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Opinion, Findings and Decision on The Premier Insurance Company's November 27, 2007 Private Passenger Motor Vehicle Rate Filing

Docket No. R2007-07

I. Procedural Background

On November 19, 2007, the Premier Insurance Company ("Premier"), submitted a filing for private passenger motor vehicle ("PPMV") insurance rates to the Commissioner of Insurance ("Commissioner") for her review pursuant to G.L. c. 175E ("c. 175E"). In accord with 211 CMR 79.19, Premier amended its filing on November 27.[1] On December 17, 2007, the Attorney General, pursuant to c. 175E, §7, moved for a hearing on Premier's rate filing, alleging that the proposed rates were excessive. On December 18, the Commissioner issued a hearing notice ("Notice") scheduling a hearing to begin on January 14, 2008.[2] The Notice informed the parties that, as identified by the Attorney General, the hearing would address whether Premier's rates are excessive, in violation of G.L. c. 175A and c. 175E, specifically because of: 1) the target return on earned premium, leverage

[1] Premier submitted corrected pages to its amended filing subsequent to the Attorney General's motion for a hearing. The Attorney General received the corrected pages on January 14, 2008. The corrections pertained to discounts that were not in issue in this proceeding.

[2] On January 10, 2008, the Commissioner announced that the Division of Insurance had completed its review of Premier's filing and did not intend to disapprove it. The filing was placed on file with an effective date of April 1, 2008. That action does not affect the Attorney General's statutory right to request a hearing.

ratios and asset returns in the profit provision; 2) the expense provision; 3) the loss provision; and 4) the symbol drift factor.[3]

The Commissioner designated us as presiding officers. The hearing began on January 14 and was completed on January 17. Christopher F. Malone, M.B.A. and Robert F. Brown, FCAS, MAAA testified for Premier. Allan I. Schwartz, FCAS, MAAA and Stacey Gotham, FCAS, MAAA were witnesses for the Attorney General.[4] Based on the testimony of the witnesses and the documents admitted into evidence, we find and conclude, as follows:

II. Standard of Review and Burden of Proof

Commissioners of Insurance have determined that conditions in Massachusetts were such that PPMV rates should be fixed-and-established industrywide for the past 30 years. On July 16, 2007, after a hearing held as in past years, the Commissioner concluded that sufficient competition existed in the PPMV insurance market such that it was not necessary for her to fix-and-establish those rates (the "*July 16 Decision"*). Subsequently, the Division of Insurance ("Division") promulgated 211 CMR 79.00 *et seq*. to govern the requirements for company rate filings for PPMV insurance rates in a competitive market. Insurers writing this line of insurance submitted individual rate filings to the Division pursuant to c. 175E and G.L. c. 175A, with effective dates of April 1, 2008.

Section 4 of c. 175E mandates that "[r]ates shall not be excessive or inadequate, as herein defined, nor shall they be unfairly discriminatory." It further provides that "[n]o rate shall be held to be excessive unless [it] is unreasonably high for the insurance provided" and that evidence "that a reasonable degree of competition exists in the area with respect to the classification to which such rate is applicable shall be considered as material, but not conclusive evidence, that such rate is not excessive." The Commissioner's task under c. 175E is to determine whether a company's proposed rates satisfy the statutory and regulatory standards.

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[3] The Attorney General's did not pursue issues of asset returns and leverage ratios.

[4] Prefiled testimony of Birny Birnbaum, a witness for the Attorney General, was stricken on Premier's motion on the ground that it addressed risk rating factors, a matter that is not at issue in this proceeding. The portion of the prefiled testimony of Stacey Gotham that relates to manual rates also was stricken for a similar reason.

The Commissioner may not disapprove proposed rates if they fall within a range of reasonableness and otherwise satisfy the requirements of the general laws. *Attorney General v. Commissioner of Insurance*, 450 Mass. 311 (2008). The Commissioner does not set the rates under c. 175E. Her authority is limited strictly to disapproving a rate or, under very limited circumstances set forth in the statute, approving it.[5] She looks at the proposed overall rates generated by the rate filing viewed as a whole to determine whether a company's proposed rates are excessive for the insurance provided. The Commissioner also looks at whether the proposed rates are generated using generally accepted actuarial approaches to ratemaking. 211 CMR 79.05(5).

G.L. c. 175E, §7 allows the Attorney General to request a hearing on a rate filing. The rate filer has the burden of proving that its filing complies with c. 175E, G.L. c. 175A, and relevant insurance regulations. 211 CMR 79.13(11). Challenges to particular aspects of the rate filing are insufficient, *per se*, to demonstrate that an overall rate does not meet statutory standards. Contrary to the Attorney General's assertion, a company's rate is not necessarily excessive if one component of it is excessive. It is possible that a component of a rate may be excessive but that the overall rate may be within a range of reasonableness after all the other components are factored together. For example, an inadequate component could temper an excessive component, resulting in a reasonable rate.

