COMMONWEALTH OF MASSACHUSETTS
Office of Consumer Affairs and Business Regulation
DIVISION OF INSURANCE

1000 Washington Street, Suite 810 • Boston, MA 02118-6200
(617) 521-7794 • FAX (617) 521-7475
TTY/TDD (617) 521-7490
http://www.mass.gov/doi

DEVAL L. PATRICK
GOVERNOR

TIMOTHY P. MURRAY
LIEUTENANT GOVERNOR

GREGORY BIALECKI
SECRETARY OF HOUSING AND ECONOMIC DEVELOPMENT

BARBARA ANTHONY
UNDERSECRETARY

JOSEPH G. MURPHY
COMMISSIONER OF INSURANCE

Massachusetts Property Insurance Underwriting Association 2011 Rate Filings
R2011-02

Order on Motions to Reject or Dismiss the MPIUA Filing

I. Introduction and Procedural History

The Massachusetts Property Insurance Underwriting Association ("MPIUA" or "the FAIR Plan") submitted a rate filing (the "Filing") on November 10, 2011, seeking overall statewide average rate increases for policies insuring homeowners and condominium owners and for policies providing dwelling fire and extended coverage.[1] It proposed an effective date of December 31, 2011 for the requested rates. Pursuant to Massachusetts General Laws Chapter ("Chapter") 175C, §5, the Commissioner of Insurance ("Commissioner") must approve the MPIUA's rates prior to their implementation.

A hearing notice was issued on November 16, 2011 scheduling a public comment hearing on the Filing and a prehearing conference for December 19, 2011; a later hearing notice rescheduled those events to January 15, 2012. The Massachusetts Attorney General ("AG"), as statutory intervenor pursuant to Massachusetts General Laws Chapter 12, §11F, and the State Rating Bureau ("SRB") in the Division of Insurance ("Division") opposed the proposed rates. Michael B. Meyer, Esq. and Robert A. Tommasini, Esq. represented the MPIUA in this

[1] For all homeowner's forms, the MPIUA proposed a 7.2 percent statewide average increase. The proposed average differs depending on the type of insured property: for residential property owners, the proposed increase averages 7.4 percent and for condominium owners 4.8 percent. For tenants insurance the MPIUA recommends a 5.9 percent rate decrease. For dwelling fire and extended coverage policies the MPIUA is seeking a statewide average increase of 6.0 percent. The MPIUA sought no increase in the average rates for commercial property insurance.

proceeding. Peter Leight, Esq., Monica Brookman, Esq. and Alex Klibaner, Esq. appeared for the AG, and Thomas McCall, Esq. and Mary Lou Moran, Esq. represented the SRB.

The Filing included pre-filed written testimony from three witnesses for the MPIUA. The AG and SRB cross-examined those witnesses on three hearing days, February 27 and 28 and March 23, 2012.[2] Twenty-six hearing exhibits were entered into evidence. The Filing itself was marked as Hearing Exhibit 2. On March 23, 2012, following completion of cross-examination, the AG announced that she intended to file a motion to reject or dismiss the Filing. The SRB stated that it was also considering that option. On March 28, 2012, the SRB filed a motion to reject the Filing; the AG filed her motion to dismiss the Filing on March 30, 2012 (collectively, the "Motions"). The MPIUA submitted its opposition to the Motions ("Opposition") on April 13, 2012.

For the reasons set forth in more detail below, we allow the Motions and disapprove the MPIUA's Filing.

II. The Framework for Filing and Review of MPIUA Rates

The MPIUA, a joint underwriting association formed pursuant to Chapter 175C, operates the Massachusetts residual market for property insurance. That market provides coverage for consumers who are unable to obtain such insurance in the voluntary market. Chapter 175C, §5(b) authorizes the MPIUA to make rate filings in accordance with Chapters 174A and 175A, and provides further that its filings are subject to the Commissioner's prior approval after notice and hearing. Chapter 174A, the Fire, Marine and Inland Marine Rate Regulatory Law, and Chapter 175A, the Casualty and Surety Rate Regulatory Law, both regulate insurance rates "to the end that they shall not be excessive, inadequate, or unfairly discriminatory." *See* Chapter 174A, §§2, 5(a)(2); and Chapter 175A, §§2, 5(a)(4).

Chapters 174A and 175A each identify specific factors that are to be considered in connection with homeowners' insurance filings, including catastrophe hazards and the cost of catastrophe reinsurance. *See* Chapter 174A, §5 and Chapter 175A, §5. Chapter 175C, §5 sets additional specific rules for MPIUA filings, including quantitative measures that may set limits on potential increases in both "large share" and "small share" territories. In reviewing an

[2] The three witnesses for the MPIUA were: Paul Ericksen,, FCAS, MAAA, a consulting actuary for the Insurance Services Office, who prepared the Filing; James Wackerman, a reinsurance broker with Guy Carpenter, who testified on reinsurance issues; and Richard Derrig, Ph.D., who testified on the underwriting profits provision in the Filing.

MPIUA filing, the Commissioner is to consider, "in addition to all other relevant factors," the loss experience of insurers in the voluntary market, as well as the MPIUA's experience, and the intent of Chapter 175C to make basic property insurance available at reasonable cost to eligible applicants in large share territories. The Commissioner is also required to 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 MPIUA.[3]

In addition to these statutes, 211 CMR 101.00, *et seq*., promulgated pursuant to Chapters 174A, 175A and 175C of the General Laws, governs the form and content of MPIUA rate filings and the proceedings, including hearings, relating to the review of its filings. 211 CMR 101.04 (1) declares that the purpose of the Filing is to "furnish sufficient evidence to enable the Commissioner to establish that the rates requested comply with the statutory requirements and fall within a range of reasonableness." It further states that the Filing constitutes the MPIUA's direct case in support of its requested rates.

211 CMR 101.04(b) also specifies that the Filing must contain "*all material*, including *all data, statistics, schedules and exhibits*, which the Filing Party *wishes to be considered* in the Proceeding and all information upon which it bases its recommendations;" "narrative statements *including all information and commentary necessary to substantiate* and explain *the Filing Party's recommendations*"; and "the *direct sworn written testimony of all witnesses for the Filing Party*," further requiring, in pertinent part, that the *direct sworn written testimony shall support every element of the Rate Filing…." *See* 211 CMR 101.04(2)(b)(iv); 211 CMR 101.04(2)(b)(v); and 211 CMR 101.04(2)(b)(vi) (emphases added) The significance of sworn written testimony, and the cross-examination of those witnesses, is evident from 211 CMR 101.09(7), which permits the Presiding Officer to strike from the record testimony of a witness who is not available for cross-examination.

The Commissioner has the power to disapprove rates if an insurer does not provide supporting information which is "reasonably adequate" to enable him to determine whether proposed rates are "excessive, inadequate or unfairly discriminatory." *See Travelers Indemnity Co. v. Commissioner of Insurance*, 362 Mass. 301, 304 (1972). The *Travelers* Court noted that

[3] The specific requirement to consider these issues was added by passage of Chapter 436, §3 of the Acts and Resolves of 2004, which rewrote Chapter 175C, §5. It became effective October 1, 2005.

the provision of adequate evidence is a fundamental requirement that is implicit in the statutory requirement that rates conform to statutory standards. *See id.* at 305. The Commissioner may refuse to approve rates if the filer fails to provide information that is deemed necessary to "afford an adequate basis for his approval and to enable him to pass upon the dependability ….of the conclusions." *Massachusetts Medical Service v. Commissioner of Insurance*, 346 Mass. 346, 348 (1963).

