EXCERPTS FROM PROPOSITION 103 TESTIMONY

Michael Miller

Q.7 Why is the approach that you recommend and that Mr. Bacon recommends preferable?

A.7 At the risk of oversimplification, the estimation of the cost of claims component of an insurance rate involves three steps: (1) the selection of the length of the experience base used in the rate calculation (i.e. 1-year, 2-years, or more), (2) the calculation of the appropriate loss development factors, and (3) the determination of the appropriate trend factors.

(1) Experience Base. The selection of the appropriate experience base is a credibility issue which varies from line to line and insurer to insurer. One insurer may have a sufficient volume of data for a particular line of insurance such that it can rely on one year of data for its experience base. Another insurer writing the same line of insurance may require five years of data to satisfy its credibility needs. There is no way to generically determine an appropriate experience base.

(2) Loss Development. The calculation of the estimated claim losses is usually achieved by applying loss development factors to known claim losses for the accident years included in the experience base. The CAS in its

Statement of Principles Regarding Property and Casualty Loss and Loss Adjustment Expense Reserves encourages actuaries to examine more than one method when estimating claim losses. There are times when the paid loss data can provide the most reliable estimate. At other times, estimates based on reported incurred losses are more reliable. I generally prefer the reported incurred method of calculating estimated claim losses because it utilizes more information than the paid loss method and because the margin for error in the estimate is generally less than for the paid loss method. Both methods are generally accepted actuarial methods. Neither method should always be used in all circumstances to the exclusion of the other method. There is simply no way to write a generic rule that will prescribe a loss development method and at the same time produce rates which are actuarially sound.

(3) Loss Trends. With respect to loss trends, the situation is much the same as with the loss development factors. There are a variety of acceptable methods for trending losses, none of which is always best. The loss trend factors vary substantially from year to year and from one line of insurance to another. Even during the same year and within a single line of insurance there is a substantial variation in loss trends from one insurer to another. This arises because each insurer's book of

business will have different geographical and demographic profiles.

For these reasons, the approach that both Mr. Bacon and I have recommended is the actuarially sound approach. I agree with Mr. Bacon when he says there is "little room for generic rules" in this area and that there "may be no other choice but to only closely scrutinize the actuarial support for these estimations of losses". That is the way that every other state a prior approval type rating law handles the administrative challenge.

Q.8 In its Preliminary Prayer [Paragraph 22(g)], the Department of Insurance (DOI) appears to suggest that a generic trend factor should be adopted as a result of these hearings. Is that actuarially sound?

A.8 No. To attempt to prescribe a single trending method, or worse yet a single trend factor applied to all insurers, will certainly result in rates that are excessive for some and inadequate for others, since the loss trend factors generally vary substantially from insurer to insurer. If a single trend factor were imposed on all insurers, it would be only by pure chance that the resulting rate would be correct for any insurer.

Q.9 In his prepared testimony, Mr. Hunter advocated competition in the development of trend factors rather than prescribing a trend factor to be applied to all insurers, and a "generic annual analysis" to be published by the Commissioner. What is your opinion of that proposal.

A.9 **I agree with Mr. Hunter's statement that all trend factors should be the subject of competition and not prescribed by a single set of rules. His suggestion regarding the annual publication of a set of "reasonable" trend factors sounds fine in theory, but in practice it will promote a set of rigid rules that will ultimately be antithetical to competition. If we are going to have competition, which is the best course for the consumer, it should be the competition rather than limited competition circumscribed by one person's view of what is "reasonable."**

Q.10 Turning next to the second component of the rate, the cost of claims settlement, Mr. Bacon appears to suggest that generic rules should not be created. Do you agree that generic standards are not appropriate for this component of the rate?

A.10 **Yes. Commonly the claim settlement expenses, especially the allocated claim settlement expenses, are included with claim losses in the ratemaking formula. The claim settlement**

expenses vary significantly over time and between lines of insurance. Even within each line, different insurers have different claim settlement expenses. All the reasons for not having generic rules for claim losses apply as well to claim settlement expenses.

Q.11 The DOI Preliminary Prayer suggests in a footnote that claims settlement expenses be "capped" at the industry average for the immediately preceding three years for "similar carriers" as the DOI defines that term. Is this proposal actuarially sound?

