



STATE OF CONNECTICUT

INSURANCE DEPARTMENT

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In the Matter of:
PROSELECT INSURANCE COMPANY:
MEDICAL MALPRACTICE RATE FILING:
EFFECTIVE DECEMBER 1, 2005:
-----X

Docket No. PC 05-177

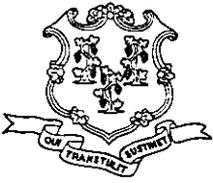
ORDER

I, Susan F. Cogswell, Insurance Commissioner of the State of Connecticut, having read the record pertaining to the above captioned matter, do hereby adopt the finding of facts, conclusions of law and recommendations of Richard J. Marcks, Hearing Officer in this matter, TO WIT:

The decision of the Insurance Department dated October 5, 2005 to disapprove a request for a Physicians and Surgeons Professional Liability 12% base rate increase submitted by ProSelect Insurance Company on June 8, 2005 is upheld on the basis that the proposed rate is excessive.

Dated at Hartford, Connecticut this 20th Day of December, 2005.

Susan F. Cogswell
Susan F. Cogswell
Insurance Commissioner



STATE OF CONNECTICUT

INSURANCE DEPARTMENT

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MEMORANDUM OF FINDINGS AND RECOMMENDATION

I. INTRODUCTION

On June 8, 2005, ProSelect Insurance Company (hereinafter "ProSelect") submitted a Physicians and Surgeons Professional Liability Rate Filing. In that filing, ProSelect submitted a proposal for the following changes, effective for December 1, 2005:

1. A 12% base rate increase;
2. An increase in the increased limits factors for most limits above \$1,000,000, with an estimated overall premium impact of +1.7%.

On October 5, 2005, having considered ProSelect's request, the Connecticut Insurance Department (hereinafter "the Department") responded to the filing as follows:

1. The proposed 12% base rate increase was disapproved, based on the department's finding that the proposed base rates were excessive. The Department specifically noted a departure by ProSelect from the methodology used to calculate previous rate changes filed with the Department. Specifically, ProSelect changed the credibility criteria used with a consequent decrease in the weight assigned to ProSelect's data. Additionally, the complement of credibility was assigned to the Connecticut experience of Connecticut Medical Insurance Company. The Department reached a determination that ProSelect rates should have been based mostly, if not solely, on the ProSelect loss experience.
2. The revised Increased Limits factors were approved, noting that the proposed factors were in line with comparable industry factors.

On November 3, 2005, pursuant to section 38a-19(a) of the Connecticut General Statutes and section 38a-8-33 of the Regulations of Connecticut State Agencies, ProSelect requested a hearing on the October 5, 2005 decision of the Department disapproving the 12% base rate increase. On

November 9, 2005, Commissioner Susan F. Cogswell appointed the undersigned to act as Hearing Officer in this matter and, on November 14, 2005, issued a Notice Of Public Hearing, to be held on November 29, 2005 at 10:00 am. On November 16, 2005, counsel for ProSelect and the Department submitted a Stipulated Notice Of Continuance for the November 29, 2005 hearing. On November 21, 2005, in accordance with Sections 38a-8-48 and 38a-8-49 of the Regulations of Connecticut State Agencies, the Connecticut Trial Lawyers Association (hereinafter "CTLA") filed a petition to be granted party status at the November 29, 2005 hearing. On November 23, 2005, CTLA amended its petition to include a request for intervenor status.

On November 22, 2005, a pre-hearing conference was held, at which time ProSelect and the Connecticut Insurance Department identified exhibits that would be stipulated to and presented at the November 29, 2005 hearing. During that conference the discussion turned to the petition filed by CTLA to be granted party status. At that point, the Hearing Officer called CTLA to include them in discussion with ProSelect and the Department. The Hearing Officer proposed steps and a time frame for resolution of the petition for party standing. Later that day, a Scheduling Order was issued specifying the required timetable for responses and decision.