The burden is on the MPIUA to furnish evidence that will enable the Commissioner to find that its rates satisfy statutory requirements. *See, e.g., 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); and *Liberty Mutual Insurance Co. v. Commissioner of Insurance*, 366 Mass. 35, 42 (1974) (burden of proof on insurers to show that workers' compensation rates fell within range of reasonableness.) The application of that standard to the MPIUA was explicitly stated in the *Decision and Order on the 2007 Massachusetts Property Insurance Underwriting Association Rate Filing*, Docket No. R2007-02 ("*Decision on 2007 Rates*").[4]

III. The Parties' Arguments on the Motions

A. The SRB

The SRB asks the Presiding Officers to reject the MPIUA's Filing for failure to comply with the statutes or the procedures and forms prescribed by the Code of Massachusetts Regulations, specifically 211 CMR 101.00. It points out that, pursuant to 211 CMR 101.04(1), the purpose of the Filing is to furnish sufficient evidence to enable the Commissioner to establish that the requested rates comply with statutory requirements and fall within a range of reasonableness. To that end, the regulation provides that the direct sworn testimony in the Filing shall support every element of that Filing. *See* 211 CMR 101.04 (2)(b)(vi)

The SRB notes that the MPIUA's Filing is subject to Chapters 175C, 174A, and 175A. Chapter 175C, §5(b) instructs the Commissioner, when reviewing MPIUA rates, in addition to all other relevant factors, to give consideration to the loss experience of insurers in the voluntary market, as well as the MPIUA's loss experience. Chapter 174A, §5(a)(3) lists the factors the

[4] In that decision, the Commissioner wrote that "[t]he MPIUA bears the burden of supporting in its filings each aspect of its rate requests and proving, by a preponderance of the evidence that its rates satisfy the statutory requirements." *Decision on 2007 Rates* at 3.

Commissioner should consider and provides that rates may not be "excessive, inadequate or unfairly discriminatory." The SRB argues that the MPIUA has failed to furnish sufficient evidence to establish that its proposed rates comply with the statutory requirements and fall within a range of reasonableness.

The SRB asserts that the MPIUA has failed to furnish sufficient evidence to establish that the data used to generate the MPIUA's recommended rates are accurate and proper for use in this proceeding, or that the rates generated from that data are within a range of reasonableness and are not excessive, inadequate or unfairly discriminatory. The SRB argues that Paul Ericksen, the MPIUA's witness who calculated the proposed rates and testified for the MPIUA, relied primarily on data that the MPIUA provided to him. The SRB points out that on cross-examination Mr. Ericksen testified that he had not audited or verified the data on which he relied and took no responsibility for any data errors or omissions.

The SRB also notes that Mr. Erickson also acknowledged that any material errors existing in the data or other information would result in changes to his rate indications. For this reason, the SRB contends, the Commissioner is unable to determine if the data used to support the proposed rates are accurate and complete. It points out that the MPIUA has offered no witness to verify the accuracy, completeness and suitability of the data, and maintains that this deficiency alone prevents the Commissioner from assessing the Filing. As a result, the SRB argues, the Filing should be rejected.

Similarly, the SRB argues, evidence is lacking on the expected hurricane losses that Mr. Ericksen included in his rate calculations. His testimony, the SRB notes, states that he relied on a hurricane loss model run "provided to us by the MPIUA from AIR [AIR Worldwide Corporation (hereafter, "AIR")] and RMS [Risk Management Solutions (hereafter, "RMS")]. We have neither audited nor verified the data." The SRB points out that Mr. Ericksen further testified that any material error in the data or other information relating to hurricane losses would result in changes to the indications.

The SRB also contends that because there is no evidence or proof about the accuracy of the catastrophe data and other information that the MPIUA provided to Mr. Ericksen, the Commissioner cannot determine that the data and information used to support the Filing are accurate and complete. The SRB notes that the MPIUA offered no witness from AIR or RMS who could verify the accuracy, completeness and suitability of the data or testify to the

methodology each modeler employed and the applicability of the model to this Filing. The SRB argues further that no witness has testified as to how the models work, what inputs were used, and how they are appropriate in this proceeding and for the MPIUA's book of business. Because this information is lacking, the SRB asserts, the Commissioner cannot determine the reasonability of the rates or perform his statutory and regulatory duties connected with the review of the Filing.

The MPIUA's compliance with Actuarial Standard of Practice ("ASOP") 38, or any other actuarial standard does not, the SRB argues, make up for the deficiencies in the Filing and is insufficient to prevent its rejection. The SRB contends that the actuarial standards of practice define an actuary's responsibilities, but do not relieve the MPIUA from its obligation to submit a properly supported Filing or the Commissioner from his legal duty to assess the Filing in accordance with the statutory and regulatory requirements.[5]

B. The AG

The AG moves to dismiss the Filing and to disapprove the MPIUA's proposed rates, analogizing its motion to that for a directed verdict that, pursuant to Massachusetts Rule of Civil Procedure ("Rule") 50(a), a party may submit at the close of evidence offered by an opponent. She argues that the *Decision on 2007 Rates* and the *Appendix* to the *2007 Decision* ("*2007 Appendix")* provide guidance to the parties about the MPIUA's burden in these proceedings, and that the MPIUA has failed to meet that burden. In particular, the AG addresses reinsurance costs and hurricane losses.

The AG states that the *Decision on 2007 Rates* determined that it was unreasonable to include in a rate a value for reinsurance that is not based on the actual costs for the reinsurance program that is expected to be in place during the rate period. She also argues that the *Decision on 2007 Rates* also made two additional findings on the MPIUA's burden with respect to reinsurance, requiring it: 1) to explain how reinsurers price their coverage, and the values they use for profit and expense; and 2) to examine whether the model used to estimate the potential returns to the MPIUA for purposes of reinsurance is consistent with that used to estimate the average annual losses in the rate calculations.

[5] The standards for the Commissioner's review, the SRB notes, are more comprehensive than those that apply to an actuary.

The AG argues that the Filing includes no information on the profit and expenses in the reinsurance costs or the model that the reinsurers used to estimate expected hurricane losses. She points out that James Wackerman, the MPIUA's witness on the cost of reinsurance, had no knowledge of these referenced matters, had not discussed them with representatives of the reinsurers or the MPIUA, and had not attempted to obtain information on profit and expenses from the reinsurers. The AG argues that Mr. Wackerman, although he estimated that reinsurers' expenses ranged from 8 to 15 percent of premium, did not know where the MPIUA reinsurers fell within that range. She also notes that Mr. Ericksen did not know what portion of the reinsurance costs in the filing reflected profit or expenses.

The AG further notes that the Filing does not indicate what models the reinsurers used to determine the MPIUA's average annual losses, a factor considered in pricing reinsurance. She points out that Mr. Wackerman testified that it was likely that the reinsurers used models that differed from those used by the MPIUA because, when the MPIUA last renewed its reinsurance, about half the reinsurers had adopted the latest versions of the RMS and AIR models while other reinsurers used their own models. In addition, the AG asserts that Mr. Wackerman's testimony also confirmed that some reinsurers use "near-term" hurricane models that produce higher expected loss results than long-term models.

The AG argues that, except for the reinstatement component in the reinsurance premium, the costs included in the Filing are those billed or spent during the 2011 policy year, not those that will be billed and paid during the period when the proposed rates are in effect.[6] She contends that policyholders should not be required to pay for hypothetical or budgeted costs or those that have not been billed or expended. The AG argues that the lack of information on reinsurance costs during the rate period is especially significant because the MPIUA need not make annual rate filings. She further observes that because reinsurance is an optional rate component, including the cost of reinsurance that has not been purchased means that policyholders would pay that cost even if the MPIUA decided not to purchase reinsurance during the rate period. For all these reasons, the AG argues, the MPIUA has not satisfied its burden of showing that the reinsurance costs in the rates are reasonable and not excessive.

The AG asserts that the *2007 Appendix* addressed the MPIUA's burden with respect to the modeled costs of expected hurricane losses, requiring that the MPIUA show that the models

[6] The MPIUA's current reinsurance program expires on June 30, 2012.

used to develop the hurricane loss component are "approximately" calibrated to Massachusetts conditions and are consistent with the record of storms that have affected Massachusetts.[7] Specifically, the AG points to language in the *2007 Appendix* stating that storm frequency in the model must correctly match the record of storms that caused wind damage in Massachusetts at a time when the storm was correctly classified as a hurricane, and that estimates of storm damage should eliminate or give little weight to potential damages from Category 4 or 5 storms, because there is no reasonable expectation that a Category 5 hurricane will strike Massachusetts and the potential for a Category 4 storm is almost equally remote. The AG contends that the MPIUA must show that the models have been carefully calibrated to reflect the transitioning behavior of hurricanes in the Northeast region of the United States and the effect of such transitioning on damage estimates, and that the vulnerability functions in the models are based on Massachusetts data and calibrated to reflect the vulnerability of structures in Massachusetts.

