EXPLANATORY MEMORANDUM

The Advisory Committee of the California Automobile Assigned Risk Plan ("CAARP" or the "Plan") submits the attached rate-level indications proposing rate revisions for the four commercial automobile sub-lines of the Plan. CAARP's analysis indicates that rates for the five commercial sub-lines should be increased an average of 17.4 percent. The calculation of the indicated rate change for the coverages provided under each commercial sub-line is set forth in the attached materials. The following discussion describes how the indications were derived.

Rate-Level Indications

Rate-level indications are calculations of the percent changes that must be applied to current rates to produce premiums that will adequately provide for all the costs of writing insurance during a specific future period of time. In general terms, rate-level indications are developed using the latest available historical premiums, losses, claims, expenses and exposures. This historical data is analyzed using accepted actuarial methodologies.

The rate-level indications for CAARP's five commercial sub-lines[1] are shown on the summary page of the attached filing ("Filing"). This Filing proposes revisions to the basic limits rates for each sub-line, as well as to the increased limits factors for the Trucks, Tractors and Trailers sub-line.

To develop these rate-level indications, the most recent data was collected and reviewed, and appropriate adjustments made. Historical earned premiums were adjusted to current rate levels. The incurred losses were developed to their ultimate levels and then trended to reflect expected changes in claim cost and claim frequency over time. Weights were selected to combine the multiple years of adjusted premium and loss data into average annual amounts.

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[1] The five sub-lines are: Trucks, Tractors and Trailers; Taxis, Limousines and Van Pools; All Buses Combined; Zone Rated Risks; and Employers Non-Ownership.

An adjusted loss ratio was determined by dividing the weighted incurred losses by the weighted earned premiums. Next, expense provisions were selected. Commissions were set at the amount established by regulation. Other Underwriting Expenses were set at the percentage established under the contract with the servicing carriers that receive assignments under the Commercial Automobile Insurance Procedure ("CAIP"), as were unallocated loss adjustment expenses. Taxes, licenses and fees were set based on statutory assessments percentages. In addition, provisions were included for uncollectibles, as well as for CAIP Miscellaneous Expenses such as collection fees, indemnification costs and central processing costs. A contingency factor was selected judgmentally based on historical financial results of the CAIP, and a cost of capital provision was included to reflect the cost of the capital necessary to back the insuring of CAARP risks.

Once the expense provisions were determined, the rate-level indications were calculated using the formulas set forth in row F of Sheets 1a-1c of Appendix 4 and Appendix 6, Sheet 7. The rate-level indication formula credits the expected investment income on unearned premium and loss reserve to policyholders. Finally, adjustments are made to the indicated rate-level changes to reflect costs related to the insolvency of CAARP member insurers and to reflect the additional premium required by the Special California Assessments.

For the Trucks, Tractors and Trailers sub-line, the increased limits factors were also revised. The revision was based on the ratio of indicated total limits premiums to indicated basic limits premiums compared to the ratio of total limits premiums to basic limits premiums at current rates. The following discussion explains the calculation of rate-level indications in more detail.

Experience Period

The table below identifies the experience period for the base data used to develop the rate-level indication for each of the sub-lines:

Evaluation

Sub-line	Experience[2]	Date
Trucks, Tractors and Trailers	Calendar/Accident Years 2007 & 2008	3/31/09
Taxis, Limousines, Van Pools	Calendar/Accident Years 2007 & 2008	3/31/09
Buses	Calendar/Accident Years 2007 & 2008	3/31/09
Zone Rated Risks	Calendar/Accident Years 2007 & 2008	3/31/09

"Calendar Year" refers to premiums that were earned during that year, while "Accident Year" refers to losses and allocated loss adjustment expenses ("ALAE") arising out of accidents that occurred in that year. An "Evaluation Date" of 3/31/XX means that the calendar, accident or policy year being evaluated reflects premium and claim transactions that have occurred and been reported as of 3/31/XX.

Data

The rate-level indications are based on CAARP exposure, premium, loss, ALAE and claim data collected by statistical agents pursuant to commercial automobile statistical plans. Claim cost and frequency trends were based on total market commercial automobile insurance data reported to ISO. Expense provisions are established by contract, statute or reviews of industry data.

Earned Premiums

Historical earned premiums are adjusted to reflect current rate levels before they can be used for ratemaking purposes. The Filing uses two methods to adjust earned premiums.

[2] For Trucks, Tractors and Trailers, the experience consists of both basic and total limits data; for the other sub-lines, the experience consists of total limits data only.

Method 1 - Premium at Present Rates ("PPR"): Under this method, earned premiums for each calendar year are developed by multiplying the number of historical earned exposures (i.e., vehicles) in each classification by the current commercial rate for that classification and then adding any applicable surcharges. This produces the premiums that would have been earned in that year if the current rates had been in effect during that period. Method 1 is used to calculate the basic limits earned premiums for Trucks, Tractors and Trailers.