On November 22, 2005, ProSelect submitted an objection to CTLA's request for party status. On November 23, 2005, CTLA filed a memorandum in response to the objection and requested, in the alternative, to be considered for intervenor status in the event that the Hearing Officer determined that party status was not warranted. In its memorandum, CTLA stated that "CTLA's participation in the proceedings would be limited to exploring ProSelect's arguments for a rate increase from the perspective of an organization with a direct and specific interest in insuring the physicians are charged reasonable premiums, not premiums which are designed to cause pain in order to further a political agenda."

On November 23, 2005, the Hearing Officer held a conference call with all participants to clarify that the petition filed by CTLA only included a request for party status and that, unless an amended petition requesting otherwise was submitted, the Department would not consider whether CTLA was entitled to intervenor status. Subsequently, CTLA submitted an amended petition requesting to be also considered for intervenor status. ProSelect submitted an objection to the amended petition. On November 25, 2005, the Hearing Officer issued a decision granting intervenor status to CTLA, subject to conditions identified in the decision.

The public hearing was held on Tuesday, November 29, 2005 at 10 am. ProSelect was represented by Dennis F. Kerrigan, Jr., Esq., and Michael Manapace, Esq. The Department was represented by Michael S. Malesta, Esq., and Beth Cook, Esq. CTLA was represented by Angelo Ziotas, Esq.

II. FINDINGS OF FACT

After reviewing the transcript of the hearing, exhibits and administrative notices entered into the record, utilizing professional experience, technical competence and specialized knowledge, the undersigned makes the following findings of fact:

1. According to accepted professional actuarial practices set out in the Casualty Actuarial Society Statement of Principles Regarding Property and Casualty Insurance Ratemaking (hereinafter "Statement of Principles"), a rate is an estimate of the expected value of future costs and, as such, should account for all costs associated with the transfer of risk. (Transcript page 65) The Statement of Principles provides considerations that commonly apply to ratemaking methodology. The Statement of Principles concludes that, while the application of recognized ratemaking principles will derive an estimate of future costs associated with the transfer of risk, other business considerations are also an important part of the ratemaking process and should be considered.
2. The documentation in the Actuarial Memorandum filed by ProSelect includes a narrative description of the methodology and 15 exhibits with detailed calculations and selections. (Petitioner Exhibit 1) ProSelect used a loss ratio approach in determining the rate level need. Premiums and losses were developed as of March 31, 2005, with losses limited to \$1,000,000 and premiums limited to a \$1,000,000 policy limit. The resulting loss ratios for nine accident years were evaluated and a selected loss ratio was compared to a permissible loss ratio to determine the rate level need.¹
3. ProSelect's premiums were developed to current level using the extension of exposures method. Historical records were re-rated based on current rates and rating factors. This on-level premium was then earned through March 31, 2005. The 2005 earned premium was annualized.
4. ProSelect projected ultimate Loss and Allocated Loss Adjustment Expenses (ALAE) were developed on an incurred basis and a paid basis. Incurred losses and paid losses were limited to \$1,000,000. ALAE was unlimited. Loss development factors to ultimate were based on historical experience evaluated as of December 31, 2004. The selected factors were interpolated to account for the three month difference in the valuation date of premiums and losses.
5. ProSelect's ultimate Loss and ALAE projections were trended to an average date of 12/1/2006 using a selected trend rate of 5%. The selected rate was comprised of a 5% severity trend rate and a 0% frequency trend rate. The severity trend rate was based on exponential fits of both Connecticut and Countrywide average paid loss data from the National Practitioner Databank (NPDB) as of 12/31/2004. The frequency trend rate was based on frequency data from Connecticut Mutual Insurance Company's Physicians and Surgeons 2004 rate filing and ProSelect's Physicians and Surgeons frequency rates.
6. ProSelect developed and trended losses were compared to the corresponding on-level earned premiums for nine accident years to produce a loss ratio for each accident year. Based on evaluation of the historical loss ratios, a selection was made for the incurred method (69.5%) and for the paid method (137.5%).