The AG points out that the Filing includes no information whatsoever on the hurricane frequency generated by the models, either overall or by Saffir-Simpson category, for storms affecting Massachusetts and the Filing does not demonstrate that modeled frequencies for hurricanes affecting Massachusetts are consistent with historical frequencies.[8] She points out that the MPIUA's witness on the models, Mr. Ericksen, is not an expert on models, on climate science, or construction and engineering and that he testified that he neither audited nor verified the model data but relied on guidance provided by ASOP 38.

The AG argues that Mr. Ericksen offered testimony on a modeled estimate of the frequency of hurricanes causing damage in Massachusetts but did not compare that value with historical frequency; she contends as well that his testimony appears to be inconsistent with information in Attachment D to his statement of compliance with ASOP 38 ("Compliance Statement"), entered into evidence as Hearing Exhibit 6. The AG points out, as well, that Mr. Ericksen in his testimony could not explain the difference in frequency estimates between the AIR model as reported in the MPIUA's 2009 filing and that in the 2011 Filing, or the difference in the estimates of average annual losses. She asserts, further, that the MPIUA did not explain the reasons for the differences between the AIR and RMS models or consider which more accurately reflected Massachusetts experience.

[7] The actual language in the *2007 Appendix* is "appropriately," not "approximately."
[8] The Saffir-Simpson scale classifies hurricanes, by intensity, into categories 1 through 5.

The AG asserts that the modeled hurricane losses include damages from Category 4 and 5 hurricanes. Under the AIR model, she argues, losses from such storms account for about a quarter of the total hurricane losses. The AG contends that the record includes no information on losses that the RMS model attributes to Category 4 or 5 hurricanes, that Mr. Ericksen did not obtain any data from RMS on such losses and that he made no adjustments to his calculations to eliminate or reduce the weight assigned to modeled losses from Category 4 or 5 hurricanes. The AG further argues that the MPIUA has failed to show that the estimates of potential hurricane losses in its Filing were derived from an analysis of events that have some probability of occurrence.

The AG also contends that the MPIUA has not met its burden to show that the modeled treatment of transitioning storms is consistent with historical data because its Filing contains no analysis of transitioning storm behavior, and no material validating the modelers' treatment of such storms. Therefore, the AG argues, the MPIUA has not shown that, for purposes of estimating hurricane losses, the models were carefully calibrated to reflect hurricane transitioning and its effect on damage estimates.

The AG further asserts that the Filing does not establish that Massachusetts construction and damage data was used to calibrate the vulnerability function in the models. She notes that although AIR claims to consider the evolution of building codes and code enforcement in Massachusetts to determine damage relationships for structures in the state, Mr. Ericksen testified that he did not know of any Massachusetts data that was used to calibrate the AIR vulnerability function. The AG also contends also that nothing in the record shows that RMS used Massachusetts data to calibrate its vulnerability function. Failure to do so, the AG contends, means that the MPIUA has failed to comply with guidance in the *2007 Appendix*.

The AG concludes that the MPIUA made a strategic decision not to provide in its Filing the information required under the *Decision on 2007 Rates* and the *2007 Appendix*, choosing not to obtain information from the reinsurers and the hurricane modelers. For that reason, she argues, the MPIUA has not met its burden to show that the reinsurance charges and modeled hurricane losses in the Filing are reasonable and not excessive.

C. The MPIUA

The MPIUA opposes both motions, arguing that its Filing complies with all statutory and regulatory standards for property and casualty rate filings in Chapters 174A, 175A, and 175C

and 211 CMR 101.00 *et seq*., and with all Division guidelines for such filings. It points out that neither the SRB nor the AG have identified any regulatory filing requirement that the MPIUA has not met. Therefore, it argues, the Filing cannot be rejected as a matter of law. Similarly, the MPIUA contends, no regulatory authority supports the AG's motion to dismiss. Because the record remains open, and no briefs have been filed on the merits, it argues that no ruling can be made at this time on the burden of proof. No precedent exists, the MPIUA argues, for the rejection of its Filing at this stage. The MPIUA also questions the merits of the SRB's assertions about the evidentiary inadequacy of the Filing on the ground that it did not make them earlier.

The MPIUA states that the goal of this proceeding is to determine whether the MPIUA's proposed rates are reasonable, *i.e.*, that they are not inadequate, not excessive and not unfairly discriminatory. It argues that its Filing comports with the principles of insurance ratemaking propounded by the Casualty Actuarial Society, and fully supports its rate request. The MPIUA further contends that the testimony of its actuarial witness, Mr. Ericksen, demonstrates careful compliance with ASOP 38, which addresses an actuary's use of models in developing rate recommendations.

The MPIUA characterizes the specific complaints about the Filing voiced by the SRB and AG as "incorrect, insubstantial, or both." In response to the SRB's concerns about the accuracy, completeness and suitability of the data on which the MPIUA's proposed rates are based, the MPIUA argues that there is no requirement that an actuary audit or otherwise verify the data underlying rate calculations, and that such audits have never been part of property and casualty rate filings. It posits that, were such a requirement to be imposed as part of a rate filing, and witnesses required to testify, the rate review process would go into "gridlock." The SRB and AG, the MPIUA asserts, make filings in rate proceedings in which the testifying actuary discloses that he or she has not audited underlying data. Similarly, the MPIUA states that there is no audit requirement for hurricane loss data. It asserts that the Commissioner, in her *Decision on 2005 Rates* approved the use of models without an audit of their data.

Addressing the AG's motion, the MPIUA argues that the document on which she relies to support her contentions, the *2007 Appendix,* does not represent the Commissioner's adjudicated findings or rulings. Characterizing the statements in that document as "dicta," and only intended to give guidance for future rate cases, the MPIUA nonetheless contends that portions of Mr.

Ericksen's Compliance Statement constitute responses from AIR and RMS to the issues identified in the *2007 Appendix*.

With respect to the AG's position on inclusion in the rates of reinsurance costs, the MPIUA asserts that the *2007 Appendix* does not impose a requirement that its Filing provide evidence of reinsurers' profits and expenses, but only comments on the inability of the MPIUA witnesses in the 2007 rate proceeding to estimate those values. The MPIUA argues that this information cannot be a regulatory requirement because, as Mr. Wackerman and Mr. Ericksen testified, the information is not generally published or otherwise available. In any event, the MPIUA contends, this information is available in the Filing, if one compares data shown in various parts of the filing and exhibits.[9]

The MPIUA characterizes as illogical the AG's assertion that the reinsurers must be shown to use the same hurricane models as the MPIUA for the purpose of estimating hurricane losses, asserting that the *2007 Appendix* does not create such a requirement. It notes that forty-nine reinsurers participated in the MPIUA's 2011-2012 reinsurance program, and that because no reinsurers disclose their hurricane modeling techniques, the MPIUA can neither know what those techniques are or force uniformity of modeling techniques on them. In addition, the MPIUA argues, because reinsurance premiums are set by the market, not by hurricane modeling, the AG's requirement, even if compliance were possible, would be futile.

With respect to the reinsurance costs included in the rate calculations, the MPIUA argues that the AG incorrectly asserts that they do not reflect the costs that the MPIUA will incur during the period in which its proposed rates will be effective. The costs at issue were for the period July 1, 2011 through June 30, 2012, while the proposed rates were to go into effect for policies incepting on or after December 31, 2011. Therefore, the MPIUA argues, there is no "mismatch." It further points out that although the future reinsurance program, for 2012-2013, has not been determined, so that no actual reinsurance cost data yet exist for that period, Mr. Ericksen testified that the current reinsurance program costs provide a proper expectation of future costs.

The MPIUA argues that the AG wrongly claims that the hurricane models have not been validated by historical hurricane data reflecting Massachusetts losses. It asserts that modeled data will differ from short-term historical data because those data do not include rarer events.

[9] On page 30 of its Opposition to the Motions, the MPIUA identifies the pages in Exhibit 2 which, it argues, permit this calculation.

The MPIUA contends that the Commissioner, in the *Decision on 2005 Rates*, approved the use of earlier versions of the AIR and RMS models. It observes that in the proceeding on 2007 Rates, actuarial witnesses for both the MPIUA and the SRB testified that these models were adequate for use in Massachusetts ratemaking, commenting that the models have "only improved in the intervening five years." The MPIUA notes that both the AIR and RMS models have been approved by the Florida Commission on Hurricane Loss Projection Methodology and have undergone extensive peer review by experts.