Method 2 - On-Level Earned Premiums: Under this method, earned premiums are adjusted to current level by use of an on-level factor. An on-level factor is the relativity between the current rate level and the average rate level during the historical period, as calculated by the traditional parallelogram method. Method 2 was used to calculate earned premiums for Taxis, Limousines, and Van Pools, School, Church and All Other Buses, Zone Rated Risks, Employer Non-Ownership, and total limits Trucks, Tractors and Trailers.

Once the adjusted earned premiums have been determined for each of the two years in the historical period, the two years are weighted together to determine an average annual adjusted earned premium. See the section on "Weights" following the discussion of Loss Development.

Incurred Losses

Incurred losses[3] for the historical period are valued as of the "Evaluation Date." For sub-lines other than Trucks, Tractors and Trailers, incurred losses are on a total limits basis. For the basic limits review of Trucks, Tractors and Trailers, incurred losses have been capped at $15,000/30,000 for bodily injury liability and $5,000 for property damage liability.

The incurred losses are shown in column (1) of Exhibit 3 for Section 1 through Section 5, and Appendix 6, Sheet 3. Before the reported incurred losses can be used for ratemaking, three additional adjustments are required. First, the losses are developed to their expected ultimate

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[3] Incurred Losses include amounts incurred for loss payments to claimants as well as Allocated Loss Adjustment Expenses ("ALAE").

settlement level by application of loss development factors. Second, the developed incurred losses and allocated loss adjustment expenses are trended to reflect changes over time in both the frequency of occurrence and the cost of claims.

Loss Development

Loss development factors ("LDF's") adjust reported incurred losses and allocated loss adjustment expenses to their expected ultimate settlement levels. History shows that reported incurred losses develop until at least 87 months after the start of an accident year for bodily injury liability coverage and 75 months for property damage liability, and is relatively stable from that point on. The 3/31/09 evaluation is 15 months after the start of the 2008 accident year and 27 months after the start of the 2007 accident year. Therefore, the immature incurred losses reported as of 3/31/09 need to be adjusted to the expected ultimate levels before being appropriate for ratemaking purposes.

The calculation of the LDF's, which are based on CAARP incurred loss data, is shown in Appendix 1. The LDF's are the product of "link ratios", which, in turn, are based on historical age-to-age ("ATA") factors. ATA factors are the ratios of accident year reported incurred losses at one evaluation (e.g., 39 months) to the accident year reported incurred losses at the prior evaluation (e.g., 27 months). The ATA factor for each accident year/ATA period combination is set forth in Appendix 1 in the triangles of ratios immediately beneath the incurred loss triangles.

The link ratios are displayed as averages of various sets of available link ratios (3-year Ex Hi/Lo, 3-year and 5-year). The selected link ratio for each development period is based upon an analysis of each of these averages, as well as the patterns evidenced by the historical data. The LDF for each accident year is the mathematical product of the link ratios for each ATA period.

Once determined, the LDF's are applied to the reported incurred losses evaluated as of 3/31/09 to determine the expected ultimate incurred losses. See column (3) of Exhibit 3, Section 1 through Section 4, and Appendix 6, Sheet 3.

Trend

A trend procedure is used to adjust experience period losses to reflect changes in claim cost and claim frequency from the average accident date of the experience period to the average accident date of the proposed future rate period. This is required because conditions that affect the ultimate level of incurred losses during the experience period (e.g., inflation) are expected to change over time.

The calculation of claim cost and claim frequency trends is shown in Appendix 3. The trend selections are based on calendar year paid severity and calendar year paid frequency data. The selected claim cost trends are shown on Sheet 7 (Bodily Injury basic limits), Sheets 3, 4, and 6 (Bodily Injury total limits), and Sheet 8 (Property Damage) of Appendix 3. Each data point on these exhibits corresponds to the average California claim cost for the calendar year ending on the specified calendar quarter.

Claim frequencies are unlike claim costs in that they are more cyclical and unpredictable. Therefore, the incurred losses are indexed for the actual change in accident year claim frequencies from the average accident date of the experience period to the average date of the latest trend period and thereafter projected with selected trend values of -1.9% (Bodily Injury) and -1.0% (Property Damage). The selected state and countrywide frequency trends are shown on Appendix 3, Sheets 10 and 11 (Bodily Injury) and Sheets 12 and 13 (Property Damage), in consideration of the prior reflection of the actual change in trend.

As shown in Appendix 3, there is a wide range of possible severity and frequency trend values. Over the past several years, there have been many factors that have impacted the automobile insurance market. For example, the higher cost of gasoline, the cost of medical care, the prevalence of driving while using cell phones, and other factors can be expected to contribute to changes in cost and frequency trends. Therefore, in order to reflect all variables and to capture the direct and offsetting effects, we have placed greater emphasis on the 8, 12 and 24 point trend periods. We

believe the extreme values appearing in the 4-point trend period are not representative of what is expected in the future market.

The calculations of composite trend factors (i.e., severity and frequency combined) are shown on Exhibit 4 of Sections 1 through 4 and Appendix 6, Sheet 4.