¹ Note that findings 2 through 11 and findings 15 through 18 relate to the rate filing in question (Petitioner Exhibit 1) and address relevant aspects of the methodology and selections in that filing.

7. An Unallocated Loss Adjustment Expense (ULAE) factor of 1.06 was applied to the selected loss ratio in each method. This factor incorporated internal claim handling expenses and was based on historical ProSelect loss, ALAE and ULAE data, as of December 31, 2004.
8. A Permissible Loss and ALAE Ratio of 86.1% reflects ProSelect's anticipated underwriting expenses, including commission, tax and other general expense (excluding ULAE), and a load for profit and contingencies. The selected profit load reflects an expected rate of return of 8.1%, based on payment patterns, cash flows and underwriting expenses, and assume a risk-free discount rate of 4.5%. (Exhibits 4 and 8; articles by Feldblum & Thandi and by Kozik)
9. The permissible loss ratio was then discounted for anticipated future investment income to be earned on the Loss and ALAE components of the rate prior to payment of losses and claim expenses. The present value factors used the Loss and ALAE payment patterns that underlie the filing and a discount rate of 4.5%. The discount rate is based on anticipated US Treasury yields.
10. An indicated rate change was calculated on both an incurred and paid basis. The selected loss ratio, loaded for ULAE, was compared to the discounted permissible loss ratio. The initial indicated rate changes were -14.4% on an incurred basis and +69.3% on a paid basis.
11. Each resulting initial indication was then adjusted for credibility. ProSelect used a full credibility standard of 1,082 claims. Mr. Ghezzi testified that ProSelect conducted a thorough review of credibility standards following the 2004 filing in order to develop a methodology appropriate for the current filing. (Transcript, page 59). Mr. Ghezzi referred to page 200 of the Longley-Cook article (Petitioner Exhibit 8) for the table in which the 1,082 standard appears. (Transcript, page 176)
12. The credibility complement was based on a comparison of Connecticut Medical Insurance Company's (hereinafter "CMIC") pure premium from its October 1, 2005 Connecticut Physicians and Surgeons rate filing and the pure premium underlying ProSelect's current Physicians and Surgeons rates. In correspondence with the Department Mr. Langlois wrote that the selection of CMIC for the complement of credibility was based on guidance in the Boor paper regarding the applicability of competitor rates as an appropriate complement (Petitioner Exhibits 5 and 8). Mr. Langlois testified that ProSelect had a 23.5% share of the medical malpractice market in Connecticut, compared to a 23.1% share for CMIC. (Petitioner Exhibit 6, page 8)
13. The list of ProSelect's current in-force business as of September 30, 2005 included approximately 2,859 physicians and surgeons. (Petitioner Exhibit 6, page 7)
14. Mr. Langlois testified that the full credibility standard used in the 2004 ProSelect rate filing was 10,000 base class equivalent exposures. (Transcript, page 30) In correspondence with the Department, Mr. Langlois wrote that the 10,000 base class equivalent exposures standard was roughly equivalent to the 683 full credibility standard taken from page 200 of the Longley-

Cook paper. (Petitioner Exhibits 5 and 8) The higher claim standard in the Longley-Cook table was selected to recognize variation of paid claim severity (Petitioner Exhibits 5 and 8; the Hewitt article)

