In The Matter Of:

Commonwealth of Massachusetts
Division of Insurance, MPIUA Rate Filings

FAIR Plan Hearing
February 27, 2012
Docket No. R2011-02

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Attorney's Notes

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COMMONWEALTH OF MASSACHUSETTS
OFFICE OF CONSUMER AFFAIRS AND BUSINESS REGULATION
DIVISION OF INSURANCE
DOCKET NO. R2011-02

HEARING RE:

Application of the Massachusetts Property Insurance Underwriting Association for Approval of Rate Filings Including Rate, Rule and Form Revisions for Homeowners Multi-Peril Insurance, and Rate and Rule Revisions for Dwelling Fire and Extended Coverage and Commercial Fire and Allied Lines Insurance, Each Filing to be Effective on and after December 31, 2011, held at the Division of Insurance, 1000 Washington Street, Boston, Massachusetts, on Monday, February 27, 2012, commencing at 10:00 a.m.

BEFORE: Jean F. Farrington, Presiding Officer
Stephen M. Sumner, Presiding Officer

APPEARANCES:

Meyer, Connolly, Simons and Keuthen LLP
(by Michael B. Meyer, Esq.)
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-and-
Tommasino & Tommasino
(by Robert C. Tommasino, Esq.)
Two Center Plaza, Boston, MA 02108,
for the Massachusetts Property Insurance Underwriting Association.

State Rating Bureau (by Thomas F. McCall, Jr., Esq., and Mary Lou Moran, Esq.)
1000 Washington Street, Boston, MA 02118.

(Continued on Page 2)

APPEARANCES (Continued):

Office of the Attorney General
(by Peter Leight, Esq.)
1350 Main Street, Springfield, MA
01103-1629 -and-
(by Alex Klibaner, Esq.,
and Monica Brookman, Esq.)
One Ashburton Place, Boston, MA 02108.

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Carol H. Kusinitz
Registered Professional Reporter

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E X H I B I T S

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P R O C E E D I N G S

PRESIDING OFFICER FARRINGTON: Good morning. This is the Division of Insurance Docket No. R2011-02, a hearing on proposed rates filed by the Massachusetts Property Insurance Underwriting Association, more commonly known as the FAIR Plan. Today is February 27, 2012, the date scheduled for cross-examination of the first witness for the FAIR Plan.

Before we begin, are there any issues that any party wishes to bring to our attention?

MR. MEYER: No.

MR. LEIGHT: No.

MR. McCALL: No.

PRESIDING OFFICER FARRINGTON: It is our custom to mark the Hearing Notice as the first exhibit in these cases. The first notice was issued on November 16th of 2011, and a revision rescheduling the public comment hearing was issued on November 30th. So, unless there is any objection, I will mark them as Exhibits 1A and 1B.

(Documents marked as Exhibits 1A and 1B in evidence)

PRESIDING OFFICER FARRINGTON: Mr. Meyer.

MR. MEYER: May the witness be sworn.
JAMES C. WACKERMAN, Sworn
DIRECT EXAMINATION
BY MR. MEYER:
Q. Please state your name for the record, sir.
A. James Craig Wackerman.
Q. And your office address, sir?
A. Merritt 7 Corporate Park, Norwalk, Connecticut.
Q. And your current job title, sir?
A. Managing Director of Guy Carpenter.
Q. And I show you a document that starts on Bates stamped Page 1193 of the FAIR Plan's filing and goes through Bates stamped Page 1464 and ask if that is a copy of your testimony in this case.
A. Yes, it is.
Q. And are the matters recited in your testimony, which goes from 1193 through 1204, true and accurate to the best of your knowledge and belief?
A. Yes, they are.
Q. And were the exhibits attached to your testimony assembled by you or by someone working under your supervision and control to document some

of the things stated in your testimony?
A. Yes, they were.
MR. MEYER: May the FAIR Plan filing, which is actually two volumes, be marked as the next exhibit, Exhibit 2, please.
PRESIDING OFFICER FARRINGTON: Any objections?
MR. LEIGHT: No objection.
PRESIDING OFFICER FARRINGTON: Yes, it will be so marked.
(Document marked as Exhibit 2 in evidence)
MR. MEYER: And one other procedural matter. We filed, on November 15th, one corrected page, a page that had been mis-xeroxed, and that should probably be marked as the next exhibit, Exhibit 3, if there is no objection. There's a cover letter dated November 15th and then one corrected page. We ask that that be marked as Exhibit 3, please.
(Document marked as Exhibit 3 in evidence)
PRESIDING OFFICER FARRINGTON: You had a second set of replacement pages as well?

MR. MEYER: I did. They relate to Dr. Derrig's testimony, and I can either mark them now, or I can do it when Dr. Derrig is on the stand, whichever you may prefer.
PRESIDING OFFICER FARRINGTON: I think it might be simpler just to have all the substitutions marked now, and then he can testify tomorrow.
MR. MEYER: I request some replacement pages for Dr. Derrig's testimony, which I filed with the Docket Clerk and the parties on November 28, 2001, be marked as the next exhibit, Exhibit 4, please.
PRESIDING OFFICER FARRINGTON: Any objections?
MR. McCALL: No objection.
MR. LEIGHT: No objection.
PRESIDING OFFICER FARRINGTON: Thank you.
(Document marked as Exhibit 4 in evidence)
MR. MEYER: That completes my direct examination of Mr. Wackerman, and he's available for cross-examination.

CROSS EXAMINATION
BY MR. McCALL:
Q. Good morning, Mr. Wackerman. My name is Tom McCall. I'm one of the attorneys for the State Rating Bureau.
A. Good morning, Tom.
Q. Could you please turn to Page 1194 of your filing. On this page you state that there were over 80 companies and syndicates that were prospective participants in the MPIUA's reinsurance program; is that correct?
A. Correct.
Q. And out of those 80 companies and syndicates, 13 were selected to negotiate quotations for the MPIUA's reinsurance program; is that correct?
A. Correct.
Q. What criteria did Guy Carpenter use to choose the 13 companies that were ultimately selected to negotiate the quotes?
A. Typically they're the reinsurers that are actually our lead reinsurers; i.e., they are the ones that will set the price for reinsurance. And out of those that set the price for reinsurance, we

try to choose the ones that will provide the most competitive quotes for the pricing of the program. And so those are the main criteria.

The other criteria would be the financial considerations that are made by the MPIUA as far as Best ratings or size of surplus or size of capacity that they could commit to the program.

Q. So the 80 companies and syndicates were reviewed by the MPIUA prior to selection of the 13?

A. In concert with Guy Carpenter, yes.

Q. Which would be you, correct?

A. Yes.

Q. You also indicate in the filing, on the same page, actually, that the MPIUA reinsurance program was a traditional reinsurance program. Could you explain what you mean by a traditional reinsurance program.

A. Well, for the traditional piece, we're using that to distinguish the component that is placed similarly to the rest of the reinsurance entities that are buying reinsurance in the marketplace from, let's say, a catastrophe bond, which not everyone purchases. So we were trying to come up with terminology that will simply

distinguish the traditional placement versus the component, let's say the cat bond or peril swap.

Q. Which would be considered not traditional?

A. Not necessarily non-traditional, but we would distinguish them -- we just use that as the verbiage to distinguish them.

Q. And is this the same type of program that was placed for the MPIUA that would be purchased by Guy Carpenter's voluntary market clients? And by "voluntary market clients," I mean non-FAIR Plan or non-residual market entities.

A. The traditional component?

Q. Yes.

A. Yes.

Q. Could you please turn to Page 1203 of your filing, and over on Page 1203 you indicate that Guy Carpenter has over 1500 clients that it assists as a reinsurance intermediary; is that correct?

A. That's correct.

Q. And of these 1500 clients, does Guy Carpenter assist any other FAIR Plans or residual market type carriers with the purchase of their reinsurance plans?

A. We do.

Q. And could you identify who those clients are, and could you give me a summary or comparison between their reinsurance programs and the MPIUA program that you placed.

A. I could list them. We work with TWIA, Texas Windstorm Insurance Association. We work with North Carolina. When I say "we," meaning Guy Carpenter, not me personally. Rhode Island. Alabama, I believe.

Q. Are these all FAIR Plans?

A. Some of them are windstorm associations. Some of them are FAIR Plans. They're essentially residual market mechanisms. We also work with the State of Florida and the State of California. That might not be an exhaustive list.

Q. And you assist them as a reinsurance intermediary?

A. Guy Carpenter does, not necessarily me personally.

Q. Could you summarize the business objectives that your non-FAIR Plan or residual market clients would try to achieve through the purchase of a reinsurance program.

A. The ones that are -- not the clients that I

work on?

Q. No. I would say, like, the voluntary market writers, which would be, like, a non-FAIR Plan or a non-residual market carrier. What would be the business objectives that those type of entities would want to achieve through the purchase of a reinsurance program?

A. Well, for the purpose of a property catastrophe reinsurance program, they would be seeking typically to protect themselves from extreme events, such as hurricanes, earthquakes or tornadoes.

Q. And protect in the sense of protecting their assets that are available to pay claims?

A. That could be one reason, yes.

Q. Do you have any other reasons that they -- any other objectives that they may have?

A. I mean, each company has their own unique objectives. So...

Q. So there are no common objectives that voluntary market carriers would have in purchasing a reinsurance program?

A. Again, I believe it would be to protect -- as I just stated, would be to protect against

extreme events.
Q. Is the MPIUA trying to achieve the same type of objectives through the purchase of its reinsurance program?
A. Yes.
Q. And does the MPIUA have any different objectives than other carriers out there, any voluntary market carriers, anything that's unique to them, versus --
A. No.
Q. So they have the same type of objectives as voluntary market carriers?
A. Yes.
Q. In assisting the MPIUA with its reinsurance program, do you account for the fact that the MPIUA is a residual market FAIR Plan?
A. Sorry. Can you repeat that, please.
Q. Sure. When you assist the MPIUA in setting up its reinsurance program, do you account for the fact that the MPIUA is a FAIR Plan and a residual market carrier, versus a non-residual market voluntary carrier?
A. I don't understand -- do we account for it? I mean, they are a residual market --

Q. Does it make a difference in the type of reinsurance program you set up for them?
A. No.
Q. Why is that?
A. We would treat them in the same manner that we would treat any other client. The process that we would go through to determine their reinsurance program or structure their reinsurance program would be the same process we would follow for any other client.
Q. The MPIUA is able to assess its members for losses; is that correct?
A. That's correct.
Q. And would you agree that its ability to assess member companies is a major difference between the MPIUA and other voluntary market carriers?
A. The ability to assess?
Q. Yes.
A. Yes.
Q. Is this ability to assess taken into consideration in determining a proper reinsurance program for the MPIUA?
A. Its ability to assess?

Q. Its member companies. Is that taken into consideration when you determine what type of reinsurance program the MPIUA should have?
A. Yes.
Q. And how is it taken into account?
A. Well, the company decides to purchase the limit and retention that it selects, and, again, we would follow that process of pricing and placing that program in the same manner that we would for any other program.
Q. But the fact that they can assess their member companies, does that have any impact on the type of program or the -- let's say, the attachment point or any of the limits that you would recommend?
A. No.
Q. And why is that?
A. Because it's still a net loss to the MPIUA as an organization.
Q. So the MPIUA can assess their members for excessive losses, correct?
A. That is correct.
Q. And individual companies can't do that type of thing; the losses they incur are the losses they incur, correct?

A. That's correct.
Q. Do you know whether the individual MPIUA member companies may insure themselves against the risk of being assessed by the MPIUA?
A. They typically do.
Q. And do you have any details as to what they do or what type of programs they set up?
A. It's typically included within their own reinsurance program.
Q. As a potential risk that they may have to cover?
A. Correct.
Q. Could you turn over to Page 1197 essentially through 2000 of the filing. Here you talk a little bit about the MPIUA's purchase of a catastrophe bond, as well as a peril swap layer as part of its reinsurance program?
A. Correct.
Q. Was this for Layer 3 of the program?
A. Yes.
Q. Could you explain what a catastrophe bond is and what a peril swap layer is.
A. Well, the catastrophe bond is essentially a mechanism utilized to develop additional capacity

for the MPIUA, given the placement objectives to complete the program. And so the mechanism of setting up the catastrophe bond essentially provides the MPIUA with nearly traditional reinsurance. There's just a different process that is undertaken to provide that capacity -- to create that capacity and provide that capacity. And so it sits side by side within that particular layer relative to the traditional program to round out the placement.

And the peril swap was a similar scenario, where we generated capacity, additional capacity from a certain reinsurer with a swap transaction in the background to allow them to write a larger line for the MPIUA, to provide additional capacity to the MPIUA.

Q. Who issues the catastrophe bond?

A. Essentially there's a special-purpose vehicle that's set up to provide the capacity to the MPIUA, and then there are investors that are set up with a bond transaction behind that that provides capacity to the MPIUA.

Q. Is this through the same 80 companies and syndicates that you discussed?

A. No, it's not. It's typically a very

different investor base.

Again, I must clarify that that portion of the transaction is actually handled by our Guy Carpenter Securities. So we do that in tandem with one another, but I'm not involved in that. Other than knowing what the structure is, I'm not involved in that actual placement with those investors. That's a different group of people within Guy Carpenter.

Q. And why did Guy Carpenter recommend the purchase of the catastrophe bond and the peril swap layer, rather than just using traditional reinsurance?

A. We felt, based upon the price points that we had investigated, that it was the cheapest way to get the most amount -- the desired amount of capacity that MPIUA required for 2011.

Q. That was less expensive than going with traditional reinsurance?

A. Correct. And remember, the cat bond was placed originally in 2010, and then it continues to roll.

Q. Each year?

A. Each year, correct.

Q. Is there a lack of capacity for traditional reinsurance at that layer?

A. It was not the layer that was most desired by the traditional reinsurance marketplace, and the capital markets had more of an appetite for that particular layer at that particular time. So it worked out to be much more efficient to place that portion of the program with the cat bond investors in 2010.

Q. Turn over to Page 1202 of the filing, please. The last sentence in the first paragraph there, you say that "Pricing neutral options such as Shore Re in 2010 and the Swap Transaction were accepted." Do you see that?

A. Yes.

Q. What do you mean by "pricing neutral options" in that sentence?

A. Okay. So what I meant by "pricing neutral options" there is that we obviously would not consider something that was more expensive.

Q. So neutral --

A. So if it was price neutral, implicit within that was, if it was price neutral or better, it would be considered; otherwise it would be rejected

by the Board and certainly by us. It wouldn't be something that we would recommend if we found that it was more expensive than to transfer risk by some other mechanism. So --

Q. So it would be neutral as to transitional reinsurance product; is that what you're saying?

A. The product that we would select, a risk transfer mechanism that we would select would have to be priced neutral or better; otherwise we would not suggest to the MPIUA that they consider such form of risk transfer.

Q. Neutral or better than traditional reinsurance?

A. Correct.

Q. And then at the bottom of that page, could you please read into the record the last section at the bottom of Page 1202, starting with "The MPIUA's program," and as well as the first two sentences on the top of the next page, 1203.