Weights

The following table displays the weights that are applied to the sub-line data of the latest and prior years:

Latest Year's Adjusted Earned Premiums	Weights	
	Prior	Latest
Less than $5 million	50%	50%
$5 to less than $15 million	30%	70%
$15 to less than $50 million	15%	85%
$50 million or more	0%	100%

Use of the table strikes a balance between responsiveness (i.e., reflecting the most recent experience) and stability (i.e., reflecting longer-term experience). At least $50 million in premiums are needed before full credibility will be given to the latest year's data.

The weights are applied to both the on-level earned premiums and the developed incurred losses resulting in the experience period average earned premiums and average ultimate losses.

Expenses

The expense provisions are shown on Exhibit 5 of Sections 1 through 4 and Appendix 6, Sheet 5. The commission provision is based on the commission percentages set by Section 52 of the CAARP regulations.

The administrative expense fee of 18.3% is the fee currently paid to the CAIP servicing carriers by contract. It is the cost to the Plan for servicing carriers to perform the functions found under the property and casualty insurance expenses definitions for General and Other Acquisition Expense.

The unallocated loss adjustment expense provision of 7.3% is the fee that is paid to servicing carriers by contract for performing non-ALAE claim adjustment services on behalf of CAIP. The taxes, licenses and fees provision is based on the statutory premium tax rate in California. Finally, a provision of 1.3% was selected which reflects miscellaneous expenses incurred directly by the Plan, such as collection fees, indemnifications and central processing costs. The calculation of this provision is shown on Appendix 2, Sheet 2.

Contingency Provision

A contingency provision is used to reflect any systematic variation between estimated costs and expected costs. The selected contingency provision of 1% is based on judgment considering the financial performance of the CAIP over 10 years, which demonstrates a systematic bias that generally understates the rate need. The CAIP inception-to-date financial results (as of 2/28/10) inclusive of each policy year from 1999 through 2009 is shown in Appendix 9. This exhibit shows that the aggregate operating result of the Plan over the entire period is 119.78, which means that for each $1 of earned premium in that period, CAIP paid out (or will pay) out approximately $1.20 in losses, loss adjustment expenses and underwriting expenses. Even generous assumptions regarding investment income on loss and unearned premium reserves would not change the fact that CAIP has been highly unprofitable. Although such an unprofitable result appears to warrant a much larger contingency factor, a factor of only 1% is included in the Filing.

Cost of Capital

A cost of capital provision of 3% has been selected to cover the costs of the capital necessary to operate the commercial automobile insurance business represented in the aggregate by the four commercial automobile sub-lines. This provision reflects two principles: (1) the coverages provided by the Plan could not be written without some amount of capital to support it, and (2) the capital required to write the business has a cost, which must be reflected in the rates.

Insolvency Costs

The indicated rate-level changes have been adjusted to provide for the estimated costs to the remaining solvent members of the CAIP caused by the insolvency of a limited number of Plan members. The adjustment is detailed in Appendix 8, Sheet 1 and represents a provision for insolvencies based on past experience.

Premium Charge-Off Provision

The selected 7.5% provision for premium charge-offs is based on California CAIP experience as shown in Appendix 2. This provision is intended to reflect the premiums which are earned on CAIP policies but prove to be uncollectible. It also includes unearned commissions paid to agents that are not refunded to the servicing carriers.

Rate-Level Indications

The calculation of the rate-level indications by sub-line, which is shown in Appendix 4, are on a basic limits basis for Trucks, Tractors and Trailers and on a total limits basis for all other sub-lines. The rate-level indications for Trucks, Tractors and Trailers on a total limits basis are found on Appendix 6, Sheet 7.

Special California Assessment

As shown in Filing Appendix 10, California regulations provide for the following three assessments to be charged per insured vehicle:

a. Investigation and prosecution of automobile insurance fraud - $1.00 annual fee per insured vehicle.

b. Consumer service functions related to automobile insurance - $0.30 annual fee per insured vehicle.

c. Automobile fraud interdiction program - $0.50 annual fee per insured vehicle.

Utilizing CAARP's Latest Year earned exposures as a proxy for "insured vehicles", these assessments generate the need for an additional $19,166 of premium and account for an estimated 0.1% increase in our current rate level indication calculations, resulting in the overall 17.4% proposed increase.

Increased Limits

Given both the total limits and basic limits rate-level indications for Trucks, Tractors and Trailers, revised Increased Limits Factors ("ILF's") were determined by way of a uniform adjustment determined at Appendix 6, Sheets 8a-8c. The uniform adjustment factor is based on the ratio of the indicated average ILF minus 1.0 to the current average ILF minus 1.0, where the average ILF's are determined by dividing the total limits premium at both the current and indicated level by basic limits premium at the same respective levels. The uniform factor was applied to the current ILF increments (i.e., the individual ILF's minus 1.0) to determine the indicated ILF increments. The final indicated ILF's were determined by adding unity to the indicated ILF increments.

Conclusion

The attached rate-level indications contain the rate revisions to commercial automobile insurance proposed by CAARP based on the latest available data, using appropriate and accepted actuarial methodology, to produce rates that are not excessive, inadequate, nor unfairly discriminatory and are actuarially sound so as to result in no subsidy of the Plan.

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