The MPIUA contends that both AIR and RMS explained how their models were consistent with Massachusetts data in attachments to Hearing Exhibit 6 and in additional materials incorporated into the Filing at pp. 699-726 and 917-966. It argues that it is too late for the AG to assert that the documents from AIR and RMS attached to Hearing Exhibit 6 inadequately respond to the *2007 Appendix* because they are similar to responses made in the proceeding on the MPIUA's 2009 Rate Filing, which no one claimed were inadequate. Addressing the issue of the potential for losses in Massachusetts from damage caused by Category 4 and 5 hurricanes, the MPIUA asserts that hurricanes are categorized at last landfall, not at the time they affect a state where damage occurs. Therefore, the MPIUA argues, it is possible for damages to occur in Massachusetts from Category 4 and 5 storms, even if they do not make landfall in the commonwealth. It asserts that the AIR has estimated average annual losses according to the category of a storm at its last landfall, claiming that if the model recategorized storms to reflect windspeed in Massachusetts, the losses would shift into lower categories.

The MPIUA asserts that, contrary to the AG's claims, the concept of transitioning storms does not require separate analysis but is a sub-part of hurricane severity and windfield calculations. It argues that the testimony of its actuarial witness in the 2007 rate proceeding showed that the hurricane models employed at the time properly and specifically handled transitioning storms, and that the SRB's witness testified that the AIR and RMS hurricane loss estimates in that case were actuarially supported and reasonable. The MPIUA asserts that the materials from AIR and RMS in its Filing present detailed and substantial evidence on how their respective models handle hurricane severity, which necessarily includes transitioning effects as storms pass over land.

Addressing the AG's position that the Filing does not establish that Massachusetts construction and damage data were used to calibrate the models' vulnerability function, the MPIUA asserts that the materials from AIR and RMS in Hearing Exhibits 2 and 6 explain in detail how the modelers estimated, calculated and validated vulnerability functions for Massachusetts data. According to the MPIUA, both AIR and RMS used MPIUA exposure data, including construction type, occupancy type and insured value in their calculations. The MPIUA asserts that there is no merit to the AG's claim that it has put in no evidence on vulnerability.

Further, the MPIUA argues, if there are any inadequacies in the evidence it has offered, the correct response, pursuant to 211 CMR 101.09 (10), is a detailed order from the Presiding Officers calling for additional evidence. To do otherwise, the MPIUA contends, would require it to file a new case, with attendant delay and expense. The MPIUA further asserts that such an order would permit it to provide the additional evidence forthwith and to explain the reasons why certain information may not be in the record.

The MPIUA asserts that the interests of public policy support deciding its rate request on the merits, rather than terminating the proceeding at this point. It suggests that dismissal would block any efforts to effectuate rate reforms that the Commissioner might view as desirable, specifically implementation of coastal zone rating factors and the methodology for assigning losses to territories. Any such changes, it asserts, could be made only as part of adjudicating the merits of the case. The MPIUA casts doubt on the Division's ability to adjudicate rate cases within reasonable time frames if its review must include peer review of hurricane models.

Dismissal of this proceeding, the MPIUA argues, would commit the Division to review hurricane models in all future rate cases. In addition, the MPIUA asserts that rejection of its current filing would mean that the discrepancy between residual market rates and voluntary rates, identified in the Division's *2010 Annual Report on Homeowners' Insurance*, will continue. Describing that discrepancy as a "rate mismatch," the MPIUA characterizes dismissal of this case as an arbitrary suppression of MPIUA rates that would exacerbate that mismatch.

IV. Analysis and Discussion.

A. The Nature of the Motions

The AG and the SRB title their motions differently and for support, rely upon different provisions of 211 CMR 101.00. The AG moves to dismiss the filing pursuant 211 CMR 101.09(4), the general provision authorizing parties to file motions in proceedings on MPIUA

rates, and to disapprove the MPIUA's proposed rate increase. She characterizes the motion as one in the nature of a "motion for a directed verdict" that may, under Rule 50 (a), be submitted at the close of evidence offered by an opponent. The SRB requests rejection of the MPIUA's rate filing pursuant to 211 CMR 101.04(4), which authorizes the presiding officer to reject a rate filing if "he or she determines that the filing party has not complied with the applicable laws or the procedures and forms prescribed by 211 CMR 101.00."

Regardless of the choice of title or the regulatory provisions cited as support for their respective motions, the AG and the SRB both make the same assertion with respect to the Filing: namely, that the evidence put forward in the MPIUA's direct case is insufficient as a matter of law to enable the Commissioner to establish that the rates requested comply with the statutory requirements and fall within a range of reasonableness. Therefore, the AG and SRB contend, the MPIUA has failed to meet its burden of proof and the Filing must be rejected.[10]

Chapter 175C, §5 states that hearings on MPIUA rates are to be conducted under the principles set out in Chapter 30A, the Administrative Procedure Act. The Commissioner, pursuant to authority granted by Chapter 30A, §9 has promulgated specific procedural rules for hearings on MPIUA rates. 211 CMR 101.09(4) permits parties to request rulings from the Presiding Officers by motion, but, unlike 801.CMR 101.01(7)(g), does not thereafter list a series of specific rulings that may be sought on motion.

We do not interpret omission of such a list, however, as a limitation on the actions that may be requested on motion in this proceeding; rather we will view 801.CMR 101.01(7) as guidance for what falls within the ambit of motions that are contemplated by 211 CMR 101.09. 801 CMR 101.01 (7)(g)(1) permits a motion to dismiss to be filed after the "Petitioner," *i.e.*, the MPIUA, completes presentation of its evidence. Therefore, we hold that the Motions are permissible under 211 CMR 101.09, and that the MPIUA's argument that the Motions filed by the AG and the SRB are untimely because the record has yet to be closed, is without merit.

B. The Directed Verdict Standard

The familiar standard for reviewing a motion for a directed verdict requires us to consider all the evidence in the light most favorable to the non-moving party, in this case the MPIUA, and

[10] As noted above, the Motions are both analogous to a request for a directed verdict under Rule 50(a). They also parallel the ground for filing a motion to dismiss at the close of a petitioner's presentation of evidence as permitted in an adjudicatory proceeding conducted under the Standard Adjudicatory Rules of Practice and Procedure, 801 CMR 101.01 (7)(g)(1).

to reach the conclusion that the evidence is insufficient to support a decision in favor of the non-moving party. The test of sufficiency must be applied without determining the credibility of the witnesses. *See Olson v. Charland*, 20 Mass. App. 954 (1985). We must determine whether anywhere in the evidence, from any source, a combination of circumstances could be found from which a reasonable inference could be made in favor of the non-moving party. *See McCarthy v. City of Waltham*, 76 Mass. App. 554, 560 (2010).

In ruling upon the Motions, we must evaluate the exhibits and the written and oral testimony of the MPIUA witnesses to determine whether they furnish *sufficient support* to enable us to conclude that the MPIUA's proposed rates comply with the statutory requirements and fall within a range of reasonableness. We will consider *only* the alleged insufficiencies that have been raised in the Motions filed by the Attorney General and the State Rating Bureau. We voice no opinion on whether the Filing is otherwise sufficient to support any other aspects of the MPIUA's proposed rates.

The MPIUA, since the effective date of the revised Chapter 175C, §5, submitted three rate filings before making its 2011 Filing. After extensive hearings, decisions were issued on both the 2005 and 2007 filings; the 2009 filing was resolved by stipulation among the parties. The Motions filed in this proceeding are specifically limited to questions of compliance with the statutes and regulations and the requirements set out in the *Decision on 2005 Rates,* the *Decision on 2007 Rates* and the *2007 Appendix,* the documents that the parties rely upon to support their positions. We have therefore considered those prior decisions and the *2007 Appendix* in evaluating the merits of their respective positions on the Motions.

C. Compliance with Regulatory Requirements

The MPIUA objects to the possible resolution of this proceeding on a motion to reject or dismiss the Filing on the ground that the Filing fully complies with the applicable statutes and regulations, including 211 CMR 101.01, *et seq*., and that neither the SRB nor the AG has identified any regulatory shortcoming in it. The MPIUA's opposition to the AG and SRB Motions suggests that it believes that its Filing need only *explain* the basis for the Filing. It misconstrues the nature of the question now at issue. As 211 CMR 101.04 makes clear, however, the Filing must do more than *explain* how the MPIUA's recommendations were reached, it must *substantiate* its recommendations and *support* every element of the Filing. Assuming, *arguendo*, that the Filing touches upon each item identified in Chapters 174A, 175A

and 175C as a relevant factor for developing rates, it does not therefore avoid the Commissioner's scrutiny.