A. You just want me to read my answer?

Q. If you could read your testimony into the record, please.

A. "The MPIUA's program attaches at approximately the 1 in 26 year return period and

exhausts at the 1 in 113 year return period based on an average of the RMS and AIR long-term hurricane model. Insurance companies structuring reinsurance programs between these return periods based upon multiple models is common. It is also common to see programs fully placed or nearly fully placed within these return periods. MPIUA desired to place 100 percent of the traditional reinsurance program of $1 billion excess of $200 million retention at 7/1/11, less the co-participation mandated by Shore Re. In the end, the MPIUA procured $863 million of traditional reinsurance, $96 million from the catastrophe bond and $25 million from the Peril Swap. In short, MPIUA retains $15.8 million throughout all four layers of their reinsurance program.

"In addition to common practice, rating agencies such as AMBest strongly suggest that insurers protect themselves to this level of loss. While MPIUA may not be concerned with AMBest, their member companies do depend on AMBest rating."

Q. Thanks. That statement that you just read refers to voluntary market insurers, correct?

A. Which statement?

Q. Well, basically the statement about A.M. Best and their suggestion that insurers protect themselves to this level of loss. That's referring to voluntary market insurers, not FAIR Plans, correct?

A. That's correct.

Q. Does the reinsurance program purchased by the MPIUA generally cover the same type of losses that are covered by the primary homeowner's policies that are issued by the MPIUA?

A. Yes.

Q. Can you turn to Page 1218 of your filing. Are you there?

A. Yes.

Q. What is this document on Page 1218? Obviously we're in the middle of the document, but what is it?

A. It is, as we're referring to it, the traditional property catastrophe contract.

Q. It's the reinsurance contract between MPIUA and the insurers, correct?

A. Correct.

Q. It's the one that's in effect --

A. And the reinsurers.

Q. Reinsurers. I'm sorry. It's the one that's in effect right now, correct?

A. Yes.

Q. Now, on that Page 1218, on section C.1.a. through e., it lists various types of losses or perils that MPIUA policyholders could experience, correct?

A. Correct.

Q. And I'm going to just read of -- these include losses or perils caused by windstorm, hail, tornado, hurricane, cyclone, riot, riot attending a strike, civil commotions, vandalism, malicious mischief, earthquake, freeze, firestorms and brush fires; is that correct?

A. Correct.

Q. And all these types of losses are covered under the MPIUA's reinsurance contracts, correct?

A. Correct.

Q. Could you please turn to the previous page, 1217. And focusing on Section B, 1 through 8, this page lists various costs and expenses that are considered loss adjustment expenses; is that correct?

A. Correct.

Q. And could you just define or say, what is a loss adjustment expense?

A. It's defined right there. Essentially it means "costs and expenses incurred by the Company in connection with the investigation, appraisal, adjustment, settlement, litigation, defense or appeal of a specific claim or loss."

Q. And those could be the losses that we just talked about earlier, losses that derive from those perils?

A. Loss adjustment expenses derived from those types of losses, certainly.

Q. Exactly.

A. Yes.

Q. And these loss adjustment expenses are also recoverable under the reinsurance contracts --

A. Correct.

Q. -- purchased by MPIUA, right?

A. Correct.

Q. Now, in your opinion, is it prudent and reasonable for the MPIUA to purchase reinsurance that covers the MPIUA for the types of losses and loss adjustment expenses that are listed on 1217 and 1218 of the filing?

A. Yes.
Q. And, in your opinion, is the coverage that the MPIUA purchased for these types of losses and LAE a valuable component of the reinsurance contract?
A. Yes.
Q. Is it possible to price separately each of the elements of coverage, or is it all just kind of combined into one total price for the program? For example, could you set a price just for the brush fire peril or the earthquake peril and then relate an LAE to go with it, or do you just kind of combine it all together?
A. We typically combine it all together, but it's possible to price it separately. The issue is typically you wouldn't receive much of a discount for certain perils that certain reinsurers may not perceive to be significant exposures to the MPIUA.
So, for example, if you ask them to take out earthquake coverage, the MPIUA has, my recollection is, very limited earthquake exposure. If you ask them to remove that, the reinsurers would not perceive that to be a significant exposure. So they might price it differently for you, but the

price differential would be minimal.
Q. I guess my question was more, could it be priced separately, not versus the perception of the reinsurers?
A. It can be priced separately, yes.
Q. Was this done in the MPIUA's program, or was it all priced together as one?
A. It was priced together.
Q. Would you turn over to Page 1195. In the middle of the page there, about the middle of that first full paragraph there, you state that "The attachment point of $200,000,000 and the exhaustion point of $1,200,000,000 remained stable"; is that correct?
A. Correct.
Q. Now, prior to the -- the reinsurance purchase was made on July 1, 2011; is that right?
A. Yes.
Q. Now, prior to making that purchase, did the MPIUA management or Governing Committee or the other individuals that may have been responsible for purchasing the reinsurance program discuss the reasonability of the $1.2 billion exhaustion point?
A. I believe it was discussed in one of the --

I recall that it was discussed in one of -- in several of the meetings leading up to the renewal discussion. I can't recall which. But, yes, it was certainly discussed.
Q. And what were some of the specific factors that were considered by the people making the decision in selecting that exhaustion point of $1.2 billion?
A. Well, certainly it would be the number of policies that are insured by the FAIR Plan. Certainly it would be what the potential exposure to those policies are from perils such as hurricanes. They would certainly look at the values associated with those.
Q. Values of the property?
A. Correct. The locations, concentration of the risk, certainly the model results, things like that.
Q. And you provide advice to them or counseling as far as the decision they made, or is it something they decide on their own?
A. Well, again, the Board -- several members of the Executive Committee negotiate and place reinsurance themselves. So they are very familiar

with it. So there may be less discussion with it because of the actual -- they know how to purchase reinsurance and the relativities themselves, so we may not have as much direct discussion about it. And they may certainly have discussions that I'm not privy to as well as far as that evaluation.
Q. And the individuals you're talking about that place it for their companies, those are all voluntary market companies, right?
A. Correct.
Q. They're not residual market.
Was the $1.2 billion exhaustion point also selected in earlier years, do you know?
A. I believe it was, yes.
Q. Do you know when it was first selected?
A. I don't recall specifically. I could look it up, but....
Q. Has the MPIUA book of business decreased or increased over the last, say, two or three years, if you know?
A. It has decreased slightly.
Q. Do you have a percentage?
A. I don't recall specifically. A couple of percentage points, perhaps.

Q. Based on your experience in the reinsurance field -- how long have you been in the reinsurance field?
A. Since 1993.
Q. And how long with Guy Carpenter?
A. Since 1998.
Q. Based upon that experience, do you have an opinion as to the probability that a hurricane will cause insured losses in excess of $200 million for the MPIUA policyholders?
A. Do I have a personal opinion?
Q. Yes.
A. I don't have a personal opinion.
Q. Do you have an opinion based upon your experience in the reinsurance business?
A. I have opinions based upon several probabilities that have been discussed within the modeling that's outlined in my testimony.
Q. What would your opinion be, based upon that?
A. In round numbers, it would exhaust it at approximately the 1-in-123-year return period, once in 123 years, I believe.
Q. What do you mean by a 1-in-123-year period?

A. Once every 123 years would be the probability -- the annual probability of exhausting the program.
Q. And would that connotate to more than a 5 percent probability of this level of loss occurring?
A. To exhausting?
Q. No, no. My question -- I guess maybe we should clarify -- was whether you had an opinion as to the probability that a hurricane will cause insured losses in excess of $200 million, not exhaust the program.
A. I don't have an opinion on that.
Q. And based upon the data that you have in your filing --
A. It's certainly possible. I don't recall what the specific probability of attaching and exhausting the program is from the perspective you're talking about.
Q. Let's go back to the other question, then. Do you have an opinion as to the probability that a hurricane will cause insured losses in excess of $1.2 billion? Is that the 1 in 123 --
A. Yes. That's the exhaustion point. That's what I thought you were referring to earlier.

Q. Sorry. Is that a probability of occurring of more than 1 percent, do you know?
A. I don't recall specifically the math.
Q. Let's move on. The reinsurance provided to the MPIUA under the reinsurance contract is for property primarily located in Massachusetts; is that correct?
A. Exclusively located in Massachusetts, yes.
Q. And as we discussed earlier, you work with a lot of different insurers and clients, many of which are private insurers, correct?
A. Public and private. Reinsurers.
Q. Does Guy Carpenter have any other clients that have a similar spread of risk; in other words, insuring just properties in one state?
A. Yes, we do.
Q. Are those other of those FAIR Plans or wind associations that you discussed?
A. Yes. So those would certainly be some of them, yes.
Q. And do these clients that we discussed earlier, the wind associations and the FAIR Plans, do they purchase reinsurance program with attachment and exhaustion points that are similar to what the

MPIUA has purchased?
A. That's my recollection, yes.
Q. What about the voluntary market companies? Do they purchase reinsurance programs with similar attachment and exhaustion points as the MPIUA purchased?
A. Yes.
Q. Last fall Tropical Storm Irene caused some damage along the East Coast and in Massachusetts, correct?
A. Correct.
Q. Do you have an estimate of the total damage that was caused by Irene on the East Coast and/or in Massachusetts?
A. I don't know specifically. I recollect it's approximately $5 billion for the event. I don't recall what the distribution of it was between the various states.
Q. That's for the entire storm and all aspects of it. One of them is a hurricane versus --
A. Correct.
Q. Do you know whether MPIUA policyholders suffered any loss as a result of Irene?
A. I believe they did.

Q. And did the losses suffered by MPIUA policyholders as a result of Irene trigger any payments under the MPIUA's reinsurance program?
A. No.
Q. Do you happen to know what the level of losses were by the MPIUA policyholders?
A. I don't recall. I believe it was around $5 million, but I don't recall specifically.
Q. The attachment point --
A. I could look the number up. I just don't recall specifically.
Q. Did you say $5 million?
A. I believe it was approximately $5 million.
Q. And the attachment point for the reinsurance was $200 million?
A. Correct.
Q. Do you have Volume I of the filing in front of you? If not, I have a copy of the page I want. I can just give you the page.
This is Page 274 from Volume I of the MPIUA filing, which is Exhibit 2. Have you had a chance to take a look at that?
A. Yes.
Q. Now, basically this page just summarizes

the total cost of the MPIUA's reinsurance program; is that correct?
A. Certainly the top part looks like it does, yes.
Q. Could you focus on Line 5, which is labeled "Reinsurance commission reimbursement." Do you see that?
A. Yes.
Q. And the value in that column or line is $5,125,352, correct?
A. Correct.
Q. Can you explain, in some detail if possible, the purpose and effect of this reimbursement.
A. The reinsurance commission reimbursement?
Q. Yes.
A. I don't know that I've seen it titled exactly that. I'm not precisely sure what that number represents.
Q. Was there a reinsurance commission reimbursement?
A. Is this with respect to Guy Carpenter and MPIUA or --
Q. Why don't I try the phrase "ceding

commission." Does that sound more familiar to you? Is this a ceding commission?
A. I don't -- I don't know.
Q. Did Guy Carpenter reimburse the MPIUA for reinsurance commissions?
A. Yes. It's typically not titled this. That's why I'm not sure exactly how this exhibit is capturing it. So I apologize for that.
Q. But is this the value that they reimbursed the MPIUA, the $5,125,352?
A. I believe it's similar to that number. I don't recall the exact number.
Q. The terminology is --
A. I apologize. I'm trying to make sure I'm on the same page.
Q. Totally fine. Just what does this represent, and what's the purpose and the effect of the reimbursement?
A. Well, essentially there is brokerage that is paid by the reinsurers that is typically charged at 10 percent on the reinsurance placement slip. They typically factor those costs into the pricing of the reinsurance program.
And then there's an arrangement that we

might have with the MPIUA, based upon the -- our relationship with that particular firm, where we might share in the brokerage that we earn on the account, based upon the size of the account. So in essence we are being paid a fee on a net basis after the application of that number for the handling of their property cap program.
Q. So it basically, like, offsets the MPIUA's direct acquisition costs?
A. They could use it -- it reduces the cost of reinsurance for the MPIUA. That's what I would say.
Q. So it lowers the premium on the total program?
A. It lowers the amount of money that they have to pay for the transfer of risk.
Q. And it lowers the MPIUA's direct policy acquisition costs somewhat?
A. They could theoretically utilize it to offset that, yes.
Q. The reinsurance program -- premiums, rather, that the MPIUA pays include a provision for the reinsurer's target profit on its portfolio; is that correct?
A. I'm sorry. Can you repeat that, please.

Q. The MPIUA pays a reinsurance premium, correct?
A. Yes.
Q. Does part of that premium include a provision or a factor for the reinsurer's target profit on its portfolio?
A. Typically it would, yes.
Q. And did it in this instance?
A. I believe so, yes.
MR. McCALL: That's it. Thank you.
MR. LEIGHT: Before we start, we just wanted to make sure it was okay with you that Mr. Klibaner and I shared the questioning.
PRESIDING OFFICER FARRINGTON: Certainly.

CROSS EXAMINATION

BY MR. KLIBANER:

Q. Good morning, Mr. Wackerman. I am Alex Klibaner, an Assistant Attorney General, and as Mr. Leight was saying, I have some questions for you, and then he's going to have some questions for you as well.
A. Okay.
Q. There is a reinstatement provision in the MPIUA's reinsurance program; is that correct?

A. Yes.
Q. Does that reinstatement provision have an automatic trigger, or can the MPIUA decide not to reinstate the reinsurance?
A. It's designed to be an automatic trigger. So if there were a loss to the program, the MPIUA would be bound by the contract to utilize the reinstatement. They could, in theory, negotiate not to do that, but that would be a negotiation that would have to alter the terms and conditions of the contract.
Q. In the current contract, for example, if the first hurricane that triggers reinsurance occurs near the end of the hurricane season, and there are no additional hurricanes in the forecast, the MPIUA must still pay that reinstatement fee?
A. Correct.
Q. Now, the reinstatement -- let me start again. Why don't I draw your attention to Page 1216 in the filing. Article 7 here discusses the reinstatement provision; is that right?
A. Correct.
Q. And this deals with the reinstatement of the policy limits and the four layers of traditional

reinsurance, correct?
A. Correct.
Q. Is the reinstatement fee prorated based on how much of the policy year remains at the time of the reinstatement?
A. Yes.
Q. Is it prorated based on how much of that --
A. How much of the limit is exhausted or ostensibly -- I believe I thought you said how much remains. It would be the inverse of the same calculation, but --
Q. I want to separate the two. One is how much of the policy limit remains, and the other one is how much of the policy year remains.
A. Correct.
Q. So is there any prorating that's done based on how much of the policy year remains?
A. No. Not in this circumstance, no.
Q. Just to be clear about this, so for every dollar of coverage used up by the first loss occurrence, the MPIUA is paying, as its reinstatement fee, the same reinsurance premium that it had paid earlier for that same dollar of coverage?