15. After adjusting for credibility, the adjusted indication is -0.5% on an incurred basis and $+32.6\%$ on a paid basis.
16. A final adjustment to each indication is made by off-balancing for the anticipated premium discount level. This adjustment reflects credits, experience rating, schedule rating and other adjustments to premium in-force as of March 31, 2005. The estimated off-balance anticipates a -8.9% premium modification.
17. After all adjustments, the final indicated rate change is $+9.3\%$ on an incurred basis and $+45.6\%$ on a paid basis.
18. The ProSelect filing requests a $+12.0\%$ change in base rates.
19. Mr. Ghezzi testified that his peer review of ProSelect's analysis covered eleven specific areas, such as loss development factor selections, discount factor calculation, claim frequency and severity trends, credibility, profit loads, analysis of historical loss ratios, and calculation of the indicated incurred and paid rate level changes. (Petitioner Exhibit 7, page 5) Mr. Ghezzi concluded that each rating component separately, and the overall rate level indication, is reasonable. (Petitioner Exhibit 7, page 6)
20. Mr. Hanson, Sr. Vice President for Underwriting for ProMutual Group, testified that the 12% increase is needed, "so that we can go forward with the company on sound financial footing." (Petitioner Exhibit 9, page 1) Mr. Hanson added that, "ProSelect has experienced inadequate earnings and insufficient cash flows in general, and in Connecticut in particular" and that ProMutual Group's surplus as of June 30, 2005 was \$15 million below the surplus position of December 31, 2000, while the population of physicians insured by ProSelect has increased from 10,606 to 15,907 during that same time.
21. Mr. Hanson testified that, "we need the requested increase so that surplus levels can keep pace with the demand for ProSelect's products." (Petitioner Exhibit 9, page 2)
22. Mr. Henry testified that he made the decision to disapprove the ProSelect filing for a 12% base rate increase, having found that the proposed base rates were excessive. (Petitioner Exhibit 2) Mr. Henry cited two major reasons in his decision: (a) the fact that ProSelect departed from the previous credibility standard by reducing significantly the weight given to ProSelect experience; and (b) the consideration given to the paid loss indication. (Transcript Page 75) Mr. Henry offered alternate calculations (Petitioner Exhibit 2; Department Exhibit 3) based on the methodology used by ProSelect in its 2004 filing (Department Exhibit 2) and information provided by Mr. Langlois regarding ProSelect credibility evaluation in the application of a 683 claim full credibility standard (Transcript, page 83; Petitioner Exhibit 5). Mr. Henry testified that ratemaking methods should be fairly consistent from year to year in

the absence of major change in the company's book of business and operations, adding that ProSelect data can be treated as fully credible for ratemaking purposes based on the stability of the incurred loss ratios. (Transcript, pages 78 and 80; Petitioner Exhibit 1) Under cross examination, Mr. Henry acknowledged ProSelect's growth over the experience period, but restated that stability in loss ratios led him to regard the data as fully credible. (Transcript, page 93) Mr. Henry added that one of the scholarly papers in evidence (Petitioner Exhibit 8, Longley-Cook) stated that a credibility standard is important when it gives consistency to the ratemaking process. (Transcript Page 92)

23. Mr. Henry testified that "the main thing [he] looked at was the stability of the loss ratios from year to year" and that Longley-Cook states that another way to determine credibility is to look at year-to-year variation in loss ratios. "The less variation there is, the more credibility – the more credible the data is." (Transcript Page 98)
24. Ms Ackerman, a consultant engaged by the Department, prepared a report that indicated that her evaluation of the ProSelect filing included many of the same items that Mr. Ghezzi evaluated in his peer review. (Department Exhibit 1; Petitioner Exhibit 7, page 5) Ms Ackerman found many of the ratemaking consideration selections in the ProSelect filing to be reasonable and noted reasonable alternative selections that could produce a higher or lower indication. Ms Ackerman stated that it was appropriate to place little or no reliance on the 2004 and 2005 years due to immaturity and high leverage. Ms Ackerman placed no reliance on the paid method for the rate indication, noting the high leverage of the method and lower stability in the developed loss ratios when compared to the incurred method. (Department Exhibit 1, page 2)
25. With respect to credibility, Ms Ackerman testified that there is no common standard for credibility in medical malpractice ratemaking and noted differences in methodology between the 2004 and 2005 filings. (Transcript, page 111; Department Exhibit 2; Petitioner Exhibit 1) Ms Ackerman added that the credibility standard used in the 2004 filing should be used in the 2005 filing because it provided balance between stability and responsiveness and produces consistent results. (Transcript Page 112)
26. Ms Ackerman's report concluded that ProSelect's selections for Unallocated Loss Adjustment Expense Load, Expense (including commissions, other acquisition, general, and taxes, licenses & fees), Expected Rate of Return and Trend were reasonable. With specific reference to rates of return, Ms Ackerman added that "target rates of return for insurers typically range from 10% to 15%, whereas actual returns, according to the 2003 NAIC profitability report, have averaged 7.0% over the last ten years." (Department Exhibit 1, page 4)
27. Based on her review and evaluation of the ratemaking components, Ms Ackerman provided an alternate calculation of a rate indication equal to -0.9% (Department Exhibit 1, exhibits 1 & 2) by changing selections for:
 - Death, Disability and Retirement load (a higher load of 1.03, increasing the final indication);