The Attorney General contends that her task in c. 175E, §7 hearings is to ensure that filings provide fair and reasonable rates. Achieving that goal requires a "fair" hearing that, she avers, includes meaningful review of rate filings, discovery of insurers' data, and investigation of "all pertinent issues." She asserts that a separate standard applies to her review, but neither explains the relationship between her stated mission and the statutory standard for reviewing c. 175E rate filings nor reconciles the concept of "reasonable" rates with the premise that rates must fall within a range of reasonableness.

The Attorney General argues that this §7 hearing was neither full nor fair. She complains that "time periods were truncated, discovery prohibited, subpoenas vacated, subjects excluded and testimony struck." Her discontent, however, arises from her misapprehension of the premise of this hearing and the burden of proof. She overlooks

[5] The Attorney General alleges only that Premier's proposed rates are excessive, and we will review them only to determine compliance with that standard.

that the regulator, the Commissioner, only can review compliance of Premier's filing with statutory standards rather than explore alternative approaches. Indeed, the Attorney General bears no burden of proof and has no role in establishing a different rate for Premier. See our O*rder on Attorney General's Motion for Discovery* dated January 7, 2008. The record of this proceeding, including arguments and orders on the motions made by the parties, speaks for itself. The rulings and orders are consistently cognizant of the overall scope of this proceeding, of the specific limits on the disputed issues as set forth in the Attorney General's initial request for a hearing, and of the time constraints engendered by the need to have new rates in place within a time frame that will maximize the benefit to consumers of managed competition and discounted rates.[6]

III. Disputed Substantive Issues[7]

A. Underwriting Profits

Mr. Malone testified that Premier employed Traveler's standard underwriting profit model and that the model is reasonable. He opined that this model produced rates that are reasonable and not excessive. He explained that the underwriting profit provisions in the filing were derived utilizing Premier's after-tax target return on earned premium. He testified that the after-tax target return on earned premium was developed within the Travelers organization but that the actual target return on surplus in Premier's filing is lower (10%) than Traveler's target return on surplus (15%) for its personal lines business, and is reasonable. This lower target return on surplus reflects the additional surplus of Premier that allows it to achieve improved financial stability in the market place for its customers.

Mr. Malone testified that Premier's return on equity is within the range that is generally accepted for insurance companies, according to Investopedia, a Forbes Media

[6] The time sensitivity of this proceeding is extraordinary. It occurs within the context of the change from a fix-and-establish system to a managed competition system in approximately eight months. The schedule was set in accord with the provisions of 211 CMR 79.11 and 79.12, which impose express timelines for proceedings on c. 175E rate filings. The rates filed on November 19 and amended on November 27, are to take effect on April 1, 2008, when the current fix-and-establish rates applicable to all insurers, including Premier, expire by operation of law. Companies require timely decisions in order to reprogram computer systems and generate the renewal notices that companies must send to policyholders 45 days before a policy expires under the law (*i.e.*, February 15 for April 1 renewals). These regulatory procedures were tailored to ensure timely completion of this proceeding.

[7] During the hearing, the Attorney General conceded that loss trending and symbol drift were no longer at issue.

Company. He stated that it is consistent with AM Best Private Passenger Automobile Composite, and comparable to the AIB's cost of equity in its Advisory Filing.

The Attorney General alleges that the profit provisions in Premier's rate filing are "unsupported and excessive" and "substantially" higher than the profit permitted in prior rate decisions and than any profit provision charged by an automobile insurance company in Massachusetts for at least the last 30 years. Specifically, she asserts that Premier's profit provision is excessive because the target return is arbitrarily selected as it did not document the source for its proposed 7.5 percent after-tax target return on earned premium.

Discussion and Conclusion

The Attorney General's comparison of the profit provisions in Premier's filing to those approved under the fix-and-establish system is irrelevant. Her invocation of the 2007 fix-and-establish rate decision and the industrywide profit provision selected by the Commissioner in the decision is misplaced. She fails to recognize that this proceeding, conducted on a filing made pursuant to c. 175E and 211 CMR 79.00 *et seq*. differs fundamentally from a proceeding to fix-and-establish industrywide insurance rates under G.L. c. 175, §113B. We are considering a particular company's rate filing that is based primarily on its estimate of its own requirements and supported by its selected methodologies. It is not our task to look at aggregate industrywide data to develop an underwriting profit provision that reflects the average financial needs of a mythical "Every Company," but is specific to none.