A. Correct. That's correct.
Q. So even if the reinstatement occurs on the second-to-last day of the policy term, the MPIUA still pays the reinstatement fee based on the -- for the same dollar of coverage as for the full year?
A. That's correct. But the reason there's a reinstatement premium negotiated into the contract is because it lowers the up-front cost of the reinsurance.
Q. By how much does it lower the up-front cost of the reinsurance?
A. Typically 15 percent, maybe more.
Q. How does Guy Carpenter know that? Is there, like, a process of teasing that number out?
A. Typically, yes. I mean, there's -- it varies. The quotations you would get by reinsurer would vary. But at the end of the day you could settle on a scenario where you purchased reinsurance without a reinstatement, and typically speaking, the price would be higher without the reinstatement.
Q. And why is the price higher without reinstatement?
A. Typically speaking, reinsurers view a second attachment of the program to be somewhat

remote. But typically they will offer an additional limit so that the companies don't have to go out and buy significant reinsurance right after an event so they're not, for lack of a better expression, bare.

But in any event, under those circumstances you have a reinsurer who feels that there may not be a second attachment, a second attachment during the course of the year. So under those circumstances, they will provide a higher up-front cost if you do not purchase a reinsurance -- a second limit, or they will provide you a lower up-front cost, with the ability to recapture a reinstatement premium in the event of a loss.

Q. Is there a reinstatement option available in the market, as opposed to an automatic trigger?

A. Typically not.

Q. And if the reinstatement provision --

A. Can I rephrase that? It's potentially available. It's typically not negotiated that way, because there's typically a price associated with doing it that way.

Q. But would the price be the appropriate price for that option?

A. It might be the appropriate price, but it

might be higher than the lower cost associated with buying a reinstatement and not having an event.

Q. If the automatic reinstatement is triggered, how would the MPIUA pay the reinstatement fee? Is it paid from the premiums, from its own reserves, from the reinsurance payment? How is it paid?

A. It could be paid in a multitude of ways. They could reduce loss recoveries by the amount of reinstatement, or they could collect all the loss recoveries and make the payment out of cash. They have a whole host of ways potentially of paying.

Q. Is there a reinstatement provision in the catastrophe bond layer?

A. There is not.

Q. Was there one available at that layer?

A. Typically not in the cat bond marketplace, because they typically -- they will only provide one limit. And under those circumstances, obviously the cost made sense, made perfect sense to the MPIUA to actually proceed with that coverage relative to traditional insurance.

Q. How much cheaper was that catastrophe bond process than -- compared to getting a traditional

reinsurance with that reinstatement provision?

A. I don't recall specifically, but I could look it up somewhere in here, like the rate on line table. (Reviewing document)

I don't recall. And the reason I don't recall is because the cat bond was priced in 2010 originally, and we don't have the 2010 direct comparison in here. So I can't do that comparison. But -- it was roughly 5 percent cheaper.

Q. So it was less than 15 percent cheaper, right? Were you comparing it to traditional reinsurance with the reinstatement or --

A. Oh, correct. That's correct. That's correct. But that's also a different type of reinsurance as well.

Q. What do you mean by "a different type of reinsurance"?

A. In order to establish the cost comparison you're speaking of, you would have to get a quote in the cat bond marketplace with a reinstatement and without a reinstatement, and you couldn't get a quote with a reinstatement in the cat bond marketplace, because they don't provide reinstatements.

Q. So --

A. So that's the cost comparison on an apples-to-apples basis.

Q. So the apples-to-apples comparison would be cat bond without reinstatement and traditional reinsurance without reinstatement; is that right?

A. Correct.

Q. And that difference was 5 percent, right?

A. No. Sorry. That would be an apple and an orange. Sorry. Because the traditional piece, you would want to have -- the traditional piece has a reinstatement.

Q. So traditional piece with the reinstatement compared to cat bond without --

A. -- cat bond without a reinstatement. And that cost comparison is already favorable, and it would only get better if the cat bond were to have a reinstatement.

Q. So the comparison that Guy Carpenter made was between cat bond without reinstatement and traditional reinsurance with reinstatement?

A. Correct.

Q. And even that comparison, the cat bond was favorable --

A. Correct.
Q. -- by about 5 percent?
A. I believe -- that's my recollection.
Q. Is there a reinstatement provision in the swap layer?
A. No, there is not.
Q. And did Guy Carpenter do a comparison for the swap layer between -- the swap layer without reinstatement and traditional reinsurance with reinstatement?
A. I don't recall if we did a specific comparison, but that particular stretch of coverage was priced out in multiple ways several years ago, and that was deemed to be the most efficient -- cost efficient purchase at the time. And it's essentially stayed in place each successive year.
Q. Was some analysis done to determine that it was cost favorable?
A. Some cost comparisons, yes. So you can see the cost comparison on Page 1435.
Q. Can you please point out that cost comparison of the swap layer for the traditional reinsurance.
A. The swap layer is listed at the top at 5.45

rate on line, and the rate on line of the penultimate layer is 6.15. So the rate on line is lower for the swap layer. And that rate on line was also lower -- that layer of -- the 5.45 was the lowest price we got for that particular stretch of coverage for the 25 xs 1.175 layer.
Q. So the traditional reinsurance at the layer of the swap was somewhere between 6.15 and 4.45; is that right?
A. I'm sorry. Can you repeat that, please.
Q. Sure. Were you comparing the swap -- the peril swap with traditional reinsurance at a different layer, or were you comparing the peril swap with the traditional reinsurance at the same layer?
A. Oh, I see. I don't believe the comparisons of the 5.45 relative to other layers are included in here.
Q. Your recollection --
A. That's my recollection, yes.
Q. Does the MPIUA or Guy Carpenter anticipate reinsurance rates rising in the coming year?
A. In general?
Q. Yes.

A. In general, they will certainly be stable, potentially rising, through the rest of the year.
Q. What do you mean by "stable, potentially rising"?
A. Well, I think -- they will certainly -- they're certainly going to be stable, and they have the potential to go up. That's the general sort of market cycle that we appear to be in right now.
Q. Do you have an estimate of how much reinsurance rates would rise in the coming year?
A. I don't know. Somewhere between 5 and 15 percent, in general.
Q. Is the reinstatement provision intended to freeze the rates for reinsurance? Is that a benefit that the MPIUA receives from the reinstatement provision?
A. No. I don't follow the question, but I think the answer is no.
Q. I'll ask it again so that, if your answer is no, you mean it. Is one of the purposes of the reinstatement provision to freeze reinsurance rates?
A. No.
Q. Do you know what the probability is that the reinstatement provision will be triggered during

the policy term?
A. No.
Q. If you take a look at Page 274 of the filing, which you have in front of you on the side, do you see where it has those Lines 6, 7 and 8 that are labeled "Expected Average Annual Reinstatement Premium"?
A. I do see that.
Q. Have you seen these numbers before?
A. No.
Q. Was there any analysis that you or Guy Carpenter took into account in determining how the reinstatement provision should be priced in the reinsurance program?
A. Meaning -- no. Not that I -- if I understand you correctly, I believe the answer is no.
Q. Just to be clear, it's your understanding that --
A. The pricing mechanism for reinstatement premiums -- in other words, reinstatements work in this contract the way they work in every contract, or most contracts, I would say. And so that mechanism is not unique to the MPIUA.

So the question of whether or not there would be a reinstatement premium and a reinstatement in this particular contract was something that would be discussed only if someone decided they wanted to change the -- increase the up-front cost of the reinsurance. And that was certainly not the objective of the Board, to change the manner in which they purchase reinsurance to increase the cost.

So therefore they just left the reinsurance -- the reinstatement premium as is, the reinstatement feature as is. And therefore the reinstatement premium is calculated automatically off of whatever the up-front reinsurance premium is.

Q. It's your understanding that there's approximately a 15 percent discount on the reinsurance premium because of the reinstatement provision, correct?

A. Correct.

Q. Was there any analysis done to determine whether the 15 percent discount was worth it for the MPIUA?

A. In other words, would you pay more --

Q. Let me put it this way.

A. I mean, the decision is, do I want -- if I want to lower my up-front costs, I would leave the reinstatement feature in; otherwise I would pay more and not have a reinstatement.

Q. Right.

A. So most people would elect to pay less and maintain the reinstatement feature in there, as most companies do.

Q. The reinstatement feature creates an expected average annual reinstatement premium, correct?

A. It does, but that's -- I mean, I can't tell you how that's calculated. This is just -- I don't know how this is calculated.

Q. The footnote says that it's based on the RMS and AIR models, and you have now exhausted my knowledge of how that number is calculated.

MR. MEYER: For the record, I would like to point out this is an exhibit prepared by Mr. Ericksen at ISO. It's an exhibit that Mr. Wackerman did not prepare, and as far as I know, Mr. Wackerman has never seen Page 274 before this morning. I would just like to note that for the record.

MR. KLIBANER: May I have my question read back, please.

(Question read)

Q. Is it your understanding, Mr. Wackerman, that the expected average annual reinstatement premium that is created by virtue of the reinstatement provision in the reinsurance program is determined in this filing by the RMS and AIR models?

A. I believe this is a notional premium that's created by the calculations that were conducted by whoever created this document, and that was the number that was derived, probably based upon some number -- some expected loss and then carrying out the math associated with the reinstatement provision, based upon a given loss size. That's my interpretation of this.

Q. And as a matter of math, would you agree that the number at Line 8 of $1,412,674 is greater than 15 percent of the reinsurance premium?

A. It's possible, but, again, this is assuming that there's been a loss that's taken place. So you're -- I don't know that that's the appropriate comparison. This is assuming a loss has taken place, not what the price of the contract would be.

Q. Do you know whether Line 8 is the accurate number for the expected average annual reinstatement premium?

A. I don't.

Q. Did you or Guy Carpenter do any analysis as part of the brokering of the reinsurance program to determine an expected average annual reinstatement premium?

A. No.

Q. If we assume that the reinstatement provision has been triggered in a given policy year, do you know what the probability is that there's a second loss occurrence that causes more than $200 million of loss and loss adjusted expenses to the MPIUA?

A. No.

Q. Did you or Guy Carpenter do any analysis of that probability in brokering the reinsurance program for the MPIUA?

A. As a matter of course, we would have calculated it -- we would have utilized the models to look at what the models would suggest that the probability is.

Q. Do you know what that probability is?

A. I don't recall.
Q. In that probability, are the two loss occurrence events independent of each other?
A. They typically would be, yes.
Q. So the second hurricane, so to speak, is just as likely to occur as the first hurricane in that analysis?
A. Well, they're independent. I'm not suggesting they're just as likely to occur.
Q. What do you mean by "independent"?
A. Well, I was simply just answering the question. I thought that was the question you asked.
Q. You're making a distinction between "independent" and "just as likely to occur," and I'm trying to figure out what you mean by "independent." If there are two hurricanes, then the probability of them occurring is independent of each other.
A. I believe that they're independent of each other. The probability of the calculation of the two events would be independent from one another, yes.
Q. Is it your understanding of "independent" that just because one hurricane occurs makes it no

more or less likely that the second hurricane will occur?
A. That's correct.
Q. And in the scenario where the reinstatement provision has been triggered, we know that there's less time within that policy term in which a second loss occurrence can occur; is that correct?
A. Correct.
Q. When did the MPIUA first obtain reinsurance?
A. I believe it was 2006.
Q. July 1, 2006?
A. Yes.
Q. Did that first reinsurance program have a reinstatement provision?
A. Yes.
Q. And did each reinsurance program that the MPIUA had since then have a reinstatement provision?
A. Yes.
Q. Has the MPIUA ever paid a reinstatement fee?
A. No.
Q. And that's because the reinstatement provision has never been triggered; is that right?

A. Correct.
Q. Now, let me ask you a few questions about the loss adjustment expenses that are covered by the reinsurance program. Is it correct that the catastrophe bond layer covers LAEs at 6 percent?
A. I believe that that's correct.
Q. Does the peril swap layer cover LAEs?
A. Yes. It covers it in the same manner that traditional reinsurance covers it. So it would be included.
Q. Can you point me to where in the peril swap contract that is that LAEs are included?
A. Well, it's defined on Page 1264. And under the "Definitions" article is where it indicates that it's covered. So it's Article 7 on Page 1263. "Such loss to include Loss Adjustment Expense."
Q. Is there any limit on the loss adjustment expense, or whatever the actual number is, that's what's covered?
A. Correct.
Q. And that's the way all the layers work other than the catastrophe bond?
A. Correct.
Q. Does Guy Carpenter receive a 10 percent

commission for placing the MPIUA's reinsurance program?
A. Yes.
Q. And then there's a commission reimbursement that you testified about, correct?
A. Correct.
Q. Is there any structure to the commission, other than it being a pure 10 percent calculation?
A. Well, it's 10 percent -- we would get 10 percent of all brokerage for non-London-based, and if there were reinstatement, we would get 5 percent on the reinstatement. And then in London it's 15 percent up front and nil on reinstatement. And that's traditional, all traditional compensation.
Q. Does that structure create any incentive for Guy Carpenter to prefer London reinsurers or alternatively prefer non-London reinsurers?
A. No.
Q. Is the commission built into the premium that the MPIUA pays?
A. Yes.
Q. Is it correct that the actual commission is paid by the reinsurers to Guy Carpenter?
A. Correct.

Q. Now, why is it that Guy Carpenter agreed to reimburse the MPIUA part of its commission?
A. That was based upon negotiations that I was not directly part of.
Q. Negotiations between whom and whom?
A. Guy Carpenter and -- individual brokers are not at liberty to negotiate or discuss compensation. So I wasn't part of those discussions.
Q. So somebody at Guy Carpenter negotiated that reimbursement with the MPIUA?
A. Correct.
Q. In terms of your testimony that the amount that the MPIUA is paying for its reinsurance program is reasonable, is that including the reimbursement of the commission?
A. Yes.
Q. And would it be unreasonable for the MPIUA to pay for its reinsurance program if it weren't for Guy Carpenter reimbursing approximately half of its commission?
A. I don't think it would be unreasonable.
Q. So it would be reasonable either way; is that your testimony?
A. Yes.

Q. Let me draw your attention to your e-mail that's found on Page 1438 in the filing. This e-mail is dated May 5, 2011; is that right?
A. Yes.
Q. And I take it you're the author of this e-mail, right?
A. Correct.
Q. The e-mail discusses an Option A, Option B, Option C and Option D; is that right?
A. Correct.
Q. Can you describe for us how Option B is different from Option A.
A. Okay. I believe the primary difference between Option A and Option B is that Option B contemplates a 2 percent increase in the traditional pricing. So for all the layers on a traditional basis, we calculated a 2 percent increase to each one of those layers and then did the math to generate what the reinsurance premium would be.
Q. When you say "increase to the traditional pricing," you mean increase to the coverage that's afforded by each layer?
A. No, just an increase to the price.
Q. To the premium?