- Permissible Loss Ratio (a lower discount rate of 4.0%, increasing the indication); and
- Credibility (full credibility to ProSelect data, decreasing the indication).

A second alternate rate calculation by Ms Ackerman was based on reproducing the methodology used in calculating the 2004 ProSelect filing. (Department Exhibits 2 and 3) This alternate calculation produced an indication of -7.9%. Ms Ackerman concluded that the requested rate change was not justified.

28. Mr. Purple, Chief Actuary for the Department, acknowledged in testimony that, following the 2004 ProSelect filing, he sent a letter to CTLA with information regarding the approved filing. (Transcript, page 149; Petitioner Exhibit 10) The letter indicated that, following review of the filing and discussions between the Department and ProSelect, a mutual agreement was reached on modification of the filing. The modification changed the credibility applied to ProSelect's experience in Connecticut from partial to full credibility.
29. Mr. Schwartz, the witness for CTLA, performed a review of the ProSelect filing and concluded that the proposed 12% increase will lead to excessive rates. (Petitioner Exhibit 1; Intervenor Exhibit 2, page 4; Transcript, page 157) He provided four reasons for this conclusion: (a) the database of the rate level calculation; (b) the experience period for the rate level calculation; (c) the loss trend factor selection; and (d) the complement of credibility and credibility weight.
30. With respect to the database, Mr. Schwartz testified that the paid loss database was too variable to be used for a rate level calculation, citing the leverage impact of high loss development factors. (Intervenor Exhibit 1, page 5) Mr. Schwartz stated in his testimony that giving weight to the paid loss development method in the filing is "actuarially inappropriate". (Intervenor Exhibit 1, page 7) This conflicts with an earlier statement that a basic statistical procedure evaluating the variance of estimates would assign 1.9% weight to the paid loss projection factors. (Intervenor Exhibit 1, page 6)
31. With respect to the experience period, Mr. Schwartz testified that the 2004 and 2005 experience years should be included in deriving the indication, adding that "by ignoring the recent favorable experience, ProSelect is hoping to be able to justify a higher, but unwarranted, rate increase". (Intervenor Exhibit 1, page 7)
32. With respect to loss trend, Mr. Schwartz testified that the trend factor used in the filing was excessive. He provided a table and graphs to illustrate severity trend considerations that support a conclusion that trend is flat or even going down in Connecticut. (Intervenor Exhibit 1, page 10; I-103; I-104 & I-105) Mr. Schwartz added in his summary that the trend used by ProSelect is, "clearly excessive and based upon improper procedures". (Intervenor Exhibit 1, page 12)
33. With respect to credibility, Mr. Schwartz testified that it is appropriate to give 100% weight to ProSelect's experience due to the stability of experience. (Intervenor Exhibit 1, page 13) Mr. Schwartz added that CMIC's credibility complement used by ProSelect was not appropriate

because ProSelect has not shown that it uses the same underwriting and claim adjustment practices as CMIC. (Intervenor Exhibit 1, page 15)