The issue presented here is not whether the Filing, by addressing specific factors identified in the applicable statutes and regulations, has therefore complied with them but, rather, whether the MPIUA's direct case meets its evidentiary burden to prove by a preponderance of the evidence that its proposed rates are not excessive, inadequate, or unfairly discriminatory, and are within a range of reasonableness.[11] As stated above, the Commissioner, in her *Decision on 2007 Rates*, explicitly confirmed that the MPIUA has the burden of supporting each aspect of its rate request in its filing. To that end, the MPIUA must demonstrate that the data underlying its rate calculations are accurate and properly support each element of those rates, and that it has used appropriate methodologies to develop its recommendations.

The MPIUA has argued that it has satisfied its burden of proof because the statements relating to filing requirements in the *2007 Appendix* are dicta that do not impose obligations on the MPIUA. The Supreme Judicial Court addressed the obligation of a rate filer to comply with stated policies, as well as statutory and regulatory filing standards in *Massachusetts Electric Company v. Department of Public Utilities*, 383 Mass. 675 (1981). In that case, the company had appealed the dismissal of its rate filing by the Department of Public Utilities ("DPU") because the company had failed to support its filing with "historic test year" data, in contravention of established DPU policy. *Id.* at 677.

The *Massachusetts Electric* Court rejected the company's view that the DPU was required to establish all its filing requirements through rulemaking, observing that such an outcome would require the DPU to conduct a full evidentiary hearing on any rate filing, no matter how contrary that filing might be to well-known past practice. *Id.* at 679. The Court further commented that "[m]ore importantly, the department would be forced to anticipate each of the myriad defects a rate filing might present and to establish regulations applicable outside of the context in which the problem might arise." *Id.*[12]

The *Decision on 2005 Rates* addressed specific issues about the MPIUA's rate filing, including the inclusion of a value for reinsurance that it had not purchased, and concerns about

[11] Similarly, the issue is not whether the Filing comports with the principles of property and casualty ratemaking propounded by the Casualty Actuarial Society.

[12] In affirming the DPU's decision to dismiss the filing as "patently deficient," the *Massachusetts Electric* court also considered the burden on other parties if it were required to conduct a full hearing on an inadequate filing. *See* 383 Mass. at 679.

the vulnerability functions in the RMS hurricane model that it used to estimate hurricane losses. The *Decision on 2007 Rates* again addressed the MPIUA's inclusion of a value for reinsurance that was budgeted, but not based on actual costs, as well as other issues relating to the evidence supporting its proposed rates, and disapproved the filing. In the *Decision on 2007 Rate,* it was noted that the MPIUA "must demonstrate that its values for the net cost of catastrophe reinsurance and predicted average annual hurricane losses are reasonable," and further noting, in footnote 25, that other observations on the 2007 filings were contained in the Appendix to the Decision. The *2007 Appendix* observed that in the proceeding the parties had raised issues that were not relevant to the specific grounds for disapproval of the 2007 filings, but were relevant to the general review of MPIUA rate filings.

To address more general concerns, the Commissioner issued the Appendix to guide the parties in future filings. The *2007 Appendix* specifically articulates some of the issues that arose in the context of the MPIUA's second rate filing following the amendment of Chapter 175C, §5, and clearly states that its purpose is to provide guidance for the future. At issue in this proceeding is whether the MPIUA failed to follow those guidelines. Its argument that it need not comply with the issues articulated in the decisions on the 2005 and 2007 rates, and in the *2007 Appendix,* is not persuasive.[13] We conclude, therefore, that motions such as those that have been brought by the AG and SRB, respectively, are appropriate if a rate filer has failed to comply with the Division's announced requirements for a rate filing, whether those requirements were promulgated as regulations or articulated in prior decisions, guidelines, bulletins, or other communications to rate filers.

D. Data Quality

The starting points for rate filings include current and historical data on the filer's book of business, loss experience and expenses and financial matters, such as income sources. For purposes of developing prospective MPIUA rates, this data is transmitted to actuaries for the purpose of developing final proposed rate recommendations, as well as to entities such as reinsurers and catastrophe loss modelers who develop specific inputs that are ultimately incorporated into the proposed rates. The MPIUA dismisses the SRB's expressed concerns

[13] As the Court noted in the *Massachusetts Electric* decision, its ruling was not intended to prevent a filing party from contending that there are unique and exceptional reasons why an agency policy should not apply to it or from advocating changes in methodology. *See* 383 Mass. at 670-681. The MPIUA in fact advances such contentions in its Opposition.

about accuracy, completeness and suitability of the data on which the MPIUA bases its proposed rates, arguing that an actuary is not required to audit or otherwise verify the data underlying the Filing. Imposing such a requirement, it asserts, would put the entire rate review process into "gridlock." The focus of the MPIUA's opposition, the potential burden on a consulting actuary to "audit" the customer's data, ignores the real issue: that a rate filer should be prepared to satisfy the Commissioner that the data used to develop rates are complete, accurate and relevant to the particular factor which they are expected to support. Material errors in the MPIUA data as submitted to its consulting actuary would, as Mr. Ericksen testified, change the rate indications. *See* Hearing Ex. 2 at 166; Transcript of the MPUIA 2011 Rate Filings Hearing ("Tr."), Vol. III, at 81.

The MPIUA presented no sworn testimony from any witness who could address the accuracy, completeness or suitability of the data that the MPIUA assembled and transmitted to Mr. Ericksen or the hurricane modelers, even though the quality of the data is a fundamental element in determining whether rates satisfy statutory standards.[14] In this proceeding, Mr. Ericksen testified that he relied upon data that the MPIUA provided but disavowed any responsibility for any errors or omissions in it. Hearing Ex. 2 at 166-167; Tr.,Vol. III, at 80-81. He commented that "we" looked at the data provided by the MPIUA and the modelers for reasonableness, but would not be responsible for or necessarily able to identify any systematic error.[15]

The MPIUA's failure to present testimony from a witness who could attest to the quality of the underlying data is inconsistent with the practice of other rate filers.[16] Although the SRB did not identify any specific data-related problems, questions posed to Mr. Ericksen about various data elements demonstrate legitimate concerns about the MPIUA's data, particularly as

[14] Material from RMS, attached to Mr. Ericksen's prefiled written testimony as Appendix C, expresses the same principle: that the accuracy of its estimates "is largely dependent" on the accuracy and quality of data that the MPIUA supplied.

[15] Mr. Ericksen testified that the MPIUA sent him a copy of the actual data files sent to RMS and AIR, and sent ISO other files that it required for its rate analysis. Although he could not verify the accuracy of the content of those filed, he commented that he "did go through the exercise in the aggregate to match that things seemed to be consistent." *See* Tr., Vol. III, at 80.

[16] *See,* for example, Section XIII of the most recent rate filing by the Workers' Compensation Rating and Inspection Bureau of Massachusetts, which addresses its evaluation of data submitted by its member companies. Affidavits from actuaries testifying in the most recent proceeding to fix-and-establish automobile insurance rates either affirm that the data is true and accurate to the best of their knowledge, or state that they have relied on the accuracy of data compiled by another entity. The MPIUA's omission of such statements may result from a decision to utilize the services of a consulting actuary, rather than MPIUA staff.

reported to the modelers. Questions about the MPIUA's data practices are appropriately addressed by a witness who is responsible for assembling and transmitting MPIUA data to its rate developers. In this proceeding, however, no person qualified to testify to those issues was offered as a witness.[17]

E. Reinsurance Provisions

The MPIUA also contests the AG's position that its Filing fails to satisfy previous enunciated requirements on inclusion of the net cost of reinsurance in prospective rates. Opposing the AG's argument that the Filing should be dismissed because it does not include a value for the cost of reinsurance that represents the actual costs for the program that is expected to be in place during the rate period, the MPIUA asserts that it is reasonable to include the cost of reinsurance now in place for the period July 1, 2011-June 30, 2012, and to consider that a proxy for the cost of reinsurance for the next 12-month period.