A. To the premium. Sorry, yes.
Q. Is it for the same coverage?
A. Yes.
Q. So is the only difference between Option A and Option B that Option B is 2 percent more expensive?
A. Yes. I believe that's the case.
Q. And Option B is what Guy Carpenter recommended; is that right?
A. That's correct.
Q. And that recommendation was declined by the MPIUA; is that correct?
A. That's correct.
Q. And the MPIUA went with Option A; is that right?
A. I believe that's correct.
Q. So under Option B, Guy Carpenter's commission would have been higher than under Option A; is that right?
A. Sorry. Can you repeat that.
Q. Sure. Under Option B, Guy Carpenter's commission would be higher than under Option A; is that right?
A. Oh. Yes.

Q. And in the e-mail --
A. That's simply because the pricing of the individual contract would be larger.
Q. Right. And Guy Carpenter's commission is merely a percentage of the premium, right?
A. That's correct. But, remember, the other objective of the MPIUA is to complete the placement. And so we have to make a recommendation to the MPIUA that we believe most efficiently accomplishes the objective that was set out before us, which was to complete the placement.
Q. What was the objective in terms of placement that the MPIUA set forth?
A. To complete 100 percent of the placement.
Q. 100 percent of the placement of what?
A. Of each of the individual layers.
Q. What were the layers that the MPIUA determined as its objective?
A. I mean, it's outlined throughout this presentation. I believe it's on -- Page 1435 would outline that. The point is that last year we were in a market environment where prices were increasing and capacity was reducing. And we had to make a recommendation to the MPIUA that was going to

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satisfy the objective, which was to complete the placement.
In so doing, that was why we recommended Option B, because we didn't feel that, if the MPIUA went out at flat pricing last year, they would generate the capacity that they desired. So that's why we made the recommendation with Option B.
Q. Did the MPIUA have the opportunity to try Option A, and if it didn't obtain the placement that it wanted, then to fall back onto Option B?
A. That option always exists, but given the timing and the market situation, what happens typically is, if you -- and several clients and other entities in the marketplace tried this -- if you go out and you don't succeed, then typically going back to Option B is no longer an option. The price becomes higher than that.
Q. Why is that?
A. The market conditions can change over time, and they were changing fairly rapidly last year. So generally speaking -- again, you're trying to give your counsel and advice to the client to achieve the most efficient cost of reinsurance, the lowest possible price, all the time. And so if sometimes

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you recommend going at the lowest number and you're not successful, the reinsurers may say -- they may -- the price may move subsequent to that if you don't generate the desired capacity.
Q. Is it the fact that the price moves because the reinsurance market is not purely competitive?
A. No. The market moves -- the market pricing moves all the time up and down.
Again, they move based upon the laws of supply and demand. So that's typically why it's important to get the pricing right the first time when you're in an environment where prices are rising and capacity is shrinking.
Q. And in this environment of prices rising, how fast were they rising?
A. Between this particular time frame and the negotiations of renewal last year, somewhere between 5 percent, maybe 10 percent, in that range.
Q. 5 to 10 percent per year or per month?
A. In the time frame in which we were negotiating the program last year. So let's say between February and June it could have been between 5 to 10 percent.
Q. And when you refer to the importance to

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maintain capacity for MPIUA in this e-mail, are you referring to that percentage of placement?
A. That was exactly what I was referring to, yes.
Q. In that paragraph that talks about maintaining capacity for MPIUA, do you see where, above that last line -- in the second-to-last line it talks about some technical analysis by the reinsurers with which Guy Carpenter disagreed?
A. Yes.
Q. And what was that technical analysis, or in some cases lack thereof?
A. Well, we don't always agree with what the reinsurers come up with. In fact, we rarely agree with the prices that the reinsurers come up with. And some base it upon a very technical analysis that they can articulate and may articulate; and some particularly, particularly when capacity -- particularly when the market conditions were such that they were last year, they may simply just hold out for a price of X.
And since they are the -- in certain circumstances they can be the arbiter -- they always are the arbiter of whether they deploy their

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capacity or not. They may give you technical reasons for it, and they may not. And so that's what that comment was simply referring to.
Q. If one insurer decides to simply hold out for a better price, in a competitive environment wouldn't you expect another reinsurer to undercut them?
A. Sure.
Q. Does that happen?
A. It happens all the time.
Q. So why are there reinsurers who hold out for a better price at all, if other reinsurers can come in and undercut them?
A. Well, they hold out obviously to a degree. It doesn't necessarily mean that everybody wants to participate at the exact same price all the time. So it's simply a matter of degrees.
Q. Are you able -- do you understand the technical analysis that they provide as their rationale?
A. I do understand a lot of the discussions and a lot of the analyses that they do. They may not be forthcoming with exactly how it is that they've calculated their precise numbers, but in

general I'm familiar with what they...
Q. Can you give us an example of the technical analysis that reinsurers provide as part of the negotiating process?
A. They won't provide specific information, but we'll have negotiations around what perceptions are regarding concentration, perceptions regarding exposure, perceptions regarding the number of programs that they may already be providing capacity for in certain territories.
The amount of the premium that they may be charging is commensurate with that or may not be commensurate with that. We may get into discussions around their view of modeled loss versus another view of modeled loss versus some of the calculations that we've done. Those are the types of discussions that we typically have with reinsurers.
They don't all calculate it in the exact same manner. So it's unique to each reinsurer, and in many cases it's unique to each deal.
Q. Guy Carpenter uses the RMS and AIR models as part of its negotiations of reinsurance programs; is that right?
A. Not exclusively, but yes.

Q. What else does Guy Carpenter use?
A. There are other models that we have. We license other third-party models, such as EQE, for example.
Q. Are there any others?
A. Not that I'm aware of for the peril of hurricane.
Q. So then there are three modelers?
A. Three predominant modelers, yes.
Q. Do the reinsurers use the same three modelers?
A. Generally speaking, yes. And they also have their own views of the model.
Q. So there are disagreements about how to interpret the results of those models?
A. Correct.
Q. Do all the reinsurers use the latest RMS and AIR models as part of their analysis?
A. Typically speaking, that's what they try to do, is our understanding, and we try to monitor that. They don't all move to the newest model at the same exact time.
Q. Does Guy Carpenter keep track of which models that reinsurers are using at what time?

A. Yes. Last year was -- there was significant flux as to when people were -- when and if people were migrating to Version 11 during the course of last year's renewal season, or for that matter AIR Version 12. There was migration going on in the marketplace.
Q. Do you have an estimate of what percentage of reinsurers migrated to Versions 11 and 12 of those models respectively?
A. I believe now it's close to 100 percent. During the course of the renewal last year, it was -- fully migrated? This is a long discussion for each individual reinsurer as to when they fully migrated. I would say probably half. I don't recall specifically the number, but it was probably about half.
Q. Does that mean that approximately half of the reinsurers were using Versions 11 and 12, and the other half were using older versions?
A. Potentially. Some reinsurers don't focus on one particular -- they may focus on RMS, they may focus on AIR, they may focus on their own model as well.
So, again, depending on each reinsurer,

that discussion can take on a totally different -- have totally different meaning. Some may migrate to RMS later because they're focusing on AIR. Some may have their own model, so they're not particularly focused on either one. And so you have a scenario where you have various migrations of versions, as it were.
Again, the other issue is reinsurers don't rely exclusively on the models to price the business. So it's just one component.
Q. Is it correct that reinsurance transfers risk from the MPIUA to the reinsurers?
A. Yes.
Q. And that transfer of risk is also from the MPIUA members to the reinsurers; is that right?
A. By way of their participation, yes.
Q. Let me draw your attention to Page 1428 in the filing. Near the top of Page 1428, do you see the statement of the long-term strategic reinsurance policy of the MPIUA?
A. Yes.
Q. And is that statement still in effect today?
A. I believe it is. I don't believe there's

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been any changes to it.
Q. Did Guy Carpenter participate in any way in the setting of this long-term strategic reinsurance policy?
A. Well, the policy was set by the Executive Committee of the MPIUA. So --
Q. I'm just asking if Guy Carpenter participated in that process.
A. We were present during some of the discussions.
Q. But the decision-making was of the MPIUA --
A. We did not make that decision.
Q. Did Guy Carpenter offer any recommendations?
A. We provided information to the Executive Committee to make the decision. And, again, as I mentioned before, they have a significant amount of experience in their own right. So they've got their own information as well.
Q. As opposed to providing their information, did Guy Carpenter make any recommendations to the MPIUA?
A. I don't recall making any specific recommendations about the policy -- the specific

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setting of the policy; in other words, that it had to be one thing or another. It was really -- the idea was, simply saying, making the policy transparent.
Q. This long-term strategic policy, right?
A. Right.
Q. Do you know how the attachment level and the exhaustion level in this strategic policy were determined by the MPIUA?
A. You mean of the specific number?
Q. Yes.
A. I believe that they conducted a study of the members, of member companies, by way of a survey that they conducted to determine generally what the member companies were doing as far as from a modeled probabilistic attachment point and exhaustion point. And I believe they conducted that survey several years ago.
Q. And why was it relevant to the MPIUA what their members were doing in terms of the members' own reinsurance programs?
A. I believe that they intend to set up a reinsurance program that's similar or not significantly different than the member companies

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set up. So it's an entity in and of itself seeking to behave like the other entities that operate in the space that they operate in.
Q. So was it a situation of the MPIUA following the lead of its members on the reinsurance policy?
A. I suppose you could characterize it that way. I'm not sure that it was necessarily the lead per se. I think they sat down to determine what a prudent course of action would be to protect the MPIUA from catastrophic loss, and they developed that plan accordingly.
Q. What guidance did Guy Carpenter receive from the MPIUA in terms of how much reinsurance to seek?
A. We typically advised them as to what various other entities in the industry would do to protect their portfolio or their policies from risk of extreme catastrophic loss. So we would provide to them advice and counsel on that basis, or is what they're doing any -- materially different from what others are doing.
Q. Is it important for the MPIUA to be doing what other insurers were doing?

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A. I think it's important to have -- it's certainly important to have the perspective of what others are doing, particularly other entities that have had significant loss associated with their portfolios.
Q. Why is it important for the MPIUA to be doing what other insurers are doing?
A. Well, I think -- it's important for them to have a perspective of what others are doing, certainly because you don't want to end up in a situation where you are not appropriately protected or didn't make the right choice or didn't prudently protect yourself from catastrophic risk. And I think that's what the Board is trying to achieve by looking at that, as well as -- again, other residual market entities, as well as member companies.
Q. Did the MPIUA ever indicate to Guy Carpenter that it was looking to buy whatever reinsurance it could get for approximately $80 million of premium?
A. I think there was some discussions at one point, I seem to recall at the outset, about -- in other words, this goes back to the discussion of how much can you place, can you place 100 percent of the

program, and the objective was to place as much of the program as possible. And I believe that the number ended up being approximately $80 million at one point in time. So that certainly became part of the discussions, I believe.

Q. How was the $200 million attachment point chosen?

A. Similarly to the manner in which the exhaustion point was determined. There was heated discussion amongst several of the member companies to determine what an appropriate retention of the program would be.

They certainly looked at various attachment points that the models provide and also the amount of TIV that would potentially be attached. So a billion dollars of TIV is the exhaustion point. That's about 1 percent. So one fifth of that is a pretty small number, I think, that people felt reasonably comfortable with as an attachment point, the Board.

Q. Was 2 percent also considered, 2 percent of TIV?

A. 2 percent of TIV as an exhaustion point?

Q. Yes.

A. No. That would be -- I don't believe that was considered. Not in my presence anyway.

Q. Is 2 percent too high?

A. It's a very concentrated portfolio, but it would be a significant amount of limit to be purchasing. So I don't think that the Board would have considered that to be an appropriate economic decision.

Q. Part of your testimony is that the amount of reinsurance that the MPIUA purchased is a reasonable amount, correct?

A. It certainly appears to be reasonable, based upon the metrics of the reinsurance business.

Q. Do you have an opinion as to whether, if the MPIUA had bought reinsurance equal to 2 percent of TIV, whether that would have been reasonable?

A. I mean, it's hard to say whether that would be reasonable, because the amount of capacity that would be required could be significant.

Q. The capacity would be 2 percent of TIV, right?

A. So you would be looking for $2 billion worth of capacity, which, again, that would be larger than most companies -- that would be one of

the largest placements in the world, under those circumstances, and finding all of that capacity can be challenging. So it might be a noble objective, but...

Q. Does the reinsurance market lose its competitiveness if you get to capacity that's too high?

A. It's more that -- it loses its availability.

Q. What do you mean by "availability"?

A. There's not enough capacity to generate -- there's just not that much capacity out there. I mean, $2 billion would be a significant amount of capacity, probably more so than you could generate, unless you spent -- you would have to go to multiple sources of capacity.

Q. So there would be fewer sources of capacity at the $2 billion amount than there are at the $1.2 billion amount?

A. There would be still -- you would be maximizing the capacity from everybody at that point. So eventually you're going to run out of capacity.

Q. And that's assuming that the MPIUA would be

willing to pay whatever premium is asked, right? There would still be less capacity?

A. When you say "There would be less capacity," you would have more capacity if you went to $2 billion.

Q. There are fewer reinsurers who would be willing to place $2 billion of capacity, right?

A. Sure.

Q. Regardless of the premium that's determined, right?

A. Yes.

Q. Now, are there benefits to MPIUA members from the MPIUA's placement of reinsurance?

A. Are there benefits to members?

Q. Yes. The MPIUA members, do they receive any benefit from the fact that the MPIUA has a reinsurance program?

A. Yes.

Q. One of the benefits is surplus relief; is that correct?

A. Yes.

Q. So the MPIUA members need less surplus, because the MPIUA has reinsurance, right?

A. They need to potentially protect a lesser

amount of their surplus.

Q. Is it correct that they need less surplus allocated towards potential assessments from the MPIUA?

A. Correct, because the MPIUA purchases reinsurance. And they also have to purchase less reinsurance accordingly.

Q. So the MPIUA members have lower reinsurance rates, because the MPIUA has --

A. They don't necessarily have lower rates. They get to purchase less reinsurance, because the MPIUA purchases what it purchases.

Q. Part of the reinsurance that MPIUA members purchase includes coverage for assessments from the MPIUA; is that right?

A. That's correct.

Q. And does the cost to the MPIUA members for purchasing that coverage decrease as the MPIUA increases its own reinsurance?

A. It depends on how you're defining cost. I will answer the question that way. They have to purchase enough to protect their own assessment -- their own policyholders from loss. Let's just say that's $100 million. And they have to purchase

protection to protect their assessments, which might be an additional $10 million. If the MPIUA purchases that protection, then they don't have to purchase that extra $10 million.

Q. So they pay less in premiums?

A. They have to purchase -- they get to purchase less reinsurance; therefore, their premiums go down. But the rate that they pay is not necessarily less. That's what I'm trying to establish.

Q. By "rate" you mean percentage for dollar of coverage?

A. Correct.

Q. And does the cost of capital for MPIUA members go down with the increase in MPIUA's reinsurance?

A. The cost of capital for the member companies?

Q. Yes.

MR. MEYER: I'm going to object at this point. There is no foundation that Mr. Wackerman knows what the cost of capital is for the MPIUA member companies. There is no relevance to this case, there is no foundation, and it's not a

material issue.

PRESIDING OFFICER FARRINGTON: Did you want to make a comment, Mr. Klibaner?

