As noted above, on November 10, 2005, it filed a motion to approve a provisional premium endorsement that would allow it, if new rates were not approved before December 31, to issue or renew policies using the rates approved for 2005 but to recalculate the rates applicable to those policies once new rates were approved.[52] Both the SRB and the AG opposed the MPIUA's motion.

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[50] Compare p. 98, Col. 5 of the SRB's advisory filing to the MPIUA's indicated rates.

[51] If the MPIUA does not choose to make revisions to its current filings, it may, of course submit entirely new filings for different rates, to be applied prospectively. If it does so, all the procedures and rights provided under the Administrative Procedures Act will apply to such filings.

[52] The MPIUA noted that in past years its rate filings had been resolved through stipulations executed within a time frame that allowed it to implement rate changes as of December 31 and to notify its customers of those changes 30 days prior to that date. Because the MPIUA's 2006 rate filings were the first made after the 2004 legislation changing c. 175C, and the first to incorporate extensive testimony, it appeared that the proceeding

The MPIUA argues that the Commissioner has authority to approve its endorsement under the general powers to approve MPIUA rate filings, granted under c. 175C, §5, as long as the rates are consistent with applicable law. It asserts that the endorsement violates no law or regulation but, rather, facilitates implementation of a rate change contemplated by the statute. Further, it contends, the MPIUA Plan of Operation authorizes the Commissioner to approve the MPIUA's policies and forms.

The MPIUA argues that the Commissioner is authorized to make interim rulings on matters relating to rate filings. It notes that she has previously approved provisional premium endorsements and that, when challenged on appeal, her approval was ultimately upheld by the Supreme Judicial Court. It asserts that concerns about the state of the Massachusetts homeowners' insurance market, as described by the Commissioner in her October 1, 2004 *Report On the Current State of the Homeowners' Insurance Market in the Commonwealth*, were the impetus for statutory changes signed into law in December 2004. Those changes, the MPIUA argues, removed the rate cap in c.175C, and allowed the MPIUA to seek rates in excess of that cap. Delay in implementing the proposed December 31, 2005 effective date of the new MPIUA rates would, it asserts, defeat the purpose of the statutory changes while approval of the endorsement would bridge the gap between the proposed effective date and the conclusion of this proceeding. That outcome, it argues, is consistent with the legislative changes.

Further, the MPIUA contends, approval of the endorsement would maintain the continuity and consistency of MPIUA rates with the calendar year. It argues that rates that are commensurate with calendar years are significant because some applicable statutory provisions, such as the definition of "large share territory" and the rate caps for such territories, require calculations based on calendar year data. In addition, the MPIUA asserts that having multiple rates in effect in a calendar year would complicate future rate filings and, by extending the period of time between the effective date of a rate and the data on which it is based, reduce consistency between rates and the experience supporting them.

The SRB argues that none of the statutes applicable to MPIUA rate filings, c. 174A, c. 175A. or c. 175C, requires or specifically contemplates the allowance of

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might not conclude within a time frame that would allow it to implement new rates by December 31. Therefore, it filed this endorsement.

provisional rates. In contrast, it points out, c. 175, §,113B, which addresses ratesetting for private passenger automobile insurance, specifically provides for adjusting rates if the decision fixing and establishing those rates is not issued in a timely fashion. The SRB argues that the combination of a specific legislative mandate in connection with automobile insurance and the absence of a comparable provision in the statutes governing the MPIUA rate filing demonstrate that the legislature did not intend that the Commissioner would approve requests like that made by the MPIUA. It notes, as well, that the Commissioner does not grant or apply retroactively requested rate changes for Medicare Supplement insurance approved pursuant to G. L. c. 176K, a statute that, like c. 175C, does not contain language specifically contemplating the allowance of provisional rates. The SRB asserts that the cases cited by the MPIUA in its memorandum as support for its position, are distinguishable and involve unrelated lines of insurance; in any event, it argues, they would not require her to exercise her discretion in the manner that the MPIUA requests.

Even if the Commissioner had authority to consider the MPIUA's request, the SRB argues, it should be rejected because the primary cause for the delay in this proceeding is the MPIUA's decision to submit its rate filing in September. The SRB asserts that it obtained data relevant to preparation of the filing and transmitted it to the MPIUA in early July, earlier than it has in the past, in order to allow the MPIUA to prepare its filing more expeditiously, noting that the statutory changes raised new issues and made it particularly important to allow sufficient time for the review process. Nevertheless, the SRB argues, the MPIUA did not complete its rate filing until September 20, when it submitted pre-filed testimony from its expert witnesses. Any expectation that the review process, including discovery, cross-examination of witnesses and submission of advisory filings from the SRB and AG, could be completed within the time frame sought by the MPIUA was, the SRB asserts, unrealistic.

The SRB argues that the MPIUA's assertion that its rates must be coterminous with the calendar year cannot be supported. It asserts that even assuming, *arguendo*, that the 2004 legislation was intended to allow the MPIUA's rates to better reflect the current marketplace, an effective date for new rates later than December 31, 2005 would not undermine or thwart that intent. Nothing in the revised statute, the SRB points out, requires a rate increase at any particular time, nor does the statute mention a December 31 effective date.[53] Further, the SRB argues, it is common in many lines of insurance for rates to change mid-way through a calendar year. Therefore, having multiple rates in effect during a calendar year is neither inherently unusual or prejudicial, nor does it complicate rate filings; actuaries must frequently deal with this issue. The SRB asserts that it is unusual for rate changes to take place annually on January 1, pointing out that rate filers use data as available from many different periods in addition to calendar years. It concludes that a January 1 rate year is neither mandated by statute nor administratively necessary.

