BEFORE THE INSURANCE COMMISSIONER

OF THE STATE OF CALIFORNIA

In the Matter of the Private Passenger Rate Application of the California Automobile Assigned Risk Plan for the California Low Cost Automobile Insurance Program, Applicant.	FILE NO. RH05050092 DECISION AND ORDER

The 2006 rate application of the California Automobile Assigned Risk Plan (CAARP) for the California Low Cost Automobile Insurance Program came on for public hearing on September 12, 2006. The public comment period was extended to October 2, 2006 to permit comment on CAARP's updated information and responses to questions asked by the hearing panel. Written testimony and exhibits were received and statements, arguments and public comments were heard. A copy of all comments as well as CAARP's recommendation and supplemental response are available for public review in the rulemaking file.

BACKGROUND

Insurance Code Section 11629.72(c) provides that, annually, CAARP shall submit to the Commissioner a proposed rate and surcharge for approval. Accordingly, CAARP submitted its

2006 rate recommendation on February 8, 2006 for an overall rate increase of seven percent and no change to the 25 percent surcharge on certain drivers. Subsequently, CAARP submitted a supplemental proposal on June 22, 2006, applying the overall seven percent increase to additional expansion counties.

Legislation involving the California Low Cost Automobile Insurance Program extended the program to Alameda, Fresno, Orange, Riverside, San Bernardino and San Diego counties, commencing on April 1, 2006. The bill further authorized expansion of the program to all counties in California at the discretion of the Commissioner, subject to specified procedures. The legislation did not specify a rate, but authorizes the Commissioner to adopt regulations establishing a rate, in consultation with CAARP, in order to implement the expansion of the program to these counties, as emergency regulations. Previous legislation mandated the availability of optional uninsured motorists bodily injury and medical payments coverages to policyholders at additional premium.

In consultation with CAARP, the Commissioner proposed rates, effective April 1, 2006, for Alameda, Fresno, Orange, Riverside, San Bernardino and San Diego counties for adoption on an emergency basis, which were approved by the Office of Administrative Law on March 24, 2006 and approved for readoption on July 24, 2006. Following statutory procedures, the Commissioner further expanded the program to eight additional counties of Contra Costa, Imperial, Kern, Sacramento, San Joaquin, San Mateo, Santa Clara, and Stanislaus. In consultation with CAARP, the Commissioner proposed rates, effective June 1, 2006, for adoption on an emergency basis, which were approved by the Office of Administrative Law on May 18, 2006 and approved for readoption on October 2, 2006.

The low cost automobile insurance basic liability policy provides bodily injury liability and property damage liability coverage at limits of $10,000 for bodily injury or death to one person/$20,000 cumulative liability for bodily injury or death per accident/$3,000 liability for property damage. Optional coverage for uninsured motorists bodily injury is available at limits of $10,000/$20,000 and optional medical payments coverage is available at a limit of $1,000.

Currently, the annual premiums for the liability policy are $355 per vehicle for Los Angeles county and $322 for the city and county of San Francisco. As approved by emergency regulations, the annual premiums are $322 for Alameda; $317 for Contra Costa; $299 for Fresno; $210 for Imperial; $239 for Kern; $312 for Orange; $246 for Riverside; $383 for Sacramento; $283 for San Bernardino; $268 for San Diego; $295 for San Joaquin; $307 for San Mateo; $290 for Santa Clara; and $359 for Stanislaus counties. A 25 percent surcharge is added to the base rate for unmarried male drivers ages 19 through 24 years of age.

Annual premiums for optional uninsured motorists bodily injury coverage are currently $65 for Los Angeles and $39 for the city and county of San Francisco. As approved by emergency regulations, the annual premiums are $32 for Alameda; $28 for Contra Costa; $51 for Fresno; $32 for Imperial; $30 for Kern; $37 for Orange; $32 for Riverside; $49 for Sacramento; $40 for San Bernardino; $26 for San Diego; $35 for San Joaquin; $25 for San Mateo; $24 for Santa Clara; and $44 for Stanislaus counties.

For optional medical payments coverage, premiums are currently $29 for Los Angeles and $26 for the city and county of San Francisco. As approved by emergency regulations, the annual premiums are $18 for Alameda; $17 for Contra Costa; $34 for Fresno; $18 for Imperial; $19 for Kern; $24 for Orange; $14 for Riverside; $23 for Sacramento; $18 for San Bernardino; $15 for San Diego; $23 for San Joaquin; $17 for San Mateo; $14 for Santa Clara; and $35 for Stanislaus counties.

At the public hearing, John Winkleman, Vice President of Actuarial Services for AIPSO, CAARP's manager, commented on written testimony updating trend data available since CAARP submitted its proposal in February 2006. Mr. Winkleman explained that, incorporating the updated information, the indicated overall rate change would decrease from 7.0 percent to 4.5 percent.