MR. KLIBANER: I am following up on Mr. Wackerman's testimony that there are benefits to MPIUA members from the purchase by the MPIUA of reinsurance. Now, his answer could be, "I don't know," and I'll move on. But if his answer is, "I know," I would like to hear it.

PRESIDING OFFICER FARRINGTON: The objection is overruled.

Q. Do you remember the question?

A. You started with the question of whether there's benefits.

Q. Yes.

A. And I thought we answered -- I answered the question about whether there are benefits, because there certainly are cost benefits.

Q. Well, one benefit we talked about was the reduction in the amount of reinsurance that MPIUA members purchased, right?

A. Correct.

Q. And then I asked, was another benefit that their cost of capital decreases?

A. I don't know the answer to that question.

Q. Okay. Do you know whether their cost of debt decreases?

MR. MEYER: Same objection. No foundation. He doesn't know what the cost of debt is for the MPIUA member companies.

MR. KLIBANER: Well, if he answers "I don't know," I'll move on.

PRESIDING OFFICER SUMNER: Overruled. You may answer the question.

A. There we go. I don't know what the cost of capital is, or debt.

Q. So is it correct that you did not consider the cost of capital to the MPIUA members or their cost of debt in any way in the brokerage process of the MPIUA's reinsurance program?

A. We didn't, but I'm sure the member companies probably had that discussion with themselves. In other words, the member companies and the Executive Committee certainly would be cognizant of that issue. If they felt it was problematic, I'm sure they would have raised that.

We didn't discuss that. That would be my answer. We didn't discuss it with them.

Q. Do you know of any discussion at the MPIUA level of the benefits that the MPIUA members would receive from the reinsurance program?
A. We just talked about some of them. Not that one in particular.
Q. So not cost of capital and not cost of debt, right?
A. I didn't discuss that. I'm not saying it's not necessarily a benefit. I'm saying I didn't discuss it.
Q. That's all I'm asking. Do you know of any discussion at the MPIUA level --
A. No.
Q. Was the reduction in the reinsurance that the MPIUA members purchase something that was discussed at the MPIUA Board?
A. Sorry. Repeat that again.
Q. Was the benefit of the reduction in the amount of reinsurance that MPIUA members purchase a benefit of the MPIUA reinsurance program that was discussed at the MPIUA Board?
A. I'm sure it's been discussed. It's been a known benefit at the outset, so it's been discussed. Was it discussed specifically this year and

specifically in this context? I don't recall specifically, but it's certainly been discussed over time.
Q. And other than the reduction in reinsurance that the MPIUA members purchase, is there any other benefit to MPIUA members from the MPIUA's purchase of reinsurance, to your knowledge?
A. Well, certainly they would benefit from the recoveries that the MPIUA would make in the event of a catastrophic loss. So they would certainly get the benefit of those recoveries.
Q. By that do you mean there is less chance of an assessment against the member companies?
A. They provide -- yes, that's correct. It reduces the amount of the assessment.
Q. Does the MPIUA's reinsurance program affect the members' A.M. Best rating?
A. I don't work for A.M. Best, but I know that A.M. Best asks specifically about making certain that the member companies provide information on how large their assessment potential is for each -- of the individual residual markets that they're part of. And so I would logically assume from that that it impacts -- or could impact their rating.

Q. Is it your understanding -- strike that. Is it your testimony that, on Page 1203, that there's a benefit in terms of the A.M. Best rating for MPIUA member companies?
A. I'm sorry. Can you repeat that.
Q. Sure. In terms of your testimony on Page 1203 where you make reference to the A.M. Best rating, is it your testimony that there is a benefit for the MPIUA members from the MPIUA having reinsurance in terms of the ratings that the members can get from A.M. Best?
A. Well, I would agree with your statement, but my testimony here specifically, it was simply drawing a comparison to what A.M. Best suggests a typical exhaustion point would be for a cat program. That's what my comment specifically here was referring to.
Q. So your --
A. So I would agree with your statement, but I'm just making a distinction that that's not what my testimony here was intended to do.
Q. I appreciate that clarification.
So your testimony, at least as written, is that the A.M. Best rating is relevant to the cat

bond layer?
A. It's simply stating that -- the prior question is referencing how much reinsurance is purchased, in other words, from what attachment point to what exhaustion point. And generally speaking, A.M. Best, for example, they have specific standards, and various entities around the country, as it relates to where they exhaust and where they attach.
In general, companies receiving A.M. Best ratings, A.M. Best -- I don't want to say they prescribe, but they look favorably upon companies that protect up to the 1-in-100-year event, as defined by some model, for the peril of hurricane. So it would not be unreasonable for a structure similar to this to be looked upon favorably by A.M. Best.
Q. So because of the amount of reinsurance that the MPIUA purchased, its members can receive a better A.M. Best rating than if MPIUA didn't purchase any reinsurance, for example?
A. I mean, in theory -- it would be looked upon favorably by A.M. Best. Whether they would receive a better rating or not, I don't know. It

would have positively influenced the analysis that A.M. Best conducts during its rating.
Q. Is it fair to say that one benefit that MPIUA members receive from the fact that MPIUA has reinsurance is that they receive a more favorable look from A.M. Best?
A. Yes.
Q. To your knowledge, does the MPIUA's filing take into account those two benefits that we talked about that MPIUA members receive from the reinsurance program; namely, a reduction in the amount of reinsurance that they purchase and a more favorable look from A.M. Best?
A. Does the MPIUA's rate filing take that into consideration?
Q. Yes.
A. I don't know.
Q. So when you testify that it's your opinion that the amount of reinsurance that the MPIUA purchased was reasonable, you are not considering those two benefits that MPIUA members receive?
A. Again, I thought you were asking the question specifically whether they took it into consideration in their rate filing. I don't know

how they specifically might have taken it into consideration in their rate filing. I would assume they would have, but I don't know specifically how they took it into consideration. That's what I'm trying to get at.
Q. When you testify to the reasonableness of the MPIUA's purchase of reinsurance, are you taking into account the benefits that the MPIUA members receive from that reinsurance program?
A. Sure. That would be certainly part of it.
Q. And how are you taking those benefits into account?
A. I don't understand the connection to the question. I'm sorry, I apologize.
Q. That's all right. Let me try it this way: In the MPIUA's filing, is the full cost of the reinsurance program passed on to policyholders?
A. Sorry. Say that one more time.
Q. In the MPIUA's filing, is the full cost of its reinsurance program passed on to the policyholders?
A. I believe that it is, but I'm not positive. I don't know the entire construct of the rate filing, but I believe that that's the intent,

certainly.
Q. And do you know of any contribution that MPIUA members make towards the reinsurance program of the MPIUA that benefits the MPIUA members?
A. I don't understand the question.
Q. Do the MPIUA members make any contribution towards the MPIUA's reinsurance program?
A. I don't know -- what do you mean by "contribution"?
Q. Do they make any payment to the MPIUA to help the MPIUA pay for its reinsurance program?
A. They are the member companies. So essentially they're paying for -- they're paying for it based upon their participation as a member company within the MPIUA.
Q. How much are they paying?
A. They're paying their share of the -- essentially you would define it as they're paying their share of the premium based upon their market share of the construct of the MPIUA. Each member company has a percentage share of the MPIUA, so that would essentially be their -- could be viewed as their contribution.
Q. Has any MPIUA member made any payment to

the MPIUA since the inception of the reinsurance program on July 1st, 2006, to your knowledge?
A. Not separate and apart -- not apart from what their obligations are to the MPIUA. As a member company of the MPIUA, they have certain obligations, so they're making their payments to -- they're a contributing member of the MPIUA by definition. So they're not separately paying any reinsurance costs, if that's what you're getting at.
Q. Are they making any payment to the MPIUA -- to your knowledge, has any MPIUA member made any payment to the MPIUA, under its legal obligations or not, from July 1st, 2006, to the present?
A. Sorry, repeat the question. I'm just trying to understand where you're going with the question. I apologize.
The member companies are the member companies in the MPIUA. So they're operating in a normal fashion, as far as I know, as far as their relationship with the MPIUA.
Q. Does that normal fashion include any transfer of money from the MPIUA member to the MPIUA?
A. I can't comment on the MPIUA members'

relationship with the MPIUA. It exits separate and distinct from our relationship with the MPIUA.
Q. Do you know whether any MPIUA member has paid any money to the MPIUA since July 1, 2006?
MR. MEYER: Objection. Asked and answered.
A. I would assume that they would have --
MR. MEYER: Objection. Let the Hearing Officers rule on it. We've been going around in circles. The same question has been asked several times.
PRESIDING OFFICER FARRINGTON: You may answer the question.
A. Sorry. Can you repeat the question.
MR. KLIBANER: May I have the question read back, please.
(Question read)
A. I don't know.
Q. Does it matter, to your opinion that the MPIUA purchased a reasonable amount of reinsurance, that the full cost of the reinsurance program is passed on to MPIUA's policyholders?
A. Sorry. Can you repeat that.
MR. KLIBANER: Can I have it read back, please.

(Question read)
A. No.
Q. If the MPIUA had purchased less reinsurance than it did, would that have been reasonable too, in your opinion?
A. It's possible, yes.
Q. Why do you say it's possible, as opposed to simply yes or no or you don't know?
A. Well, the answer is yes.
Q. If the MPIUA decided to purchase no reinsurance, as it had before July 1, 2006, would that have been a reasonable thing for the MPIUA to do?
A. Again, the Board needs to determine what the amount of -- what is reasonable, based upon its view of what reasonable companies do in the industry to protect themselves against catastrophic risk. Whether something is -- it's very difficult to say what the precise magnitude of reasonableness is under those circumstances.
If you have a loss that's a billion dollars and you didn't buy a billion dollars worth of reinsurance, it looks unreasonable.
Q. But that's in retrospect, right?

A. Well, prospectively you don't know. So prospectively it's very difficult for anyone to say what exactly is reasonable or unreasonable as it relates to the amount of reinsurance purchased.
Q. Well, your opinion --
A. So therefore you would simply say what might be prudent as to what you would purchase, and based upon the determination of what's prudent, you might look at what other companies are doing, and you might look at what other residual markets are doing, to figure out how much reinsurance to purchase.
Q. I apologize for interrupting. Are you finished with your answer?
A. Yes.
Q. What do you take into consideration in opining that the amount of reinsurance that the MPIUA purchased was reasonable? You had mentioned the prudence and what other companies have done?
A. Sure.
Q. And the fact that the MPIUA Board made a decision. Are there any other factors that you take into account?
A. Well, I certainly listed them in my

testimony, but one of them, you would certainly -- you could look at historical storms. In the case of the MPIUA, you don't have any, so you would use a model to potentially figure out what those historical storms would do to their book of business today. So that would be one thing you could do.
You look at all of those numbers, and you end up making sure -- at least the Board's objective or the Executive Committee's objective was to make sure that certain of those storms were contained within the program that they purchased.
You would look at certainly the total insured value of the MPIUA, and certainly protecting a mere 1 percent of the total insured value for a concentrated portfolio like this is not unreasonable.
Those would be, you know, sort of two main things that you would look at.
Again, the other thing you would do is try and get a sense for making sure you don't have something significantly -- that you're purchasing something significantly different than what everybody else is doing. In the case of the MPIUA, they're purchasing something similar to what the

member companies are purchasing and certainly something similar to what many residual markets are purchasing.
Q. Did you take into account, as part of your opinion of the reasonableness of the amount of reinsurance that the MPIUA purchases, how much it costs?
A. Sure.
Q. And would you agree that if the MPIUA purchased no reinsurance, it would cost less than if it purchased reinsurance?
A. Sure.
Q. Would it be unreasonable, in your opinion, for the MPIUA to purchase no reinsurance?
A. Based upon the objectives that they've set out, it would be unreasonable.
Q. Are their objectives reasonable?
A. Again, their objectives are not dissimilar to what the other member companies are doing, and not dissimilar to what A.M. Best would suggest that other member companies do, and they're not significantly different than what other residual markets are doing. So from that perspective, it would seem reasonable, they would seem reasonable,

and they would seem prudent.
Q. And if the MPIUA made a strategic policy decision not to have reinsurance, would that be a reasonable decision to make, in your opinion?
A. It could be reasonable, but it wouldn't seem reasonable based upon the objectives that were set, and it wouldn't seem prudent.
Q. Why would it not be prudent?
A. You wouldn't be protected in the event of a loss.
Q. Well, the MPIUA can assess its members in case of a loss; is that right?
A. That's correct.
Q. So how would the MPIUA not be protected in the event of a loss?
A. The individual insurance -- the individual entities that make up the MPIUA would not be protected. They might have coverage in their reinsurance program, but they wouldn't have as much coverage as needed in their reinsurance program. So they would have to buy more reinsurance, subject to the review of A.M. Best and/or other rating agencies and/or internal constituents.
Q. Does the purchase by MPIUA of reinsurance

in effect transfer the cost of the MPIUA members purchasing some amount of reinsurance from those members to MPIUA's policyholders?
A. Repeat that, please.
MR. KLIBANER: Could I have the question read back.
(Question read)
A. Yes.
Q. * If the MPIUA decided to transfer all of its risk to reinsurers, would that be reasonable, in your opinion, assuming that it got a competitive price in the reinsurance market?
A. That would typically not be reasonable, because there is some amount of risk that all the member companies could choose to bear upon -- to keep net for themselves.
Q. Can you explain what you mean by that.
THE WITNESS: Can you repeat his original question. I'm sorry.
(* Question read)
MR. MEYER: I don't understand the question.
PRESIDING OFFICER FARRINGTON: Let's let the witness respond.

A. The MPIUA could choose to purchase 100 percent quota share for its entire book of business. That's been done before.
Q. And would that be reasonable, in your opinion?
A. Based upon -- again, based upon the objectives that the MPIUA has set out for it, it would not. But it's certainly possible.
Q. Well, I'm asking assuming that the objectives are different. Assume the objective is not to -- is to transfer -- excuse me. I'll start again.
If we assume that the objective of the MPIUA is to transfer all its risk to reinsurers, would it be reasonable for the MPIUA, then, to purchase enough reinsurance to transfer all its risk to reinsurers?
A. If that's what the objectives are, it could certainly -- there could be reasons to do that, yes.
Q. And so would it be reasonable for the MPIUA to do that?
A. It could be reasonable. I'm not saying I would recommend it. I'm saying it could be reasonable, based upon certain circumstances.

Q. What are those circumstances?
A. It could be set out as the objective. It could be set up so that certain member companies decide they want to take no risk. They could elect to set up a scenario where all of the risk is -- all of the risk for a hurricane is borne by reinsurers and the appropriate price is charged for it. They could decide that that's reasonable. It's not something that I would necessarily recommend, but it could certainly be decided to be reasonable.
MR. KLIBANER: It's around noon, so I would offer to take a break, if the Hearing Officers and the other parties would wish to do so.
PRESIDING OFFICER FARRINGTON: How much longer did you anticipate your set of questions going? Quite a while?
MR. KLIBANER: I would estimate roughly 15 minutes to a half hour, but then I know there would be more questions afterwards from Mr. Leight --
PRESIDING OFFICER FARRINGTON: No, no, I understand. What I'm trying to see is if it makes more sense to let you finish your block, and then take a lunch break, and then we'll come back for Mr. Leight.