The Commissioner, in her *Decision on the 2005 Rates*, issued in connection with the MPIUA's first filing after the effective date of the revised Chapter 175C, §5, disapproved the inclusion of a value for the cost of reinsurance that the MPIUA had not yet purchased.[18] She declined to approve inclusion of a prospective expense absent evidence that the insurer had or would in fact incur the expense during the period that the requested rates would be in effect. The MPIUA's 2007 Filing included a value for reinsurance consisting of an amount it had budgeted for that purpose, but had not actually purchased. The Commissioner again disapproved the Filing for the stated reason that it was unreasonable to include in a rate a value for reinsurance that was not based on the actual costs for the reinsurance program that the MPIUA expected to have in place during the rate period.

The MPIUA's argument that its filing satisfies the requirement to include actual costs because, had its requested December 31, 2011 effective date for the proposed rates occurred, they would incorporate the cost of reinsurance into rates that would be in effect during 2012, is

[17] Because assurances that the data underlying each aspect of a filing are accurate, complete and suitable for the use to which they are put is essential, in the future the MPIUA should offer a witness who is qualified to address the accuracy, completeness and suitability of the data sets that it used directly or transmitted to others for the purpose of developing each aspect of its proposed rates.

[18] The *Decision on 2005 Rates* noted that in that proceeding, the MPIUA had expressed reluctance to purchase reinsurance until the cost was actually incorporated into the rates. In this proceeding, the MPIUA seeks to incorporate a value for reinsurance before any decisions have been made on the purchase of coverage after expiration of the current program.

not persuasive.[19] The Filing includes a value for the MPIUA's current reinsurance that terminates six months after the proposed effective date, but the MPIUA provides no specific information on the reinsurance program contemplated for any subsequent period, or the cost of any such program. The MPIUA's argument that the costs of the 2011-2012 reinsurance program are a reasonable basis for estimating future costs does not satisfy the requirements set out in the *Decisions on the 2005 and 2007 Rates* for developing a reasonable estimate for the cost of reinsurance. In 2007, the Commissioner found that the MPIUA's Filing did not meet its burden of proof on the costs of reinsurance, observing that the MPIUA must substantiate the reasons for purchasing coverage at various levels and demonstrate that the premium, in light of prevailing market conditions, is reasonable.

The MPIUA's witness, Mr. Wackerman, in his prefiled testimony in Hearing Exhibit 2, reviewed the decision-making process that the MPIUA followed in determining its reinsurance program for 2011-2012, which included an evaluation of its exposure to severe catastrophe loss, an analysis of the available options for structuring a reinsurance program, and the anticipated costs of those options.[20] Hearing Ex. 2 at 1194-95, and 1201. In Mr. Wackerman's prefiled testimony, he further stated that the worldwide reinsurance market is competitive, and that reinsurance is priced at competitive levels. Hearing Ex. 2 at 1200. On cross-examination, he further testified that market conditions change over time, sometimes fairly rapidly, and that market pricing moves up and down based on the laws of supply and demand. *See* Tr., Vol. II, at 61-62.

No statute obligates the MPIUA to purchase reinsurance or prescribes the structure of its program, such as the attachment points for different layers or the funding vehicles that are most appropriate for coverage at those layers.[21] Because the elements that factor into determining the cost of the MPIUA's reinsurance program, including market conditions, are not constant from year to year, and the MPIUA is free to decide each year whether to purchase reinsurance and, if so, how to structure the program, we find that the MPIUA's proposal to accept the cost of the current reinsurance program as sufficient evidence of the reasonable cost of future programs

[19] Its position also reflects the somewhat unrealistic expectation that, absent a stipulated resolution, proposed rates filed in November 2011 would be approved for a December 31 effective date.
[20] A timeline attached to Mr. Wackerman's testimony indicated that preliminary discussions about the 2011 renewal began in January 2011, six months in advance of the expiration date of the program. Hearing Ex. 2 at 1373.
[21] Mr. Wackerman testified that the 2011-2012 reinsurance program includes traditional reinsurance, a catastrophe bond and a peril swap, selected as methods of maximizing reinsurance coverage at the lowest costs. Hearing Ex. 2 at 1193-1200.

does not satisfy its burden of proof. We have been presented with no reason to change the Commissioner's prior decisions establishing the specific factors that the MPIUA must address in establishing the cost of reinsurance for purposes of developing its rates.[22]

The MPIUA argues as well that the *2007 Appendix* did not require that the Filing provide evidence of reinsurers' profits and expenses, but merely commented that the MPIUA witnesses in that proceeding were unable to estimate those values. The *2007 Appendix* determined that a reasonable approach to valuing the reinsurance factor in the rates is to determine the portion of the net earned premium that represents the reinsurers' profits and expenses. The MPIUA argues that this cannot constitute a regulatory requirement because, according to its witnesses, the necessary data are not generally published or otherwise available, but then asserts that the value can be determined by comparing data presented in various sections of the Filing.

Neither Mr. Wackerman nor Mr. Ericksen testified in this proceeding as to the publication or availability of information on reinsurers' profits and expenses. Mr. Wackerman testified only that he did not recall any discussions with reinsurers either about their profit load or their expenses, but offered an opinion, as he did in a prior proceeding on MPIUA rates, that he thought expenses were between 8 and 15 percent of the reinsurance premium. Tr., Vol. II, at 133. Mr. Ericksen also testified on cross-examination that he had seen no estimates of the reinsurers' expenses or profit load, and had not attempted to determine either value. Tr., Vol. III, at 174-175. It is apparent from the testimony that the MPIUA chose not to present evidence on that portion of the reinsurers' net earned premium that represents their profits and expenses.[23] The shortcoming in the MPIUA's evidence noted in the *2007 Appendix*, that the witnesses did not know about reinsurance pricing, persists this year.

The MPIUA now asserts that it offered sufficient proof on reinsurers' profits and expenses because those values can be derived through calculations from data in Hearing Exhibit 2. The MPIUA had an opportunity to present testimony from its witnesses both on the accuracy of the data underlying its proposed calculation and the appropriateness of its proposed

[22] The MPIUA chose to make a rate filing with a proposed effective date of December 31 when its reinsurance program is issued on a July 1 through June 30 basis, perhaps thereby creating a dilemma with respect to including actual reinsurance costs in proposed rates. The MPIUA need not, however, implement new rates on a calendar year basis and in fact, in 2007, filed for a July 1 effective date. It offers no reason for its failure in the 2011 Filing to synchronize its reinsurance purchases with its rate requests.

[23] Mr. Wackerman testified that reinsurers' profit load is not the same for every entity but varies by individual reinsurer and from negotiation to negotiation. Tr., Vol. II, at 136-137. For those reasons, the reinsurers' profit load directly relates to assessing the reasonableness of the MPIUA's reinsurance cost.

methodology, but failed to do so. Statements in a memorandum do not constitute sworn testimony on this issue and therefore do not sustain its burden of proof.

The MPIUA characterizes as "illogical" the AG's argument that the MPIUA and its reinsurers should use the same hurricane models to estimate hurricane losses. It asserts that the *2007 Appendix* did not impose such a requirement and that, in any event, factors such as the number of reinsurers participating in the MPIUA's 2011-2012 program and non-disclosure of their modeling techniques would make it impossible to achieve. The MPIUA develops the hurricane loss load in its rates from estimates of average annual losses that it obtains from its selected hurricane modelers. As Mr. Wackerman testified on cross-examination, not every reinsurer utilizes the modeled output from the MPIUA's vendors (*i.e*, the results that AIR and RMS provided to the MPIUA), and reinsurers may adjust model results to address their own concerns.[24] Tr. Vol. II, at 128 and 150.

Mr. Wackerman also testified that he discusses with reinsurers the models that they use to estimate the losses that they anticipate covering, both to understand reinsurers' pricing and to ensure that the numbers they utilize "make sense" in relation to the MPIUA's numbers. Tr., Vol. II, at 128. He further testified that some reinsurers use "near-term" models that produce higher expected loss estimates, several create their own model, and almost all create their own view of existing models. Tr., Vol. II, at 128 and 150.