The SRB takes the position that approval of a retroactive effective date for MPIUA rates would have at least three harmful results. First, it would set a precedent that would encourage the MPIUA, and perhaps other rate filers, to make filings whenever they choose to do so and to implement a desired effective date, regardless of the time between the filing and that date. The SRB observes that filings could be made using time frames that would not permit adequate review before the chosen effective date, with no repercussions for such delays. Second, consumers seeking homeowners' coverage would not be able to determine whether a quote is advantageous. The MPIUA, the SRB argues, if it wants its rates to be more consonant with the voluntary market, is obligated to provide policyholders with exact information on its rates. Enabling consumers to have complete information when making coverage decisions is, it contends, the reason why insurers should not be allowed to increase rates retroactively.[54] Concerns about the health of the homeowners' insurance market and the MPIUA's market share are also, the SRB argues, better addressed if consumers are given actual information on rate changes, rather than general warnings of possible changes. Policyholders who know about actual increases in premium are more likely to seek alternative sources of coverage.

The AG argues that the Commissioner has no authority to apply retroactively any rate increase or decrease approved in this proceeding. He points out that the MPIUA rates are subject to the Commissioner's prior approval, and cannot be altered until she approves revised rates. Because there is no specific statutory authorization to approve provisional premiums, the AG asserts, the Commissioner must deny the MPIUA's motion. The AG

[53] In contrast, it notes, c. 175, §113B sets dates certain for issuing a decision on the fixed-and-established private passenger automobile insurance rates, and for implementing those rates.

[54] The SRB points out that for that reason companies offering Medicare supplement coverage are not allowed to increase rates retroactively.

points out that the Supreme Judicial Court has noted, on several occasions, that ratemaking is prospective, and has ruled that retroactive adjustments to prior approved rates may not be awarded absent specific statutory authorization. He asserts that the two cases cited by the MPIUA to support its motion both involved specific statutory authorizations for provisional premiums, and are therefore distinguishable from the circumstances in this proceeding.[55] However, the statute governing the MPIUA c. 175C, contains no authorization, specific or otherwise, for approval of provisional premiums or retroactive ratemaking.

The AG points out that the MPIUA does not identify any section of c. 175C that authorizes provisional rates, but instead makes general policy-based arguments on the utility of aligning its rates with the calendar year. The MPIUA erroneously relies, the AG argues, on the statutory provision that determines caps for large-share territories based on rates charged by voluntary insurers during prior calendar years. The statutory references, he contends, define the period of time used to determine the rating cap, but have no broader meaning, and do not support the MPIUA's request to approve its endorsement. Because there is no specific statutory authority to approve provisional rates or retroactive ratemaking for the MPIUA, the AG concludes, the Commissioner should deny its motion.

Discussion and analysis

As the SRB and AG point out, ratemaking is a prospective process.[56] In Massachusetts, provisional premiums and retrospective premium adjustments have been allowed only when implemented in response to specific legislation authorization. The MPIUA has cited to no statute and no precedent in case law that supports its request for approval of an endorsement that would allow provisional rates. We find no language in the 2004 legislation that alters the procedures for reviewing MPIUA rate filings; it specifies no time frame for submission of rate filings and sets no standard period within which rates must be in effect.

In a competitive market, such as that for homeowners' insurance, we are persuaded that consumers can make decisions effectively only when accurate information is available to them about policy provisions and premiums. It is therefore important to consumers that the MPIUA, like insurers in the voluntary market, provide actual rate

[55] The AG points out that, in addition to the statutes addressed in the MPIUA cases, certain others such as G.L. c.176A, §1C and c. 176B, §7C specifically provide for provisional premiums or retroactive ratemaking.
[56] Mr. Ericksen, the MPIUA's expert, shares their position.

information to applicants for coverage. Further, we do not find persuasive the MPIUA's argument that administrative considerations necessitate December 31 effective dates for its rates. Policies are purchased and renewed throughout the calendar year; assuming that each policy is written for a one-year time period, at no time will all policies in force be written on a single rate base. We note, as well, the SRB's argument, supported by the affidavit of Kevin Beagan, the SRB Director, that many insurers file for rate changes throughout the year.[57] We are not persuaded that competent actuaries find it difficult to develop rate filings when rates change in the course of a calendar year.

VII. CONCLUSION

The MPIUA's September 9, 2005 rate filings are hereby disapproved. The MPIUA may, within thirty days, submit revised filings that are consistent with this decision.

Issued this 30th day of June, 2006

Stephen M. Sumner, Esq. Presiding Officer	Jean F. Farrington, Esq. Presiding Officer

I have reviewed this decision by the hearing officers and approve their findings and conclusions.

June 30, 2006

Julianne M. Bowler
Commissioner of Insurance

This decision may be appealed pursuant to G.L. c. 30A.

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[57] Although the MPIUA links its request for a December 31 effective date to the December 31 time period for calculating caps in large share territories, that calculation looks at rate increases in the voluntary market, which could occur at any time during the year.