MR. KLIBANER: That's fine. I'm just estimating 15 minutes to a half hour.
PRESIDING OFFICER FARRINGTON: Is that acceptable?
THE WITNESS: That's acceptable. Can I just ask for a refill on this water?
PRESIDING OFFICER FARRINGTON: Sure.
BY MR. KLIBANER:
Q. Besides Guy Carpenter's commission, are there any other transaction costs to the MPIUA purchasing reinsurance?
A. There is associated with the cat bond, yes. And those are outlined in one of the exhibits that -- I wouldn't be able to speak offhand about them, but they're outlined somewhere in here, I don't remember exactly where. Other than that, no, not for traditional fees.
Q. Is it reasonable, in your opinion, for MPIUA policyholders to pay for the transaction costs of the MPIUA's risk transfer to reinsurers?
A. It's a cost of doing business for the MPIUA. So I would argue it would be reasonable, yes.
Q. And, in your opinion, is it reasonable

regardless of the amount of reinsurance that the MPIUA purchases?
A. I apologize for the answer, but as long as the costs are reasonable, then it would be reasonable to pass those costs on to the policyholder.
Q. Is that 10 percent -- I'm sorry. Strike that.
Is the brokerage commission, including the reimbursement, is the brokerage commission a reasonable expense for MPIUA policyholders to pay for the transfer of risk from the MPIUA to reinsurers, regardless of the amount of the actual reinsurance that's purchased?
A. Yes.
Q. And am I correct to understand that it's your testimony that the transaction costs are reasonable because they are an expense of doing business?
A. And they're reasonable.
Q. Well, what do you mean by "reasonable"? Are you referring to the amount of the transaction costs?
A. They're not unreasonable; let's put it that

way. So if it's not unreasonable, I would argue it's reasonable to transfer those costs, as a cost of doing business, to the policyholders.
Q. So --
A. That would be -- that's my answer. That's my testimony.
Q. When you say "not unreasonable," what do you mean by that?
A. They're reasonable.
Q. So am I correct to understand, then, if the MPIUA decided to buy a lot of reinsurance, then paying the brokerage commission on that reinsurance purchase would be reasonable for the policyholders to do, and if the MPIUA decided to buy less reinsurance, then paying the brokerage commission on that smaller purchase is also reasonable for the policyholders to do?
A. I would argue that that's reasonable, yes.
Q. And is the transfer of risk from the MPIUA members to the international reinsurance market a benefit to MPIUA's policyholders?
A. The transfer of risk in and of itself is the benefit. As long as it gets transferred to an entity that people feel is creditworthy, the

transfer of risk is a benefit.
Q. How is the transfer of risk from one set of insurance companies, the MPIUA members, to another set of insurance companies, the reinsurers, a benefit to the MPIUA policyholders?
A. The same manner -- it's a benefit in the same manner that it's a benefit to the policyholder to transfer the risk to the MPIUA in the first place. They've decided they don't want to take that risk themselves; somebody else should take it in exchange for a premium. So that -- it's presumably the reason for the original policyholder purchasing the policy to begin with, to transfer the risk.
Q. But isn't there a cost to each transfer of risk?
A. Sure.
Q. And the cost includes transaction costs, right?
A. Sure.
Q. And each insurance company that agrees to accept a transfer of risk loads into the premium that it requests some profit provision, correct?
A. Why wouldn't they?
Q. Well, they do, right?

A. Yes. Sorry, I apologize. You're not supposed to answer a question with a question.
Q. So if we take this to its logical extension, right, if each entity that accepted risk transferred the risk, it would just add to the total cost, would it not?
A. Not necessarily.
Q. What do you mean by that?
A. It depends on the math behind it. I mean -- so, in other words, you could certainly have a scenario where premiums were transferred to the MPIUA, and then a similar amount -- then for a portion of that risk, premiums were transferred to another entity, and the sum total of that premium would be less than the amount of premium that the MPIUA generates in the first place. So that could certainly be a scenario where it's not additive.
Q. And do you know whether that scenario is reflected in the MPIUA's filing?
A. I don't specifically know the details of the rate filing to that degree.
Q. And do you know what effect the MPIUA's reinsurance program has on the MPIUA's profit provision that's in its filing?

A. I don't.
Q. Do you know whether the fact that the MPIUA has a reinsurance program means that the MPIUA policyholders are being asked to pay more than merely the additional reinsurance premium?
A. I do not know the details to that degree.
Q. In opining that the amount of reinsurance that the MPIUA purchases is reasonable, did you take into account the effect that reinsurance program has on the premiums that MPIUA policyholders pay?
A. No.
Q. Is it correct that in the long term, the cost of reinsurance is greater than the expected recovery from reinsurance?
A. Yes.
Q. Let me draw your attention to Page 1112R in the filing.
A. I'm sorry, what page?
Q. 1112R, R only because it was replaced.
A. I don't have that page, I believe. 1112?
MR. MEYER: That's part of the profit filing that Mr. Wackerman is not responsible for.
Q. Mr. Wackerman, I'm handing you what was marked as Exhibit 4 this morning, and it includes

Page 1112R from the filing. Have you seen this page before today?
A. No.
Q. So independently of this page, do you have any understanding of the magnitude by which the long-term cost of reinsurance exceeds the long-term expected recovery from reinsurance?
A. No. I don't have any perspective on this exhibit.
Q. Independently of this exhibit, do you have an understanding of the magnitude of the difference between the long-term expected cost of reinsurance and the long-term expected recovery from reinsurance?
A. No.
MR. KLIBANER: I have no further questions at this time. Thank you, Mr. Wackerman.
PRESIDING OFFICER FARRINGTON: Thank you.
All right. It's about a quarter past twelve. Shall we take an hour's lunch break? I think everybody knows there's a cafeteria on the 11th floor of this building.
MR. MEYER: Can we have how much Mr. Leight has roughly, so we can plan.

MR. LEIGHT: Not a huge amount. Maybe an hour.

MR. MEYER: Thank you.

(Luncheon recess)

AFTERNOON SESSION

PRESIDING OFFICER FARRINGTON: Back on the record.

CROSS EXAMINATION

BY MR. LEIGHT:

Q. Mr. Wackerman, the testimony that's in Exhibit 2 and the various exhibits and attachments that relate to the reinsurance and the swap transaction were for a purchase that began on July 1, 2011, and ended June 30, 2012; is that correct?

A. Yes.

Q. Is there any material in your testimony that relates to reinsurance or to the swap layer to be purchased for any time period after June 30th, 2012?

A. No.

Q. Now, MPIUA also purchased a catastrophe bond in 2010 initially, correct?

A. Correct.

Q. Now, during what time period does that bond remain in effect?

A. It's a three-year incepting in 7/1/2010, so it will expire 7/1/13.

Q. And what is the annual premium for the

bond?

A. I don't recall specifically, but it's in my testimony.

Q. Is it paid on an annual basis?

A. It's paid -- we looked at it annually. I believe it's paid -- there's multiple installments associated with it, I believe. I don't recall specifically the installment plan associated with it.

Q. Would you look at Page 274, the single sheet that's on the table right in front of you. There is a line on that -- do you see Line 3, "Reinsurance premium: CAT Bond"?

A. Yes.

Q. Is that number the accurate annual premium for the cat bond?

A. I believe it is, yes.

Q. So that's about $7.6 million, correct?

A. Correct.

Q. You mentioned earlier in your testimony that the cat bond was set up by a special-purpose vehicle, and I think you said that you were not actually involved in that transaction; is that right?

A. Correct.

Q. Do you know anything about the special-purpose vehicle?

A. I have very limited knowledge, other than that it was just generally set up in the customary fashion that a catastrophe bond would be set up in, based upon my knowledge.

Q. Who set that up? Was that something that Guy Carpenter set up?

A. Correct. We have a team of people in Guy Carpenter Securities that would be responsible -- that are responsible for that transaction.

Q. And can you go through -- do you know how the transaction was structured?

A. I know how it was structured in relation to where it fits in with the MPIUA's cat reinsurance program, but I don't know how the deal was actually structured, i.e., set up as far as the special-purpose vehicle in that. The nuances of setting up the special-purpose vehicle I'm not familiar with.

Q. The special-purpose vehicle was set up in the Cayman Islands; is that right?

A. I believe that's correct.

Q. And who were the investors in the special-

purpose vehicle?
A. I don't recall.
Q. Did you at any time know who they were?
A. I've seen a list.
Q. Are any insurance companies investors, or reinsurers?
A. I don't recall.
Q. Are these investors people that work with or are clients of your firm?
A. Not to my knowledge, but it's possible they could be.
Q. And is there any rating or any kind of analysis of the special-purpose vehicle done to determine how safe the investment is, to your knowledge?
A. I believe there is, but I'm not familiar with the circumstances under which they would be done.
Q. In terms of the actual payment of premium, do you know how that works? Presumably the MPIUA pays the premium to -- does it go through your firm to the special-purpose vehicle, or how does that work?
A. I don't recall specifically how that

portion of it works, whether it goes through Guy Carpenter or whether it's a direct payment to the special-purpose vehicle.
Q. The bond had some form of a start-up cost initially, did it not?
A. Yes.
Q. And do you know how much that was?
A. I don't recall specifically.
Q. Is that amortized over the three-year period as part of the premium?
A. It was amortized over a three-year period to do cost comparisons to traditional reinsurance.
Q. Well, in terms of the amount we were looking at before, the $7.6 million, does that include some prorated portion of the start-up?
A. I believe it does.
Q. And in terms of -- when I asked you about, you know, the proration and whatnot, is it your understanding that the amount was actually paid up front, even though, for accounting purposes or rating purposes or whatever, it's considered over the three-year period?
A. Certain components would have been paid up front, yes.

Q. Do you know what the start-up payment is paid for, what the purpose of that is?
A. There's a number of start-up costs that are associated with the cat bond. But, again, the specific details behind that is not something I'm an expert in.
Q. Is one of the up-front costs a payment to Guy Carpenter?
A. I believe one of the up-front costs is an annual cost to Guy Carpenter. So it would have been part of the up-front cost, but it would have been -- I don't believe the entire fee was paid up front.
Q. So if we're talking about the fee to Guy Carpenter, that would have been paid on an annual basis?
A. Correct.
Q. Before, when we were talking about the amount of the commission, you mentioned 10 percent. Is that applicable to all of these different forms of reinsurance?
A. No, that was just as it relates to traditional reinsurance.
Q. And how did the fee work for the cat bond?
A. I believe it was based upon a percentage of

the amount of reinsurance purchased by the bond, is my recollection. So, in other words, it would be a percentage of the $94 million.
Q. Do you know what percent that was?
A. I don't recall specifically, but I believe it's outlined as part of the cat bond testimony.
Q. Do you want to point to that for us so we can take a look at that?
MR. MEYER: If I may help Mr. Leight, it's Page 1370.
MR. LEIGHT: You always help, Mike.
MR. MEYER: And that's one of the ones that got amended because it was Xeroxed wrong.
Q. So we're looking at 1370R. Now, is it correct that this is a page that refers to the cost calculation for the cat bond?
A. That's correct.
Q. And the values at closing in the column that's entitled "At Closing" were the up-front costs; is that right?
A. That's correct. And, again, I just want to emphasize, I don't recall whether this is -- if this was the actual cost at closing or the estimated cost at closing. I know at the time this was provided, I

believe that they were -- some of the prices associated with these were still being negotiated. So I believe that this was an original estimate of what those prices were to be.

Q. Well, let me just ask you if you know what the amount of the commission on the cat bond was.

A. I don't recall specifically what it was.

Q. Do you recall what the -- if we're looking at the value on Page 274, which was the single page to your right there, what the total amount of the commission included in the $79,252,883 value on Line 9 is?

A. I don't know specifically what goes into the calculation of the subelements, 6, 7 and 8, but I'm assuming that that math just carries through to result in the expected cost of reinsurance purchased of $79 million, roughly.

Q. So let me back up for a second. Is it your understanding that, during this period, July 2011 through the end of June 2012, the FAIR Plan spent $79.25 million on reinsurance?

A. I believe that the amount spent was $82.9 million. I believe that was the amount actually spent, less the commission reimbursement. So it

would have been roughly $75 million -- excuse me, $77 million, roughly.

Q. So you think this number, 79.25, is inaccurate, is not accurate?

A. I think it's accurate for -- I don't know whether it's accurate relative to what's on this page.

Q. Well, it refers -- it is referred to here as "Expected total cost of reinsurance purchased." Is it your understanding that that amount, $79.25 million, was the expected total cost of reinsurance purchased during the period July 2011 through June 2012?

A. Again, I don't know how you calculate the expected average annual reinstatement premium at the bottom there.

Q. Forget about that for a second. Just answer my question. Do you know whether the value $79.25 million is the expected total cost of reinsurance purchased for that period?

A. Again, I don't know if that's the case, because I don't know how these three pieces are calculated. So I would assume that that's the case, based upon looking at this exhibit, yes.

Q. But you don't know?

A. I don't know for certain.

Q. And in terms of the reimbursement, the commission reimbursement, is that -- are those dollars that are actually paid from Guy Carpenter to the FAIR Plan?

A. I believe that they are, yes. I don't know whether it comes by way of an actual payment from us to the MPIUA or a reduction of the amount that the MPIUA pays the reinsurers in its reinsurance deposit; in other words, whether it's offset or not. That's what I'm saying.

Q. Right. But either way it is a transaction in which dollars flow from Guy Carpenter back to the MPIUA?

A. Yes.

Q. And that means, roughly speaking, that the commission is reduced from somewhere in the $8 million range to somewhere in the $3 million range; is that approximately right?

A. Approximately, yes.

Q. Is the reinsurance reimbursement -- would you consider that a rebate?

A. I would consider it a reinsurance

commission reimbursement or a broker services agreement. That's the definition that we typically have for it.

Q. And is there an agreement -- is that part of the reinsurance agreement?

A. Meaning the contract between reinsurers and the MPIUA?

Q. Yes.

A. No.

Q. Is there a separate agreement between the MPIUA and Guy Carpenter that deals with this return of commission funds?

A. Yes.

Q. And is that in the filing?

A. I'm not certain if it's in the filing.

Q. Well, is it in your portion of the filing?

A. No, not that I recall.

Q. And what exactly -- have you seen that document?

A. I have. I can't recall whether it's an official document or just an agreement. But I believe -- yes, I have seen it at some point, yes.