A company must develop a profit provision that reasonably reflects its financial needs and that, when included in its proposed rates, produces an overall rate that complies with the statutory standards and produces competitive rates. In a competitive market, companies are free to incorporate their own target profit provisions into their proposed rates; price competition is expected to exert pressure on rates to provide some control on profit levels. Differences between profit provisions developed for an entire industry in a fixed-and-established system and those developed for individual companies in a competitive market are to be expected.

That Premier's underwriting profit provision would be lower if it were based on industrywide input values from a prior rate decision does not demonstrate that it is excessive. The prior rate decision, and its use of such input values, is irrelevant to this

proceeding, particularly because it was developed for 2007, using data appropriate for that year, not for 2008. The issue in this decision is whether Premier's profit provision is developed using generally accepted actuarial techniques and whether it falls within a range of reasonableness. We find that it satisfies both standards.

B. Finance Charge Income

Mr. Malone acknowledged that Premier excluded the finance charges, other revenue and earned but uncollected premium ("EBUP") from the profit provision. He explained that these items are financing-related charges. He stated that historically Travelers has not included the fees in its property filings and this approach is consistent with Traveler's standard countrywide approach for both automobile and property insurance.

The Attorney General asserts that Premier's rates are excessive because it ignored income that it will receive from finance charges or other miscellaneous sources. The Attorney General argues that past decisions on private passenger automobile insurance rates acknowledge that insurers receive income from miscellaneous sources, such as finance charges, and concludes that such income should be reflected in the underwriting profits provision. She contends that omitting such income from the rate filing is inconsistent with Actuarial Standard of Practice ("ASOP") No. 9 and Casualty Actuarial Society Ratemaking Principles.

The Attorney General argues that by excluding finance income from its profits provision, Premier failed to comply with past decisions of the Commissioner of Insurance and violates ASOP No. 9, which requires "other income" to be considered. The pertinent portion of G.L. c. 175E, §4 instructs the Commissioner to consider, "to the extent applicable . . . a reasonable rate of return on capital after provision for investment income . . . and all other factors, including judgment factors, deemed relevant within and outside the Commonwealth." 211 CMR 79.06(4)(n) instructs insurers to include in rate filings information on "underwriting profit, including due consideration of investment income." Neither identifies finance charge income as a factor that must be included or otherwise addressed in connection with rate filings. That Premier's rate might be different if it had chosen to include investment income on surplus and finance charge income in its underwriting profit provision is not a sufficient reason to conclude that its proposed rates

are excessive for the insurance provided. It is not obliged to select methodologies that are identical to those used to fix-and-establish rates or to conform to those chosen by other companies or the Attorney General.[8]

The Attorney General's allegations that Premier's chosen methodologies do not comply with ASOP No. 9 is a path leading to nowhere. The Attorney General attempts to substitute for the statutory standard of review of competitive rate filings, regulatory requirements for such filings, her own rigid interpretation of the application that ASOPs provide for actuaries. Even if the evidence were sufficient to demonstrate non-compliance with an ASOP, the Attorney General has not linked non-compliance to a determination that Premier's overall rates are excessive.

On this record, we find that Premier has met its burden of proof relating to the underwriting profits provisions in its proposed rates.

C. Commission Expenses

Premier observes that the Attorney General's December 17, 2007 letter only objects to "contingent commissions."[9] Because Premier does not pay such commissions, it argues that this issue is moot. Notwithstanding this position, Mr. Malone testified that Premier, like other Traveler's companies, does not pay contingent commissions on personal lines of business. It bases its agent compensation program on a value that is 90 percent of the commission percentage generated by the "Commissioner's rate," and pays additional compensation for certain risk characteristics associated with a vehicle. In 2008, Premier expects to pay additional amounts for compensation comparable to those paid under that program in 2007, and may pay commission overrides in accordance with Traveler's nationwide policy.

Mr. Malone explained that the provision for commission payments in Premier's rate calculation is correct for five reasons: 1) Casualty Actuarial Society Ratemaking Principles and ASOP No. 13, issued by the Actuarial Standards Board, states that a rate is an estimate of the expected value of future costs; 2) ASOP 29 states that expense provisions in rates should reflect the conditions expected during the time the rates are

[8] In any event, the methodologies used to develop the underwriting profits provisions in fixed-and-established rates were not static, but changed over time to reflect the use of different models.

[9] The Attorney General's language in her December 17, 2007 letter was incorporated into the Notice.

expected to be in effect and should include all expenses expected to be incurred in connection with the transfer of risk, including specifically commissions and other acquisition expenses; 3) Premier expects to incur overrides during the rate effective period; 4) contingent commissions and overrides routinely are included in file-and-use filings for homeowners' insurance in Massachusetts, and are allowed routinely by regulators in other lines of insurance and other states; and 5) insurers pay contingent commissions and overrides in order to compete for business. These costs are necessary and appropriate for a competitive environment. Mr. Malone opined that including overrides in rates is reasonable and will not lead to excessive rates.