34. Mr. Schwartz made alternate selections for the four ratemaking considerations above and derived an alternate indication of -17.2% to support his conclusion that the proposed 12% increase will lead to excessive rates. (Intervenor Exhibit 1, page 15)
35. Mr. Schwartz commented on a fifth ratemaking consideration, the Underwriting and Profit Contingency Factor, concluding that higher values should be used for both the cost of capital and the investment rate of return. The higher values would lead in turn to a lower rate level indication experience. In his analysis, however, Mr. Schwartz did not change the value used in the ProSelect filing, stating that it was in a range of reasonable values. (Intervenor Exhibit 1; I-102, pages 5-6)

III. DISCUSSION

Connecticut General Statutes Section 38a-665, the pertinent statutory provision that sets standards for the use and making of rates for commercial risk insurance policies, provides in relevant part that:

The following standards, methods and criteria shall apply to the making and use of rates pertaining to commercial risk insurance: (a) Rates shall not be excessive or inadequate, as herein defined, nor shall they be unfairly discriminatory. No rate shall be held to be excessive unless (1) such rate is unreasonably high for the insurance provided or (2) a reasonable degree of competition does not exist in the area with respect to the classification to which such rate is applicable. No rate shall be held inadequate unless (A) it is unreasonably low for the insurance provided, and (B) continued use of it would endanger solvency of the insurer, or unless (C) such rate is unreasonably low for the insurance provided and the use of such rate by the insurer using same has, or, if continued, will have the effect of destroying competition or creating a monopoly.

The Hearing Officer was asked to take administrative notice of the Statement of Principles. Notice was taken without objection from ProSelect, the Department or CTLA. ProSelect, the Department and CTLA provided witnesses who are credentialed members of the Casualty Actuarial Society and the American Academy of Actuaries. Members in these organizations are bound to follow standard and accepted actuarial practice by a professional code of conduct. The Statement of Principles reflects accepted actuarial practice in ratemaking. The first principle in the Statement of Principles, that a rate is an estimate of the expected value of future costs, inherently allows for a range of estimates that can be considered reasonable.

Many estimates/indications have been presented into evidence. (Petitioner #1; Exhibit 1, sheets 1 & 2; Intervenor, pages 8, 9; Exhibit I-102; Department 2, Exhibits 1, 3; Department 3) The Statement of Principles identifies 18 considerations that commonly apply as a foundation for actuarial procedures. A rate indication is the product of applying selected values in the application of the considerations. The variations in estimates presented into evidence are the

result of alternate selected values of ratemaking components. Because a range of reasonable alternate selections is possible for each of the ratemaking considerations, the possible outcome results in a range of possible rate indications. The process of following professional practice does not, and cannot, identify the “correct” rate. Whether an estimate is accurate in measuring the costs of the coverage provided will not be known until all claims are settled and all costs are paid. However, a decision on a specific rate to be charged must be made before these costs are known.

The purpose of the present hearing is not to determine which of the many indications represents the correct estimate. Rather, it is to decide the validity of the Department’s determination that a 12.0% base rate increase is excessive.

Several significant ratemaking components in the ProSelect filing are not subject to dispute in the evidence presented or in the testimony. Among these are:

- the development of on-level earned premiums through the extension of exposures method;
- the off-balance adjustment to the rate level indication; and
- the loss development factor selections and factors to ultimate.

There is also general acceptance of the loss ratio approach in developing a rate level indication. The disputed issues involve the selection of specific ratemaking component inputs. Those disputed issues will be addressed in order.

The Paid Loss Ratio Method and the Resulting Indication

Mr. Henry, Ms Ackerman and Mr. Schwartz testified as to the immaturity of the paid loss data and the volatility of the paid loss ratios. They stated their opinions that the paid method should, therefore, receive no weight. Mr. Schwartz, however, provided statistical support for a non-zero weight to be given to the paid indication. While it is true that the filing does not provide an explicit description of the steps followed in arriving at the requested 12.0% requested rate change, elementary mathematical calculations show that the incurred indication receives a weight of 92.5% and the paid indication receives a much lower weight of 7.5%. If one were to consider ProSelect’s experience as fully credible, then it would be reasonable to consider all aspects of ProSelect’s experience, even the experience that shows a certain amount of volatility. Volatility is, after all, a characteristic of the coverage provided.