Q. It is a written document, though?

A. Correct.

Q. So I guess when you said "official" --
A. Well, I mean, again, it's not part of this --
Q. It's not part of the reinsurance --
A. And it wasn't something that was created this year.
Q. When was it created?
A. I believe in -- somewhere around 2006, or 2008, I apologize, somewhere around there.
Q. But it is an agreement that covered the purchase of the reinsurance during the policy year July 2011 through 2012?
A. Yes.
Q. Do you recall what the agreement said?
A. It basically outlined the amount of, for lack of a better expression, sharing that would take place between Guy Carpenter and the MPIUA as it relates to the brokerage we would earn on a particular contract.
Q. Did it do so in terms of a percentage of the commission that would be refunded to the MPIUA?
A. Yes.
Q. And do you recall what that percentage was?
A. I believe it's a 75/25 percent split for

amounts in excess of I believe it's a million, but I don't recall specifically. But I believe that's what it is.
Q. Now, you don't have this in front of you. I'll just show you my copy. This is the filing that's been marked as Exhibit 2. If you just look at Page 275, on this page it shows that the reinsurance premium for the owners forms represents 29.4 percent of the total premium at year-end 2010 adjusted to current rates. Do you see that?
A. I'm sorry. Where am I supposed to be looking at.
Q. Page 275.
A. Okay. Sorry.
Q. And for owners forms, the reinsurance premium as a percent of direct premium, do you see that, in Column 6 --
A. Yes.
Q. -- represents 29.4 percent of the premium?
A. Uh-huh.
Q. And for all forms, 28.2 percent of the premium? Do you see that?
A. Yes.
Q. Were you aware of those numbers before you

just looked at that page?
A. No.
Q. If you were to be advising an entity about how much money the entity were to pay for reinsurance, is one of the things you would consider the percent of premium that was represented by the reinsurance purchase?
A. It certainly could be.
Q. But you weren't aware of that when you were advising the MPIUA?
A. Not specifically in this manner, no.
Q. Did you or anyone else at your firm perform any kind of market analysis that shows the premium used to purchase reinsurance for other companies in the Massachusetts homeowners market?
A. Not necessarily specific to the amount of premium, but that information could certainly be available.
Q. Well, I'm not asking whether it could be but whether you did perform an analysis that essentially looked at other companies in the Massachusetts market and determined what percentage of their premium was used to purchase reinsurance.
A. We did not do that in this circumstance.

Q. When you placed the FAIR Plan's reinsurance, did you have direct contact with any employees of reinsurers?
A. Yes.
Q. So you actually have interaction with reinsurance people?
A. Yes. Of reinsurers that are on the MPIUA's program?
Q. Yes.
A. Yes.
Q. And are those underwriters or account executive?
A. Underwriters typically.
Q. And would you have interaction with underwriters for each of the companies on the FAIR Plan's program, or would there be kind of a lead one that you would talk to mostly?
A. Typically speaking, you would have -- whoever the underwriter is that is assigned to the MPIUA account is the person that we would typically discuss this account with, or their team of people, if they had more than one person. And we would be certainly speaking to those people on a fairly regular basis.

Q. And would that be for numerous companies or --
A. Yes.
Q. In the course of your contacts with these individuals, did they show you the calculations they used to price the premium for MPIUA's reinsurance?
A. No.
Q. Did you ask for those calculations?
A. Yes.
Q. And they refused to give them to you?
A. They do not typically disclose all of the calculations behind their rating.
Q. When you asked for them, did they say, "No, we're not going to share them with you"?
A. Yes.
Q. Isn't it the case that the primary purchase of reinsurance -- and when I use that term, I'm referring to all the various kinds, the swap layer, the catastrophe bond -- is to provide coverage for expected ceded losses?
A. That would be one objective, yes.
Q. Is there another?
A. Well, the way you just defined that I thought would be sort of from an actuarial

perspective. But generally from an underwriting perspective, it would be to cover the MPIUA for hurricane losses, losses that might arise out of a hurricane.
Q. Right, so ceded hurricane losses?
A. Yes.
Q. As part of the process of purchasing the reinsurance, did you or anyone at Guy Carpenter perform a calculation of the amount of expected hurricane losses that were to be ceded to the reinsurers?
A. Yes. We would have looked at expected losses -- we would have looked at what the expected loss to each layer would have been, as calculated by the various models.
Q. And that was something that -- would you have done that, or was that something another function within Guy Carpenter would have done?
A. It would typically have been calculated as part of another function of Guy Carpenter.
Q. Were those numbers shared with you?
A. Yes.
Q. Are they in the filing?
A. I don't believe so, because the MPIUA did

its own calculation of those figures directly with AIR and RMS.
Q. Did you share the numbers that you calculated with the MPIUA?
A. Not -- we might have shared -- I don't recall specifically if we shared the expected loss to the layer with the MPIUA. I believe we did, but I don't recall specifically.
Q. Do you recall comparing the calculation you did with the calculations that the MPIUA did?
A. I recall looking at the -- not the expected loss to the layer, but the distribution of losses; in other words, the 1-in-100-year PMLs that were produced by AIR directly and the calculations that we utilized.
Q. But you did not look at the total expected losses?
A. I did look at the expected losses that I calculated, but I didn't compare those specific losses to the MPIUA. But I did that in another way by comparing the PMLs, so the 1 in 100, for example.
Q. And what about the reinsurers' calculations; did you look at those?
A. We asked for those calculations as best we

can, and, again, based upon my earlier testimony, the reinsurers utilize different methods to establish what the price is going to be, and not all of them use each of the vendor models, or not all of them use the vendor models in the same manner.
Q. I was asking a simpler question.
A. Sorry.
Q. Did you look at the reinsurers' calculations of expected losses?
A. If they shared them with me, yes.
Q. Well, did they share them with you?
A. In some circumstances, yes.
Q. And did you compare those to the calculations that you had performed?
A. Yes.
Q. And were they the same numbers?
A. In some cases yes, in some cases no. Sometimes they were higher, and sometimes they were lower.
Q. And are those numbers anywhere in the filing?
A. No, I don't believe so.
Q. What about at the MPIUA Board meetings that you attended? The amount of expected ceded losses,

was that a subject that was discussed with the Board?
A. Not that I recall.
Q. Do you know whether the Board, to your knowledge, whether the Board or the members of the Board had knowledge of the expected ceded losses?
A. I'm not sure.
Q. You don't know?
A. I don't know.
Q. Let me just show you an exhibit. You may not have seen this before. This was produced to us by the MPIUA.
MR. LEIGHT: Can we mark this for identification Exhibit 5.
PRESIDING OFFICER FARRINGTON: Any objection?
MR. MEYER: No objection. Could you just tell me on what question this was a response to, what discovery response this is? You can do it off the record.
MR. LEIGHT: We'll look it up.
(Document marked as Exhibit 5 for identification)
Q. Mr. Wackerman, have you had an opportunity

to look over Exhibit 5?
A. Briefly, yes.
Q. Let me ask you first whether this or something like this is something that you have seen before.
A. I've seen exhibits similar to this, but not exactly like this.
Q. Okay. This exhibit shows, in the column on the right, the ceded hurricane loss and LAE. Do you see that?
A. Yes.
Q. And if you add up all the forms there, roughly, the amount of ceded losses will add up to about $18 million. Do you see that?
A. Yes.
Q. Is it your understanding that that $18 million is a accurate representation of the ceded hurricane losses under the MPIUA's reinsurance program?
A. I don't recall -- I don't know the ceded loss number calculated by the models specific to this rate filing. So I would hesitate to confirm that.
Q. Okay. Well, do you have a recollection, as

you sit here today, of approximately what the ceded hurricane losses were as you understood them at the time the reinsurance was placed?
A. This looks roughly in line with my recollection of that.
Q. Now, when you had discussions with the reinsurers, did you ever discuss with them whether, in their view, this was an accurate representation of the losses that they were expecting to cover under the reinsurance program?
A. The discussion with reinsurers is typically focused on understanding the --
Q. I don't want to cut you off, but this is basically a yes or no question.
MR. MEYER: May the witness be allowed to answer the question, and we'll find out what the answer is.
Q. Go ahead.
A. The ultimate answer to the question is yes. I'll just leave it at that for now.
Q. And do you recall whether, in your discussions concerning the ceded losses, the $18 million number or something around that was also the number that the reinsurers believed that they were

covering under the reinsurance program?
A. Therein lies the answer to my question I was getting to. Not each reinsurer will utilize the modeled output precisely from the vendors. They may believe that it's too high or too low. There may be other elements that they feel are not included in the actual modeling result. So, as an example, some reinsurers may say, "Well, the model doesn't include tree damage, estimates associated with tree damage. So we're going to factor that in," because it's not -- the model will say it's not included.
So those are the types of discussions that we seek to understand from the reinsurers to try and understand whether they're pricing the business appropriately and whether the numbers that they're utilizing are something that makes sense to us in relation to the number that we might have based upon our calculation.
Q. And is it also true that some of the reinsurers use the so-called near-term models that produce higher expected results?
A. That is true, yes.
Q. And would it be fair to say, as a general matter, that, based on your discussions with the

reinsurers, it appears that some or all of the reinsurers would have come up with different expected losses from the ones that you or the MPIUA came up with?
A. **Yes.**
Q. Now, when you -- I take it you're not an expert on the models yourself, right?
A. **Correct.**
Q. Or an expert on climatology or any of the vulnerability functions and so forth that are part of the model. You're not an expert on any of those?
A. **Correct.**
Q. Did you review -- in the process of placing the reinsurance for the MPIUA, did you review the frequencies of the hurricanes in the models?
A. **I did not, no.**
Q. And did you review any of the historical data on Massachusetts or New England hurricanes in that context?
A. **I have looked at the historical data for Massachusetts.**
Q. And is one of the -- in the context of the MPIUA purchase of reinsurance, did you compare the historical data on Massachusetts and New England

hurricanes with the model frequencies to determine whether they were consistent?
A. **No, I did not do that specifically.**
Q. Did you examine the vulnerability functions in the model to determine whether they were specific to Massachusetts?
A. **No.**
Q. Did you review the models to determine whether they reflect only hurricanes that made landfall in Massachusetts or passed by so closely that hurricane winds damaged property in Massachusetts?
A. **No, I did not.**
Q. In determining the MPIUA reinsurance premium, do you know whether the reinsurers charged the MPIUA an extra amount of premium because the MPIUA is a residual market as opposed to a voluntary company?
A. **No, I do not.**
Q. Is that something you would have discussed with the reinsurers or they would just not tell you?
A. **We attempt to spend a significant amount of time highlighting all the reasons why the MPIUA is like a member company to avoid any ability on their**

part or willingness on their part to price it as if it were not.
So we are trying to highlight as many times as we can the benefits of the MPIUA and the manner in which it's structured and the manner in which it's organized and the things that it does just like member companies do, to attempt to negotiate the best price for the MPIUA.
Q. Let me ask you this: In your view, should the MPIUA be charged more premium than a voluntary market company in the same position?
A. **No, absolutely not.**
Q. But you don't know whether the reinsurers share that view; is that fair?
A. **That's fair, although I believe that most of them, because of their understanding of the MPIUA now, do not price it significantly different than the member companies.**
Q. And the same thing with respect to expected ceded losses. Is it your view that the MPIUA -- assuming that we have an $18 million expected ceded loss here, that the MPIUA should be charged the same premium for reinsuring that expected ceded loss as a voluntary market company with the same expected

ceded loss?
A. **Yes.**
Q. Are you familiar with the term "net cost of reinsurance"?
A. **Very generally.**
Q. Well, are you generally familiar with the fact that a reinsurance premium includes, in addition to the expected cost of the ceded losses, an additional amount that covers either expenses for reinsurers or reinsurers' profit over and above the amount of losses?
A. **Yes.**
Q. Now, the amount -- the total amount of the premium we were looking at before that was on Page 274 was about $79.25 million. Do you recall that?
A. **Yes.**
Q. And assuming once again, and I know that this is not your number, but that the numbers on Exhibit 5 accurately reflect the expected ceded hurricane losses of roughly $18 million, that would represent between 22 and 23 percent of the reinsurance premium? You're welcome to do that calculation for yourself.
A. **It looks reasonable.**

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Q. And was that generally your knowledge of the percentage that the ceded losses bore to the total reinsurance premium at the time you purchased the reinsurance?
A. Again, I wasn't thinking of it in that manner at that point in time. But, yes, it sounds reasonable.
Q. But that's roughly in line with --
A. It's in line, yes.
Q. Now, you had previously testified a couple of years ago that you weren't sure exactly what the reinsurers' expenses were, but you thought they were somewhere between 8 and 15 percent of premium. Do you recall that?
A. I don't recall that.
Q. Well, let me just ask you now. Do you have any knowledge of what portion of the reinsurance premium has to do with the reinsurers' expenses?
A. It would be between those numbers, I would agree.
Q. And do you know what -- can you describe generally what expenses those would cover, those dollars?
A. Certainly brokerage expense is paid by the

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reinsurer, so that's typically 10 percent. And then they have other underwriting expenses that they would attribute to any individual deal. That would essentially make up the balance.
Q. And how does the reimbursement, the commission reimbursement, factor into that? Is it the case -- let me --
A. It doesn't.
Q. So is this reimbursement arrangement an unusual one, or is it the case that on most accounts of any size, you would have some similar kind of arrangement?
A. It's my understanding that it would be typical of large transactions of this nature, yes.
Q. And that would tend to reduce, at least from the client's standpoint, that would tend to reduce the amount of the expenses in the rate?
A. Correct.
Q. What about the insurers' profit? Do you know what portion of the premium is represented by the insurers' profit?
A. I do not.
Q. To the extent that we're looking at, say, 22 percent ceded losses and roughly 10 percent of

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expenses, is the remainder of it profit?
A. Sorry. Could you share those numbers again.
Q. Well, we looked at the expected losses, which were about 22 percent of the reinsurance premium?
A. Uh-huh.
Q. And you testified that the expenses represented 8 to 15 percent, something in that range. Is the remainder profit?
A. It could be profit, or it could be, you know, a risk charge.
Q. But --
A. Charge for taking -- I mean, again, the exact component that each portion makes up for each individual reinsurer may differ.
They may look at an expected loss -- even though we've agreed on a common price, each reinsurer has its own view of what the loss potential is for the contract. They will have obviously the expense portion, which is not the same for every reinsurer, and they will have a risk charge component that is not the same for every insurer. And then they will also themselves have

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their own individual implied margins or yields that they need to have, based upon the construct of their own portfolio.
Q. Let me ask you this --
A. So my point is it's different for every reinsurer. To suggest that every reinsurer does this in the exact same manner is not the case. So that's why, when I say to you I don't know exactly what it is, that's what I mean. It's different for every reinsurer.
Q. Well, would you have the ability to determine on average what the numbers are for all the reinsurers?
A. I don't know what the profit load is that each individual reinsurer makes.
Q. Do you know the profit load for any individual reinsurer?
A. I don't recall specifically.
Q. Well, when you say you don't recall, would that have been something that you would have discussed with the reinsurers?
A. It may have been something I tried to get them to tell me specifically what it was. But, again, it's because in each individual negotiation

and each individual discussion, they would hesitate to provide that information because it's not the same to for every single entity, for the reasons that I just described. They have different concentrations and different appetites for different risks. So it's all unique negotiation and discussion.
Q. And in terms of the placement of the MPIUA's reinsurance, do you recall any of the reinsurers telling you what the profit load in their portion of the rate was?
A. I don't recall specifically.
Q. And the same question with respect to expenses. Did you have that discussion with anyone?
A. I don't recall specifically.
Q. In your mind, is there a difference between a risk load and a profit load?
A. Well, the risk load would be the component that the reinsurer is trying to charge for the actual risk that they're taking.
Q. Well, isn't that why -- I'm sorry.
A. And then the profit component would be, okay, I'm going to take this risk, so as part of taking this risk, I should be paid some number to

pay for a profit for actually taking that risk, because there is risk associated with it.
Q. But once you determine the expected ceded losses, those losses are the risk that the reinsurer is taking, are they not?
A. Well, it's a representation of expected risk. But the risk could be significantly higher.
Q. Or lower, right?
A. It could be lower or higher, yes, because the expected is so much closer to the nominal -- it's closer to zero than it is to the limit of the contract.
Q. Well, that has to do with the probability that there will be a loss. The probability that there will be a loss is extremely low, right?
A. There's a lot of volatility, yes.
Q. And that's why, even for -- you could have a $1 trillion event with a probability of 1/1 trillion which is priced at $1, right?
A. In theory you could.
Q. So I guess the question I was asking is, to what extent -- isn't the profit that the reinsurer is earning the correct payment for the risk?
A. Is it the correct profit?