The choice of models and the adjustments that reinsurers may make to them directly relates to the pricing of the various layers of the MPIUA's reinsurance program. Consistency between the estimates of average annual hurricane losses that the MPIUA obtains from its vendors and the estimates that reinsurers use to price their product hurricanes therefore provides a sound basis for determining the reasonableness of the reinsurance factor in the rates, and it is the need for such consistency that the Commissioner addressed in the *2007 Appendix*.[25] The optimum method for achieving consistency is not necessarily to require the reinsurers, for purposes of pricing their product, to use the model results purchased by the MPIUA; what is essential, however, is that the MPIUA present evidence supporting a conclusion that the outputs of models used to estimate potential returns to the MPIUA for reinsurance purposes are

[24] Mr. Wackerman noted, for example, that reinsurers may consider model results to be too high or too low, and may not include estimates of specific items such as tree damage. Tr.,Vol. II, at 128.
[25] Significant differences in those estimates might also raise questions about the quality of any of the models.

consistent with model outputs of estimated average annual losses that the MPIUA uses in developing its rates.

F. Hurricane Loss Provisions

The MPIUA asserts that the documents from AIR and RMS included in the Filing satisfy its obligation to support the proposed hurricane loss provisions, contending that this proceeding should not be transmuted into a peer review of competing catastrophe models. Those documents include Responses to Questions Related to the MPIUA Rate Hearing from AIR and RMS, Attachments D and E to Hearing Exhibit 6, and longer documents submitted as Appendix A (RMS) and Appendix B (AIR) to Mr. Ericksen's pre-filed testimony in Hearing Exhibit 2, both identified as ASOP 38 packages.[26] Because none of these materials has been presented in the form of direct sworn written testimony and, as a result, no cross-examination is possible, they do not comply with 211 CMR 101.04 (2)(b).

Rather than present witnesses who could testify about the models, the MPIUA relies on Mr. Ericksen's Compliance Statement, in which he acknowledges that the hurricane models incorporate specialized knowledge that is outside his area of expertise and confirms his reliance on the modelers' ASOP 38 packages, and his cross-examination testimony.[27] Tr., Vol. III, at 75-78. ASOP 38 lists five recommended practices that an actuary should follow when using models that incorporate specialized knowledge outside his own area of expertise. Hearing Ex. 6 at 17. Mr. Ericksen's statement addresses each practice.

We are not persuaded, however, that compliance by its actuary with ASOP 38 satisfies the MPIUA's burden of proof to demonstrate that the hurricane loss provisions in its Filing satisfy the statutory standards. Mr. Ericksen also testified that ASOP 38 is not intended to set a standard for the Commissioner's review of the model, but only gives guidance to the actuary who is preparing a rate filing. Tr., Vol. III, at 77-79, and 180. The MPIUA's submission for the purpose of satisfying its obligation to support each element of its rate filing requires a different analysis.[28]

In his Compliance Statement, Mr. Ericksen states that it is appropriate to use models to develop hurricane losses, that it is common practice to use model results in rate filings, and that

[26] The RMS package is Bates-stamped pages 687-883 and the AIR package is pages 885-1041 of Exhibit 2. .
[27] On cross-examination, he affirmed that he is not an expert in the climate science or engineering side of the models. Tr., Vol. III, at 76 and 181.
[28] We express no opinion on whether Mr. Ericksen's statement satisfies his obligations as an actuary.

the MPIUA's use of AIR and RMS model output is consistent its past filings and with the way other insurers use such models in their filings. Hearing Ex. 6, at 8. Those matters are not contested. The *Decision on 2005 Rates* affirmed that is it appropriate to use mathematical models to develop rates, that it is not *per se* unreasonable to utilize multiple models, and that the reasonableness of using the RMS and AIR models was manifested by their widespread acceptance in the insurance market. The *2007 Appendix* observed that the *Decision on 2005 Rates* reached no conclusions on the merits of either the RMS or AIR model.

Both the *Decision on 2005 Rates* and the *2007 Appendix* identified specific issues that the MPIUA must address in connection with the use of models. In her *Decision on 2005 Rates*, the Commissioner stated that, with respect to developing vulnerability functions, a model should consider specific provisions in the Massachusetts building code relating to wind loading and building practices. In 2007, she identified a number of additional issues that a filer must address relating to the use of models. A filer who proposes to rely on an actuary's statement of compliance with ASOP 38 to satisfy its burden of proof should, at the very least, ensure that the statement responds to specific issues that have been identified as essential for meeting that burden. Mr. Ericksen's compliance statement does not do so.

The *2007 Appendix* pointed out that a mere finding of the Florida Commission on Hurricane Loss Projection Methodology that a model is acceptable for use in that state, does not demonstrate that the model is appropriate for use in Massachusetts. As set forth in the *2007 Appendix*, the MPIUA must affirmatively demonstrate that any model approved for use in Florida is appropriate for estimating the characteristics of hurricanes and hurricane damages in Massachusetts. In his Compliance Statement, Mr. Ericksen identifies approval of recent versions of the AIR and RMS models in Florida as evidence that he has appropriately relied on other experts to support his hurricane loss provision. Hearing Ex. 6 at 6. He does not address the question, however, of the suitability of those models for developing hurricane loss provisions for Massachusetts.

The *2007 Appendix* criticized the MPIUA's filing because it had conducted no analysis to explain the differences among model results to determine which most accurately represented potential hurricane losses in Massachusetts. Mr. Ericksen offered an explanation for differences in the RMS and AIR estimates of the MPIUA's total insured value, but expressed no opinion on which constituted the more accurate representation of the MPIUA's potential hurricane losses.

Tr., Vol. III, at 125-126. The *2007 Appendix* further stated that the MPIUA's task is to demonstrate that the hurricane model outputs it has used in its rate-making are validated to show: 1) that the outputs reflect only hurricanes that make landfall in Massachusetts or pass by so closely that hurricane-strength winds damage insured property in Massachusetts; 2) consider the vulnerability to wind damage of insured structures in Massachusetts; and 3) develop reasonable estimates of the economic loss that a hurricane would cause the MPIUA.

The MPIUA must show that the models it employs to develop its provision for hurricane losses reflect wind damage to property in Massachusetts caused by hurricanes, not wind damage from storms that no longer are hurricanes when they enter or pass by the state. The *2007 Appendix* recognized that because modelers use different methodologies and formulae for measuring functions such as frequency, intensity and vulnerability, the model outputs will differ. That expectation of difference does not, however, release the MPIUA from demonstrating that the model results are consistent with historical events, reasonably reflect current conditions relating to Massachusetts and reasonably estimate the potential effect of hurricanes on the MPIUA's book of business. Mr. Ericksen's statement of compliance with ASOP 38 does not address those issues.

Mr. Ericksen's Compliance Statement was based only on his review of materials in the AIR and RMS ASOP 38 Packages. His testimony confirmed his familiarity with the basic model components, as reported in his compliance statement, but did not demonstrate that the MPIUA Filing satisfactorily addressed issues identified in the *2007 Appendix*. Hearing Ex. 6 at 7. Tr., Vol. III, at 112-139. His testimony on the model methodology for categorizing hurricanes is directly at odds with the Commissioner's requirement that the intensity of a storm, for purposes of determining its status as a hurricane, be evaluated at the time when the storm is causing damage in Massachusetts.[29] The correct classification is essential because, as the Commissioner noted in the *Decision on 2005 Rates*, proposed rate increases for large share territories that exceed the statutory cap on such increases are permitted only to the extent that they are based on hurricane losses and the cost of catastrophe reinsurance.

[29] Mr. Ericksen testified on cross-examination and on re-direct that AIR categorizes storms when they first make landfall in the United States, so that an event that is downgraded to a tropical storm when it reaches Massachusetts would still be assigned to Category 4. Tr., Vol. III, at 130 and 216. The *2007 Appendix* commented that a storm that is correctly classified as a hurricane when it makes landfall in New Jersey may not remain a hurricane when it moves into other jurisdictions.

In this proceeding, Mr. Ericksen was unable to explain differences in hurricane frequency estimates in the AIR model used to develop 2009 rates and the model used in 2011. Tr. Vol. III, at 193-198. He had no information on the extent to which hurricanes that caused damage in Massachusetts were used to calibrate vulnerability functions, despite concerns expressed in the *Decision on 2005 Rates* and the *2007 Appendix* about the models' calculation of vulnerability functions as they relate to Massachusetts properties. Tr., Vol. III, at 183-184. Those issues have not been addressed in the 2011 Filing.