Based on the above, incorporating a non-zero weight to the paid method indication is reasonable.

Consideration of accident years 2004 and 2005

All data for the 2005 year is annualized, based on a March 31, 2005 valuation date. As of such date, however, projections relating to the whole year are primarily estimates relying on a mechanical exercise based on extremely limited information. The 2004 year, while complete as of the valuation date, remains immature because no loss payments have been made by ProSelect as of the March 31, 2005 valuation date. The 2004 year should be excluded, therefore, from

consideration in the paid method. On an incurred basis, the 2004 year is less than 50% developed. It is, therefore, a reasonable actuarial judgement to exclude the 2004 year from consideration in the incurred method.

Based on the above, it is reasonable to exclude the 2004 and 2005 years from consideration on both the paid and incurred methods.

Loss Trend Factor Selection

CTLA argues that the trend selection is excessive. I do not think that the argument supports the conclusion for two reasons: 1) each of the trend rates calculated uses the latest year as the sole base for comparison (Intervenor Exhibit 1, page 11) and 2) an evaluation of trend should not hinge so heavily on a single point, such as the last point or the first point in a series, but should include consideration of all points in the data set. Standard linear or curve fit analysis is not provided. A visual evaluation of Intervenor Exhibit 1, I-103, I-104 and I-105 suggests that linear or curve fits would produce positive trend, even for CMIC severity.

The table on page 11 of Intervenor Exhibit 1 also contains a clear error. The table shows the 1998 CMIC average claim severity equal to \$157,887 and the 2003 CMIC average claim severity equal to \$171,559. The 2003 average claim severity is clearly higher than the 1998 value. Yet the calculation of the severity trend rate for the 1998-2003 period shows a declining rate of -0.4%. Correction of the error would clearly produce an increasing rate, which weakens CTLA's argument that the selected trend rate should be lower.

Based on the above, ProSelect's trend factor selections are reasonable.

The Complement of Credibility

CTLA's argument that CMIC is not an appropriate credibility complement is not persuasive in that it places an unreasonably high burden on ProSelect without providing evidence that the practices of CMIC are materially different. ProSelect argues that the complement selected is based on common limits of the same coverage, in the same state, of an appropriate competitor. In my opinion, however, the application of the complement is only relevant to the extent that weight is given to it, which depends on the credibility standard discussed next.

The Credibility Standard

The application of the ProSelect credibility standard has a significant impact on the rate level indication. The witnesses for ProSelect testified that after the 2004 Connecticut filing ProSelect undertook an extensive review of credibility procedures and that, as it applies to ratemaking, the 1,082 claim standard is a "higher standard" than the 683 claim standard. While 1,082 claims is certainly a higher amount than 683 claims, the table on page 200 of the Longley-Cook article²

² From Longley-Cook, page 200 (Petitioner Exhibit 8): The model can be used to establish the number of claims required to reduce to negligible proportions the probable departure from the

indicates that the two are alternate standards. The 1,082 standard reflects a 90% probability of being within 5% of the expected number of claims. The 683 standard reflects a 95% probability of being within 7½% of the expected number of claims. In other words, the 1,082 standard reflects a *lower* probability of being within a *smaller departure* from the expected number of claims. A decision about which standard is actuarially superior is a matter of judgement. ProSelect’s judgement includes consideration of variation in paid claim severity. Quantification of that consideration is not apparent in the evidence presented. Regardless of the merits of ProSelect’s judgement, the impact of the change has the effect of producing a significantly higher rate level indication.