Q. Isn't the profit that's loaded into the rate what the reinsurer expects to earn for taking on the risk of the ceded losses?
A. Well, I would argue that it's the risk load -- I would argue that it's the risk load and the profit margin combined would be the amount that would be charged.
Q. But you don't know what that number is for any of the reinsurers?
A. Not specifically, no.
Q. And do you recall at any of the MPIUA Board meetings whether any discussion of the reinsurers' profit on the reinsurance transaction took place?
A. Not specifically, no.
Q. Did anyone on the Board of the MPIUA ask you to obtain information about the portion of the reinsurance premium that was represented by the reinsurers' expenses or profit or risk load?
A. No.
Q. And as far as you are aware, when the Board made the decision to purchase the reinsurance, it didn't have this information, correct?
A. I'm not sure whether it had the information. I just know that it didn't ask -- that

I wasn't involved in any discussions. I could not assume whether they had that information or not.
Q. You don't know whether they did or not?
A. I don't.
Q. But as far as your participation in the Board meetings, you did not provide that information and --
A. Correct.
Q. -- you did not hear any discussion of that information?
A. Correct.
MR. LEIGHT: Thank you very much. That's all I have.
PRESIDING OFFICER FARRINGTON: Did you want to retain the ID note on Exhibit 5 or --
MR. MEYER: No, as long as they tell me off the record where it came from, I have no problem with it being an exhibit.
MR. LEIGHT: 24D.
MR. MEYER: Thank you.
(Document marked as Exhibit 5 received in evidence)
PRESIDING OFFICER SUMNER: I would like to ask you a few questions about the reinstatement

provision.

EXAMINATION
BY PRESIDING OFFICER SUMNER:

Q. You started discussing that on Page 1196 of the filing, and you say the reinstatement premiums are equal to the original premium paid by the MPIUA.
A. Correct.
Q. Is that the original amount reduced by the reimbursements, or is that --
A. How is it actually set, you mean? The way the reinstatements work is once you set the up-front premium for a contract, it essentially gives you the option -- you're buying the second -- you have the ability to buy the second limit at the same premium that you've set for the original limit.
So that's just the way the reinstatements work in general, and that's the way contracts are typically structured, to include that reinstatement provision, because if you didn't have the reinstatement provision, then you wouldn't have that second limit available, and you would essentially be bare for the remainder of the year, and you might not want to be.
But if you had to go out and negotiate

another limit at that point in time, it would cost you significantly more. So that's why people typically have a reinstatement within the contract, and it's simply just set at that point in time as the equivalent price of the original.
Q. Right, but the original premium includes the commission to Guy Carpenter, does it not?
A. Oh, yes.
Q. So that's my question. You're giving back some of that commission to the MPIUA.
A. Correct.
Q. For the original premium.
A. Correct.
Q. Will that also be true for the reinstatement premium?
A. Well, we wouldn't earn -- or for the reinstatement provision, we would earn 5 percent for -- so the answer is yes. Yes, it would. It would operate in the same manner. It would just -- based upon the calculation that I advised before. So yes, we would return revenue in the same manner.
Q. One thing I'm not quite clear about is the reinsurance attaches at $200 million; is that correct?

A. Yes.
Q. So if there were a loss from one hurricane of $201 million, what would the reinstatement premium be?
A. It would be the percent -- whatever one dollar part of the first layer, which is -- let me make sure I get my numbers right. Hold on one second. (Reviewing documents)
Q. Would it just be the premium to reinstate --
A. It's just a percentage -- I'm just trying to get the numbers correct, and I'm just forgetting the exact number. What page was that on?
MR. TOMMASINO: 1405.
A. Okay, this makes it easier. The first layer is a $100 million stretch. I couldn't remember the precise... So it would be one dollar part of $100 million, that ratio. That's the ratio of the deposit premium that you would pay again.
Q. I wasn't sure if that was clear from the filing, but I just wanted to make sure that was clear on the record.
A. Okay.
Q. Can you tell me, what's the philosophy of

having 100 percent reinsurance at the higher level, at the highest level layers of reinsurance?
A. Well, it's an area that is typically fairly remote, but it's also the area where the risk transfer, if you will -- the economics of it are most advantageous. It's the lowest rate on line layer, so there's the most risk transfer, if you will, there. So typically people place larger amounts of the upper layers as a result of that, again, with the objective still to be to protect to, in this case, the 1-in-123-year event.
Q. At Page 1195 of the filing, the answer to the first question that's asked -- well, to the only question that's asked on that page, you write, "The MPIUA Executive Committee and Board evaluated severe catastrophe loss potential by reviewing several factors," and then you list some, saying this is "including, but not limited to, MPIUA's unit count, total insured value, geographical concentrations, wind deductibles, and deterministic and probabilistic catastrophe model outputs from AIR and RMS."
Can you tell us what other factors were considered?

A. I'm not aware of any other factors specifically. It's just some of the other -- the Executive Committee members could be using their own judgment and experience based upon their views, and I'm not aware of anything else specifically or I can't think of anything else specifically off the top of my head right now that was evaluated.

PRESIDING OFFICER FARRINGTON: I have a few questions, Mr. Wackerman.

EXAMINATION

BY PRESIDING OFFICER FARRINGTON:

Q. Several times in the course of your testimony, you referred to probabilistic and deterministic modeling scenarios.

A. Right.

Q. What exactly do those two terms mean?

A. So the probabilistic loss scenario would be what is the chance of a -- it would be the example of a loss distribution, so at a 1-in-100 year interval, you could estimate that the loss to the layer would be this, and at a 1-in-50-year, it would be that. So that would be a probabilistic loss scenario over the course of a significant period of time.

A deterministic loss scenario would be typically, okay, if I reevaluated the Hurricane of 1938, what kind of impact would that have on the program. So it's looking at a specific storm and asking the model to tell you what the estimate would be based upon the storm characteristics of that individual storm. So that would be deterministic.

Q. Do you know how the modelers reconcile those two approaches to come up with the result?

A. Not necessarily reconcile. I'm not sure, but they --

Q. Combine, whatever.

A. You typically would have -- I mean, essentially those deterministic storms are included within the storm set. So you will have a whole bunch of storms of -- the actual storm that took place will be part of the analysis that they have, so historical storms that have specific known characteristics. And then they're -- my understanding is they're attempting to mimic those types of storms and have different probabilities associated with them. And they put all that together, and that becomes what is the probabilistic storm scenario.

Q. You mention also in your paragraph on 1195 that "Supplemental underwriting information was provided in April." I think that's of 2011. What kind of supplemental information was that?

A. Can you just direct me where that is? Oh, here it is. I got it.

Q. Around Line 4.

A. (Reviewing document) Okay. In this case supplemental underwriting information was simply meant to mean additional data from the MPIUA that we used to compile the underwriting information that we provided to reinsurers. So it would have been just be a listing of the exposures by county, by ZIP Code, what the final -- what the subject premium was, what the estimated total insured value will be prospectively, those types of things.

Q. I sense from your testimony, and whatever history we have gathered over having these hearings, that the MPIUA actually has never collected on a reinsurance policy.

A. That is correct. The hurricane hasn't hit yet, at least the big one.

Q. Does that sort of history -- how does that affect the desirability of the risk?

A. Well, we certainly make the argument that it makes the risk more desirable from the reinsurer's point of view. We tend to point out pretty regularly that there haven't been that many hurricanes hitting the Northeast.

Q. The other thing is, you talk about -- what you refer to in your testimony is reinsurance to cover catastrophic losses, but in terms of the actual discussion that we're having, it seems to me that we're considering those only as hurricane losses; is that correct?

A. That seems to be the most likely severe event that could take place. I mean, there could be a riot that would be covered under the MPIUA's policy. It's possible. The most likely outcome is a hurricane. I mean, there could also be an earthquake that would be covered if it were to occur, but it doesn't seem to be likely in the Northeast.

So those are the types of things that could also be covered, but it's usually -- and also tornado/hail events. Those would be covered, if they were to occur similarly to the way they did in Joplin earlier last year. If those types of events

came through Massachusetts, to that widespread of a degree, they would be covered.

Q. When you indicated in your earlier testimony that there was nothing particularly unique about the MPIUA, is that -- do other insurers, reinsurers, tend to cover for a single type of loss, anticipated loss?

A. There tends to be a primary peril that is the one in consideration, similar to the Massachusetts FAIR Plan.

Q. You have mentioned two different return periods. In your testimony you talk about 1 in 113 years, and then you mentioned 1 in 123 years today.

A. I think it was 1 in 123 is what I intended to say.

Q. In your written testimony --

A. I believe my written testimony says 1 in 123, does it not?

Q. No, it says 1 in 113. Page 1202, the bottom question, "attaches at 1 in 26 and exhausts at 1 in 113."

A. Okay, there you go. 1 in 113 is what I intended to say, and thank you for your clarification.

Q. So it is 1 in 113?

A. My written testimony is correct.

Q. How many reinsurers, to the best of your knowledge, develop their own models for catastrophes?

A. There are several that create their own model, and almost all of them create their own view using the existing models.

Q. Is there any sort of standard for the amount of -- whether you reinsure to 1 percent of your total insured value?

A. There is no typical standard. It's that you typically look to see how concentrated a portfolio is to determine the reasonableness.

Q. And is 1 percent a reasonable -- what you consider a reasonable value for a concentrated portfolio?

A. When you have a highly concentrated portfolio, that's reasonable.

Q. And what happens in a less concentrated portfolio?

A. Well, typically in a less concentrated portfolio, there would be a much higher amount of TIV that would be spread out more. So you would

typically -- it would typically end up changing the numbers in the manner that you would expect, so that you wouldn't have the same calculation. It would probably be a lesser percentage of TIV that people would purchase to.

Q. And if you know, is that the sort of standard that A.M. Best would apply when making some kind of recommendation for what they would like to see?

A. I don't know that they would necessarily -- because they would be looking at so many different entities with so many different concentrations, it would probably be difficult for them to come up with a standard per se. It would be simply more of a reasonability test, I would suspect.

Q. Looking back at Page -- there seemed to be a number of times in which these models are consulted in this process. I note that on Page 1370R, we have a -- as part of the closing fee, there is, again, something that says AIR, $112,500 for modeling. And my question is, why would there be a different run for this particular cat bond fee?

A. I believe the cat bond actually has specific criteria, the investors have specific

criteria under which they want the model to be run. And so for clarification purposes, it is run in that manner by -- essentially it has to be disclosed exactly how the model was run and under the prescriptions of what -- under what basis. So was it near term or long term, was it AIR Version 11 or Version 12, did it include demand surge or storm surge. So that's specifically why it was outlined in that particular exhibit.

Q. You were asked some questions about the reinsurers and their sort of profit model. Do the calculations differ depending on what layer of reinsurance you are looking at?

A. Again, typically speaking, yes, because the closer to risk that you are, in theory, the more certain the outcome, and the further away you are, the less certain the outcome. So typically the profit margins might change accordingly.

PRESIDING OFFICER FARRINGTON: That was all my questions. Thank you.

Do you want a short break, Mr. Meyer?

MR. MEYER: No, thank you. No questions on redirect.

PRESIDING OFFICER FARRINGTON: Mr. McCall?

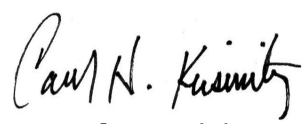
MR. McCALL: I just have a couple, I guess.
RECROSS EXAMINATION
BY MR. McCALL:
Q. Can you turn to Page 1203, please.
In the first full paragraph there, you indicate that the MPIUA's total insured value as of 9/30/2011 was $98,207,533,264. Do you see that?
A. Yes.
Q. How was that value calculated?
A. It's provided by the MPIUA.
Q. And they provided it to you, and you included it in your testimony?
A. Correct.
Q. Is it possible for an insurer to insure its obligation to pay reinstatement premiums?
A. Yes.
Q. And is that something that the MPIUA has done before, do you know?
A. Yes.
Q. Did they do it this time?
A. No.
Q. Previous?
A. Previous, I believe in 2006 or '07. It was called an RPP, reinsurance premium protection

coverage.
Q. Not this year. Do you know why they didn't do it this year?
A. The Board felt that there was enough risk transfer based upon the placement totals, and they decided -- they elected not to purchase that.
Q. If the MPIUA were to pay a reinstatement fee, would the accounting treatment for this payment be the same as the treatment that would be applied when the MPIUA pays its first dollar of reinsurance premiums?
A. I believe so, yes.
Q. Could you turn over to Page 1272 of your testimony. And in Article 18, there's a reference to a federal excise tax in the paragraph. It's actually in Article B.1. Do you see that?
A. Yes.
Q. Could you please describe what this means. What is a federal excise tax?
A. It's just a tax on the premiums that are paid by the MPIUA.
Q. And who pays the tax?
A. The reinsurers.
Q. And do the reinsurers remit any applicable

state premium tax back to Massachusetts that may be payable on the premiums that were paid?
A. I don't believe so.
Q. And do reinsurers provide any premium relief to the MPIUA to account for agent commissions that are paid on direct premium collected?
A. No.
MR. McCALL: That's it. Thank you.
PRESIDING OFFICER FARRINGTON: Mr. Klibaner, Mr. Leight, do you have any follow-up?
MR. LEIGHT: No.
MR. KLIBANER: No, thank you.
PRESIDING OFFICER FARRINGTON: Thank you all very much. Thank you, Mr. Wackerman. The testimony is concluded.
Before we break, I just want to remind everybody that we are in the room next door tomorrow, which is much smaller. So we will try and bring another table to try to make you more comfortable, but it's going to be rather close quarters.
MR. MEYER: Thank you.
(Whereupon the hearing was adjourned at 2:47 p.m.)

C E R T I F I C A T E

I, Carol H. Kusinitz, Registered Professional Reporter, do hereby certify that the foregoing transcript, Volume I, is a true and accurate transcription of my stenographic notes taken on Monday, February, 2012.



Carol H. Kusinitz
Registered Professional Reporter

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