At the hearing, Allan Schwartz of AIS Risk Consultants (AIS), on behalf of the Foundation for Taxpayer and Consumer Rights, (FTCR),[1] recommended an overall decrease of -2.4 percent, based on its analysis, a copy of which is available for public review in the rulemaking file. Mr. Schwartz commented that the AIS analysis differs from that of CAARP in four key areas – loss development, loss trends, underwriting expenses, and investment yield.

In oral and written comments, Sandra Chapin, the Program Director for the Consumer Federation of California,[2] expressed support for the program. She commented on the important benefits of the program to individuals and working families in California. Ms. Chapin indicated that the Consumer Federation of California opposes any increase to program rates because it would make insurance unavailable to many who need it.

The statutes specify that rates shall be sufficient to cover losses and expenses incurred under policies issued under the program. Rates shall be set so as to result in no subsidy of the program or subsidy of policyholders in one county by policyholders in any of the other counties.

In accordance with these rate-setting standards, on July 28, 2006, the Commissioner issued a Notice of Proposed Action and Notice of Public Hearing and Initial Statement of Reasons to consider current rates and CAARP's 2006 rate recommendation.

DECISION

After carefully considering all comments and written testimony and exhibits submitted during the public hearing period, the Commissioner has declined to accept CAARP's

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[1] The FTCR petitioned to participate in this proceeding August 29, 2006, which was granted.

[2] The Consumer Federation of California submitted a petition to participate in this proceeding on or about September 13, 2006, which was conditionally granted on October 20, 2006.

recommendation of an overall increase of seven percent or the AIS suggestion of an overall decrease of -2.4 percent. Based on an independent actuarial analysis, the Department has determined that an overall rate decrease of -0.7 percent, with no change to the current surcharge for certain drivers, is adequate and consistent with statutory rate-setting standards. The Department has determined indicated rate changes for all coverages, delineated as follows:

	CAARP's Proposal	Department's Indicated Rate Change
Liability	6.0%	-1.4%
Uninsured Motorists	9.4%	2.9%
Medical Payments	54.6%	28.0%

Loss Development

CAARP based its loss development factors on three-year average development from nine months to 21 months for the low cost auto program, combined with development factors from 15 months to ultimate from CAARP data. The development ages from the CAARP data did not match the development ages of the low cost auto data, so CAARP performed an interpolation on the CAARP data by fitting an exponential growth function.

For the 21 month and 33 month to ultimate factors, CAARP relied exclusively on the interpolated CAARP data. For the nine month to 21 month factor, CAARP first multiplied the low cost auto factor by .75, to account for the reduction of the full year back to a partial year, then averaged the result with the nine month to 21 month CAARP factor based on the interpolation.

Mr. Schwartz made two criticisms of CAARP's loss development factors. First, he said that the CAARP interpolated factors, based on the fitting of the exponential growth function, produced unreasonable age-to-age factors. The unusual age-to-age factors result from the differences between the fitted values and the actual values. Mr. Schwartz interpolated by simply taking the average of the factors.

Second, Mr. Schwartz said that the .75 factor, to account for the reduction of the full year back to a partial year, is based on the assumption of a uniform distribution of exposures during the year. The exposures, Mr. Schwartz said, are not uniform, because they were growing at an annual rate of about 100%. Mr. Schwartz said that a factor of .69 is more reasonable.

To the first criticism, CAARP responds that interpolating by averaging assumes that losses develop in a linear pattern and that it is known that this is not true. CAARP further responds that there are unusual factors in the actual data, so unusual factors in the interpolated data are not unexpected.

To the second criticism, CAARP says that the .75 factor was approved in the previous decision and order.

We agree with Mr. Schwartz that the fitting of an exponential growth function introduces new anomalies into the calculation. We agree with CAARP that the linear assumption underlying Mr. Schwartz's averaging is incorrect. We therefore replace the average of the development factors with the reciprocal of the average of the reciprocals.

For the full year to partial year reduction factor, we agree with Mr. Schwartz that the additional refinement to reflect the growth in exposures is reasonable and so we reject CAARP's .75 factor and accept his .69 factor.

<u>Loss Trends</u>

For bodily injury and property damage, AIS criticized CAARP for not using the most recent data, and makes selections based on the new data. However, CAARP subsequently submitted updated data at the hearing to include lower selections based on the new data. The differences between AIS's selections and CAARP's revised selections are smaller.

For bodily injury, uninsured motorists and property damage, CAARP's updated selections appear reasonable.

For medical payments, CAARP uses the consumer price index for medical care for severity and assumes zero for frequency. As we said in our previous decision, neither of these assumptions is reasonable.