When one considers that the Longley-Cook also notes that, “the standard of full credibility is not normally important in itself, but is important as a means of introducing consistency in the ratemaking procedure...”, it is reasonable to conclude that Longley-Cook advocates consideration of more than just claim counts when incorporating credibility into the ratemaking process. (Petitioner Exhibit 8, page 200) Longley-Cook adds “while it is essential that premium rates correctly follow overall trends, year to year fluctuations in rates can prove most unfortunate...(and) cast doubt in the mind of the public and of regulatory authorities on the correctness of the rate making procedure.” (Petitioner Exhibit 8, page 205)

The Department argues two points supported by the article by Longley-Cook article:

- that the stability in the incurred loss ratios is evidence of high credibility; and
- that the credibility standard is important when it gives consistency to the ratemaking process.

ProSelect has not demonstrated that the alternative credibility standard of 1,082 claims is superior to the prior standard of 683 or that the departure from the prior standard introduces consistency in the ratemaking procedure. On the contrary, the departure from the prior standard introduces a significant inconsistency and increases the estimate of rate need.

The need for the filed 12% increase

number observed which could be attributed to chance variation. The table displays the number of claims necessary to meet some typical values of P (the probability that the number of accidents will be within + / - 100k% of the expected number of accidents) and k as follows:

Maximum Departure from expected (k)	Probability of meeting test (P)		
	99%	95%	90%
2½ %	10,623	6,147	4,326
5 %	2,656	1,537	1,082
7½ %	1,180	683	481
10 %	664	384	271

ProSelect's argument that the filed increase is needed so that its surplus can keep pace with the demand for ProSelect's products is also not persuasive. Mr. Hanson presented surplus decline and exposure growth figures on a ProMutual Group basis. This comparative information is inappropriate and does not contribute to a conclusion on this filing, which is specific to Connecticut rate levels for ProSelect, a subsidiary of ProMutual. Moreover, given the information provided by Mr. Hanson that ProSelect writes in the six New England states and New Jersey, general company-wide surplus data information does not necessarily reflect the company's Connecticut experience. Further, Mr. Langlois' testimony indicates that the number of Connecticut physicians and surgeons accounts for only about 20% of the ProMutual Group's population identified in Mr. Hanson's testimony. Based on the evidence provided, it is not reasonable to attribute the ProMutual Group exposure growth and surplus decline to ProSelect's Connecticut experience alone. While the premium increase identified in the filing (Petitioner Exhibit 1, exhibit 1 sheet 1) is evidence of growth, Connecticut is not the sole source of the exposure growth cited by Mr. Hanson. In addition, ProSelect has not provided any evidence to support the argument that Connecticut experience has any effect on the inadequate earnings and insufficient cash flows that ProSelect may be experiencing.

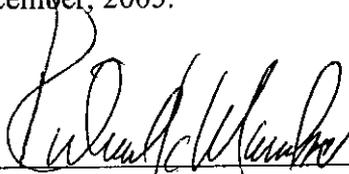
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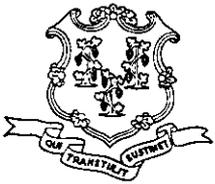
Removing the effect of the change in the credibility standard and giving full credibility to ProSelect's data, I find that the proposed +12.0% base rate increase is not supported and is not reasonable. The Department was justified in concluding that the proposed base rates are excessive.

IV. CONCLUSION

On the basis of the foregoing Facts and Discussion, it is recommended that the decision of the Department to disapprove ProSelect's request for a 12% base rate increase be upheld.

Dated at Hartford, Connecticut, the 16th of December, 2005.


Richard J. Marcks
Hearing Officer



STATE OF CONNECTICUT
INSURANCE DEPARTMENT

CERTIFICATION OF SERVICE

I hereby certify that a copy of the foregoing Order and the Memorandum of Findings and Recommendation was sent by email and by First Class Mail, postage prepaid, to all the Parties of record and to the Intervenor as follows:

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A handwritten signature in black ink, appearing to read "Richard J. Marcks", written over a horizontal line.

Richard J. Marcks
Hearing Officer
Connecticut Insurance Department
(860) 297-3815

Dated at Hartford, Connecticut, this 22st day of December, 2005