The Attorney General contends that Premier should not have included override commissions in its rates. She argues that override commissions are within the ambit of contingent commissions and that Premier fully understood the basis for the Attorney General's objection. The Attorney General characterizes such commissions as a form of profit sharing between insurance companies and agents, and asserts that it is unreasonable to include them in the rates and expect policyholders to fund the company's profit. Mr. Schwartz testified that Premier should not be allowed to include contingent commissions, or override commissions, in its rates because prior decisions fixing-and-establishing PPMV rates consistently have excluded them.

Discussion and Conclusion

The Attorney General does not challenge Premier's statement that it does not pay contingent commissions, but argues that Mr. Schwartz's reference to contingent commissions includes overrides and any other commission payments over the percentage approved in the *Decision on 2007 Rates.* We will consider override commissions in adjudicating this matter.

The Attorney General does not contend that Massachusetts law prohibits or limits the payment of contingent commissions to insurance producers or challenge the reasonability of the contingent commission provision in Premier's filing. The mere inclusion of such a provision, she argues, renders Premier's proposed rates excessive.[10]

[10] The Attorney General offered no testimony or evidence to support the assertions in her request for a hearing that contingent commissions have been criticized as "creating serious potential conflicts of interest and leading to anticompetitive effects such as the steering of business away from more cost effective carriers."

She argues that because decisions fixing-and-establishing rates did not allow them to be included, they should continue to be rejected in a competitive environment.[11]

Past fix-and-establish decisions are not relevant with respect to rate filings made pursuant to G.L. c. 175E. Testimony from Mr. Malone supports Premier's argument that including contingent commissions in the rates is consistent both with actuarial principles of ratemaking and rate filings made by competing agency companies in Massachusetts. No evidence supports the Attorney General's argument that inclusion of contingent commissions in rates is a *sub rosa* approach to increasing the profit provision in those rates. On this record, Premier has met its burden of proof with respect to its commission expense provisions.

D. Material Evidence of Competition

Section 4 of c. 175E provides that: "[e]vidence that a reasonable degree of competition exists in the area with respect to the classification to which such rate is applicable shall be considered as material, but not conclusive, evidence that such rate is not excessive." Premier cites to specific conditions within the market and certain products offered by companies to support this argument.

Mr. Brown testified regarding the adequacy of competition in the market. He reviewed the Sample Policy rates provided within the filings submitted by the companies that comprise 80 percent of the Massachusetts PPMV insurance market and found that there was sufficient variability among competitors. Mr. Brown stated that the range of discounts and product features that companies offer also is evidence that competition is adequate. He opined that the multiplicity of product offerings in addition to the variety and spread of rates is sufficient to ensure a competitive market and constitutes material evidence that Premier's rate is not excessive.

The Attorney General argues that Mr. Brown's analysis should be rejected. She contends that he is not an economist and is unfamiliar with the specific market occurrences upon which he relied to form his opinion. The Attorney General asserts that Mr. Brown did not conduct an economic analysis but did an analysis based on variations in discounts, rates, and product features that companies offer. She argues his analysis is insufficient to show that the market is competitive or that Premier's rate is not excessive.

[11] The Attorney General states that no prior decision suggested that companies may not pay contingent commissions, but did exclude them from consideration in fixing-and-establishing PPMV rates.

Discussion and Conclusion

We do not find that Mr. Brown's testimony should be discounted as suggested by the Attorney General. Mr. Brown reviewed the rate filings of the companies that make up 80 percent of our market and compared them by product and price. While he did not conduct an economic analysis in the format acceptable to the Attorney General, his findings are objective and helpful in determining that competition in our market exists with respect to certain classifications. The introduction of many new products and rating variables constitutes some indicia of competition within certain classifications. While not dispositive of the issues in this case, his testimony does present material evidence that Premier's rates are not excessive.

IV. Conclusion

The Premier Insurance Company has met its burden of proof regarding the issues that are the subject of its proceeding. Premier's rates are not disapproved.

DATED: January 31, 2008

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Elisabeth A. Ditomassi
Presiding Officer

Tesha M. Scolaro
Presiding Officer

Affirmed this 31st day of January 2008.

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Nonnie S. Burnes
Commissioner of Insurance

Any person aggrieved by this decision may, in accordance with G.L.c. 175E, §13, petition for review within 20 days in the Supreme Judicial Court for Suffolk County.