CAARP argues that medical payments is a first party coverage and therefore does not lag the pure medical indices as much as bodily injury. CAARP also argues that bodily injury also includes lost wages and pain and suffering. Both of these arguments go to severity rather than frequency. Despite these arguments, it remains more reasonable to suppose that the low limit has a capping effect on severity. It also remains more reasonable that the frequency tracks somewhat with bodily injury. Using the bodily injury trend, as AIS does, is reasonable, even conservative, since it includes a small increase in severity.

Underwriting Expenses

CAARP's calculation for general and other acquisition expenses relies on A.M. Best's Aggregates and Averages. Best's used a three-year average of countrywide data, then reduced it to remove advertising expenses. Taxes were taken from the State Taxation Manual of the American Insurance Association.

AIS relied on the NAIC Study of Profitability. AIS notes that these numbers are California-specific for taxes, licenses and fees, and are allocations to California from countrywide for other acquisition and general expenses.

CAARP responds that the NAIC general and other acquisitions numbers are not collected state and line specific, but instead are allocations and therefore the Best's numbers are more appropriate.

The differences between AIS's and CAARP's numbers are small and ultimately they derive from the same source, insurers' statutory annual statements. On the whole, we find that the NAIC numbers are somewhat more California-specific because the numbers for companies doing more business in California are given more weight than they are in Best's. Therefore, as we did in our last decision, we reject CAARP's numbers and replace them with those of AIS.

Investment Yield

CAARP calculated the yield using data from A.M. Best's Aggregates and Averages. The yield is based on the latest year plus a five-year average of realized capital gains. CAARP notes that this method follows the current regulations for prior approval of insurance rates under Proposition 103 and is the method we have approved in past decisions for the Low Cost Automobile Insurance Program and for CAARP.

AIS calculates yield using a method that the Department has proposed for prior approval ratemaking. It is a prospective method, considering the distribution of assets and current yields, while the current method is historical and is actuarially preferable.

The low cost automobile insurance statute and regulations are silent on the specifics of a yield calculation. The proposed change to the yield calculation in the prior approval regulations has not been finalized. However, public comment has mostly been favorable. Therefore, we reject CAARP's calculation and replace it with that of AIS.

County Relativities

For the county relativities, CAARP relies on the relativities of voluntary market pure premium, as compiled by the Department. CAARP also provides a calculation that includes experience period loss ratio, loss ratio relativity to statewide, credibility and credibility-weighted relativity by county, but this calculation has little bearing on the final county relativities.

The primary focus is on the bodily injury and property damage rate for the city and county of San Francisco. CAARP proposes an increase in the relativity of San Francisco to Los Angeles county from .907 (322 divided by 355) to 1.027. Thus, while program rates would generally be decreasing, San Francisco would see a substantial increase. The concern is that the actual experience from the program shows a considerably lower loss ratio in San Francisco than in Los

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Angeles county, thus indicating a decrease in the San Francisco relativity. However, with only 31 claims, the San Francisco data has limited credibility.

We adopt a credibility-weighted relativity for San Francisco. This still results in an increased relativity for the city and county of San Francisco, but it is a somewhat smaller increase than that proposed by CAARP.

ORDER

For the reasons stated above, it is hereby ORDERED that the statutory rates for the low cost automobile liability policy be decreased to $350 for Los Angeles; $318 for Alameda; $313 for Contra Costa; $295 for Fresno; $208 for Imperial; $236 for Kern; $308 for Orange; $243 for Riverside; $378 for Sacramento; $280 for San Bernardino; $265 for San Diego; $292 for San Joaquin; $303 for San Mateo; $286 for Santa Clara; $354 for Stanislaus; and increased to $336 for the city and county of San Francisco, and that the current 25 percent surcharge for unmarried male drivers between the ages of 19 and 25 years of age be maintained.

It is further ORDERED that the annual premiums for uninsured motorists bodily injury coverage be increased to $67 for Los Angeles; $33 for Alameda; $29 for Contra Costa; $53 for Fresno; $33 for Imperial; $31 for Kern; $39 for Orange; $33 for Riverside; $50 for Sacramento; $41 for San Bernardino; $27 for San Diego; $36 for San Joaquin; $26 for San Mateo; $25 for Santa Clara; $46 for Stanislaus counties; and decreased to $25 for the city and county of San Francisco.

In addition, it is ORDERED that the annual premiums for medical payments coverage be increased to $37 for Los Angeles; $23 for Alameda; $22 for Contra Costa; $44 for Fresno; $23 for Imperial; $24 for Kern; $31 for Orange; $18 for Riverside; $30 for Sacramento; $23 for San Bernardino; $19 for San Diego; $29 for the city and county of San Francisco; $30 for San

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Joaquin; $21 for San Mateo; $19 for Santa Clara; and $45 for Stanislaus counties.

Dated: November 13, 2006.

JOHN GARAMENDI
INSURANCE COMMISSIONER