A.11 No. The theory underlying the capping proposal is that claim settlement expenses above the industry average are in and of themselves proof of inefficiencies. That is a false premise.

A good claim investigative process aimed at mitigating fraudulent claims could well put an individual insurer above the industry average. The easiest way to reduce claim settlement expenses is to stop investigating claims and pay all claim losses without question. Sound claim settlement procedures benefit consumers because the reduction in fraudulent or exaggerated claim payments can more than offset any added expense.

To arbitrarily limit or cap claim settlement expenses in the

ratemaking formula is actuarially unsound and will encourage insurers to reduce their claims investigation process. It would be more correct to encourage insurers to increase their efforts to control fraud. No meaningful generic rules can be adopted for this rate component without producing rates which are inadequate for some and excessive for others.

With respect to auto insurance in California, there is now a requirement that insurers provide coverage to all good drivers as defined by the law. This means that insurers which, for sound and honorable business reasons, have geographically limited operations within the State will be forced to provide coverage to applicants in areas where no service capabilities now exist. To establish a claim service capability in an area where there are only a few policyholders can be expensive, albeit necessary. To limit or cap the claim settlement expenses in the ratemaking formula will only serve to punish an insurer which was forced into an inefficient situation because of the workings of the law.

Further, the part of the DOI proposal that advocates that a three year historical average be used as the basis for expense capping fails to give any recognition to expected trends in claim settlement expenses or to the fixed nature of some portions of the claims settlement expenses (such as

rent for claims settlement offices). It is inconsistent with an actuarially sound approach and will produce rates that are inadequate for some insurers.

Q.12 The DOI Preliminary Prayer can also be read to say that settlement expenses should be allocated by line and by state based upon written premium. Is that actuarially sound?

A.12 **No. Allocated claims settlement expenses are, by definition, identified to specific claims. All companies have allocated claims settlement expenses that are state and line specific. This actual expense information should not be supplanted by an arbitrary allocation formula. No arbitrary allocation formulas are necessary or desirable to determine California's specific allocated claims settlement expenses. With respect to unallocated claims settlement expenses, insurers should be allowed to use any California expense data that is available and specifically identified with California. In any event, an allocation formula based on written premiums is inappropriate. Unallocated claims settlement expenses are more closely related to loss activity than to written premium.**

Q.13 Turning next to the operational/administrative component of the rate, Mr. Bacon suggests no generic rules should be applied with the exception of certain expense disallowances.

Excluding for a moment the issue of expense disallowances, do you agree that no generic standards are appropriate to govern this rate component?

A.13 **Yes. There are important differences in expense levels between lines of insurance and between insurance companies. There is simply no way to create a generic rule that defines uniform expense ratios and trends without discouraging competing levels of service and creating excessive rates for some and inadequate rates for others. Every other state with a prior approval rating law judges the reasonableness of the expense provision in the rate by scrutinizing the actuarial support for the estimated expenses on a filing by filing basis. That is not an exceptionally difficult administrative task, and it is the only way the law can be administered fairly.**

Q.14 The DOI in its Preliminary Prayer apparently disagrees with Mr. Bacon and proposes to adopt a very specific rule for determining the expense provision in the rate. Could you describe that procedure and tell us whether or not it is actuarially sound?

A.14 **The proposal made in the DOI Preliminary Prayer is not actuarially sound. The DOI Prayer proposal states that the insurer's expense provision "shall be the lower of the**

insurer's actual expenses or the "Average Expense". "Average Expense" is defined as the actual average expenses for the immediately preceding three years. Both alternates, the insurer's actual expense or the "Average Expense" are actuarially unsound because the expense provision in the rate should reflect the reasonably expected expenses for the future. The DOI's approach erroneously makes no provision for any trends in expenses. An insurer's past expenses may be instructive in developing the expected future expenses, but the actual past expenses cannot be used mechanically in the ratemaking process.

In addition to being retrospective, the DOI's proposal is unsound because it fails to account for differences in service levels, for differences in rate levels and differences in customer bases.

Service levels can vary substantially. An insurer that is staffed and equipped to promptly process policy applications, mid-term coverage changes, and answer general questions from customers may have higher expenses than an insurer which is understaffed and unconcerned with prompt service. Insurance consumers are not well-served by punishing insurers which give good, efficient service. A superficial comparison of expense ratios to the industry average is not a workable means of identifying inefficient insurers.