With respect to the AG's contention that the MPIUA has failed to offer evidence that the models appropriately consider the behavior of hurricanes as they move closer to New England (so-called "transitioning storms"), the MPIUA argues that: 1) evidence presented in the 2007 proceeding is adequate to meet its burden of proof; and 2) the concept itself is a sub-part of hurricane severity and windfield calculations, and does not require separate analysis. It asserts that the ASOP 38 packages from AIR and RMS show how their respective models handle hurricane severity, which necessarily includes transitioning effects as storms pass over land.

The MPIUA misstates the relevant issue. As identified in the *2007 Appendix*, the question to be addressed is not how hurricanes behave when they make landfall; it is the changes that occur as they pass over colder water. In any event, the MPIUA did not include, as part of its filing, testimony from the 2007 rate proceeding. Even if it had done so, because the *2007 Appendix* notes that transitioning is a relatively new concept, such testimony, without confirmation that it is still appropriate, is insufficient to demonstrate the accuracy of severity functions produced by later versions of hurricane models. The MPIUA has not shown in this proceeding that, for purposes of estimating its hurricane losses, the hurricane models have been carefully calibrated to reflect the transitioning behavior of hurricanes in the Northeast and the effect of transitioning on damage estimates.

The MPIUA argues that in the proceeding on 2007 Rates actuaries for both the SRB and the MPIUA testified that the AIR and RMS models were adequate for use in Massachusetts, and that they "have only improved in the intervening five years." That the models have changed since 2007 supports a conclusion that a determination as to their reliability for use in Massachusetts ratemaking in 2011 should only be made upon evidence in the form of sworn testimony that is subject to cross-examination.

Chapter 30A, §11 provides that agencies need not observe the rules of evidence observed by courts, but may give probative effect to evidence *only* if it is the kind of evidence on which reasonable persons are accustomed to rely in the conduct of serious affairs. Even if it were possible to waive the regulatory requirement that a filer support each element of its proposed rates with sworn written testimony, we find that the AIR and RMS ASOP 38 packages that are included in the Filing do not meet the standard for admission of hearsay. The materials are best described as generic descriptions of the models that offer no explanation of the manner in which they were applied to the MPIUA's data for purposes of the Filing, and neither address the specific questions identified in the *2007 Appendix* nor quantify issues, such as demand surge, identified as a matter of concern in the *Decision on 2005 Rates*.

Attachments D and E to Hearing Exhibit 6, submitted in response to questions from the MPIUA, similarly provide little specific information on the modelers' development of hurricane loss estimates for Massachusetts. Neither attachment identifies the author or his or her qualifications. We find that the MPIUA has failed to meet its burden of proof with respect to issues related to hurricane models because it offered no sworn testimony that might support a conclusion that rates based on those models satisfy the statutory standards.

G. Public Policy Issues

The MPIUA's argument that dismissal of the Filing will prevent implementation of potential rate reforms, such as the implementation of key factors for rating purposes, that the commissioner may view as desirable is without merit. A contested issue in the proceeding on the MPIUA's 2005 Filing was the Commissioner's authority to order specific changes to MPIUA filings, such as a provision for revised coastal zone rating factors and a methodology for assigning losses to territories that incorporated additional splitting of coastal zone territories. The Commissioner's *Decision on 2005 Rates* concluded that she did not have authority to substitute alternative methodologies for those in the Filing.[30] The Commissioner has specifically rejected the MPIUA's theory that changes to its rating methodology could only be made as part of adjudicating the merits of the case.[31]

[30] In her *Decision on 2005 Rates*, the Commissioner found some merit in the SRB's proposals to change the MPIUA's methodologies, and urged the MPIUA to cooperate with the other parties to study the issue more closely.
[31] The parties, of course, might agree to such changes and present them to the Commissioner in the form of a stipulation.

The MPIUA objects to what it characterizes as a mismatch between voluntary and residual market rates, arguing that dismissal of its Filing at this stage would arbitrarily suppress proposed rates that, if approved, would reduce or eliminate discrepancies between MPIUA rates and those in the voluntary market. The MPIUA's argument essentially restates the position it took in its 2007 Rate Filing, that its rates are inadequate because they are lower than those in the voluntary market and that it seeks increases that will bring its rates to, or close to, a level that exceeds those of voluntary insurers.

The Commissioner has previously rejected the argument being made by MPIUA as a reason to approve proposed rates, noting in the *2007 Appendix* that "[n]either Massachusetts law nor the concept of actuarial soundness requires residual market rates to be higher or lower than rates in the voluntary market." We find no merit to the argument in this proceeding that dismissal of the filing is improper because it will prevent the MPIUA from increasing rates to match more closely rates in the voluntary market.

As previously noted, the MPIUA argues that the correct response to any inadequacies in the evidence it has offered is not to dismiss the Filing but for the Presiding Officers to issue a detailed order calling for additional evidence. In support of its position, it cites 211 CMR 101.09 (10), which permits the Presiding Officer, at any stage of a hearing, "to call for further evidence upon any issue, and may require any Party, or Parties, to present such evidence." Such an order, the MPIUA contends, would permit it to provide the additional evidence forthwith and spare it the expense and delay associated with making a new rate filing. The MPIUA's argument however, in essence, inflates the status of regulatory provisions that authorize a Presiding Officer to require a party to provide additional data, information or evidence to a *requirement* that he or she do so. In an effort to prevent dismissal of the Filing, the MPIUA improperly proposes to recruit the neutral decisionmakers to its team.

In any event, the procedural rules do not support the MPIUA's proposal. The language of the provisions in 211 CMR 101.00 that permit a Presiding Officer to require a filing party or a party making a responsive filing to furnish supplemental uniformly employ the word "*may*," signifying that such an action is discretionary.[32] 211 CMR 101.09 (10) confirms that any efforts

[32] 211 CMR 101.04(3) and 101.05(4), applicable, respectively, to rate filings and responsive filings, both note that the Presiding Officer *may* require any Filing Party to furnish any additional data or information which the Presiding Officer determines to be necessary or appropriate. *See, e.g.*, 211 CMR 101.04(3) ("*Except as permitted or requested*

to introduce material that is not in a rate filing is entirely discretionary. Nothing in the regulations suggests that it is appropriate for the MPIUA to rely on the Presiding Officers to request supplementary material to remedy the alleged deficiencies in its Filing.[33] The MPIUA's request for a detailed order instructing it on the shortcomings of the Filing is particularly egregious because of its failure to address issues specifically discussed in prior decisions on the 2005 and 2007 rate filings, and in the *2007 Appendix*.[34] It is also problematic to the extent that the MPIUA might seek an opinion from the Presiding Officers on the adequacy of the evidence to support other aspects of the Filing.

V. Conclusion and Order

The AG and the SRB challenged the adequacy of the evidence presented by the MPIUA in its direct case to support its proposed rates. For each of the reasons expressed above, we conclude that with respect to the issues raised by the AG and the SRB, the MPIUA, in its direct case, has not met its burden of proof to demonstrate that its Filing meets the applicable statutory and regulatory standards. We address no other potential issues relating to the adequacy of the evidence offered in support of the Filing. The AG and the SRB's Motions are hereby allowed, and the MPIUA's 2011 Rate Filings are hereby disapproved.

IT IS SO ORDERED this day, May 11, 2012.

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

I have reviewed the record and the order of the Presiding Officers and approve their findings and conclusions.

Joseph G. Murphy
Commissioner of Insurance

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by the Presiding Officer, or in accordance with 211 CMR 101.09, no additions, amendments, or corrections to the Rate Filing *shall be allowed*."(Emphasis added).

[33] The Presiding Officers, in their discretion and for good cause shown, may permit a party in the course of the hearing to introduce exhibits or raise issues not included in its filing. The MPIUA has not sought in this proceeding to introduce exhibits or raise issues that are not included in its rate filing.

[34] Even if the MPIUA had sought a ruling under 211 CMR 101.09 (10), we are not persuaded that it would be appropriate in these circumstances to allow the MPIUA to supplement the Filing. It would be challenging to find "good cause" for the MPIUA's failure to address matters that were specifically stated in prior decisions to be essential to the Commissioner's meaningful review of a rate filing.