An insurer that markets its policies, either directly or through agents, to an affinity group is likely to have lower expenses than does an insurer which markets to the general public. The DOI's proposal will have a tendency to punish those insurers which market to a broad spectrum of the public including the hard-to-insure segments of the market and favor those insurers which market to relatively small, low-risk market segments.

The DOI further fails to reflect the so-called "fixed" nature of some of the operational/administrative expenses. An insurer with lower average rates will have a somewhat higher expense ratio, all other things being equal, than a high-rated insurer because of the "fixed" nature of some expenses. There is no good reason to punish low-rated insurers in the way proposed by the Department of Insurance. There are times when premiums increase at a faster pace than the operational/administrative expenses. During those periods, the expense ratios may actually decline. The DOI's approach would erroneously fail to adjust for any expected decline in expense ratios. The DOI's proposal will almost certainly lead to rates which are excessive for some and inadequate for others.

The DOI also proposes to allocate all expenses to specific

lines of insurance and to California, based on written premiums. Such an approach ignores the fact that some expenses do not vary directly with premium. These are the so-called "fixed" expenses. To the extent that the average rate in California is above the average for all states in which an insurer operates, this approach may allocate too much of the expenses to California. The DOI approach also ignores the fact that some companies have accounting systems that capture actual expense data by state and, thus have no need for an arbitrary expense allocation procedure.

Q.15 Now let's return to the issue of expense disallowances. Do you believe that the generic standard proposed by Mr. Bacon and the DOI disallowing certain expenses is proper?

A.15 Mr. Bacon and the DOI both propose a generic rule that disallows political contributions, charitable contributions, fines and penalties, institutional advertising and losses from employee discrimination claims. A cap on executive salaries is also proposed as long as it does not make the insurance industry non-competitive with comparable industries. In its Preliminary Prayer, the DOI adds bad faith judgments and any payments to affiliates to the list of disallowances.

With respect to the disallowance of expenses in general, I

agree with Mr. Bacon that the Commissioner has a right to review expenses. The real problem with generic rules disallowing certain categories of expenses is that there will be no end of self-anointed "experts" coming forward to advance their own theories as to how to manage an insurance company. Each will have his or her own idea as to what social policy should be advanced or inhibited. While this may, to some degree, serve the social policy agenda of the Commissioner in office at the time, in truth it will do virtually nothing to lower insurance rates for the consumer. Here, as in several other areas, the focus is on politically controversial issues that produce endless debate, but the reward for all the time and energy devoted to it is almost purely a psychic reward for those involved in the debate rather than an economic reward for consumers.

Further, arbitrary rules disallowing expenses or capping expenses at certain levels will ultimately have an anti-competitive effect to the extent that they suppress rates below the levels of actual costs and thus either drive insurers from California or encourage them to curtail their services in California. The long term result of that process would be higher rates rather than lower rates.

The Casualty Actuarial Society, in its Statement of Principles of Ratemaking, addresses the issue of expenses to

be included in the rates. The first ratemaking principle states that a rate is the expected value of future costs. This means that any costs expected to recur in the future are to be included in the rate.

I recommend that in all ratemaking calculations actuarially sound expense provisions be used. Specifically, the expense provisions should reflect all expenses reasonably expected to occur in the future. This does not mean that the Commissioner has no right to review expenses. For example, expenses such as fines, penalties, employee discrimination judgments, and bad faith judgments should not be expected to recur in the future and, thus, should be excluded from the rate base.

I disagree with the Insurance Department's proposal that political contributions, charitable contributions and institutional advertising should be eliminated from the rate base and that executive salaries should be capped.

The executive salary issue is pure demagoguery. No one has ever shown that executive salaries for the insurance industry are unreasonable. Nor can it be shown that a cap on executive salaries will have any significant impact on the rates. On the other hand, artificial ceilings imposed on executive salaries could well have a major impact on a

company's ability to hire and retain competent executives. Mr. Bacon says the Department will select the cap so as "to make sure the insurance industry is competitive with comparable industries". Such a standard may sound appealing, but it has no real meaning and will necessarily be arbitrary. Other than through the competitive employment market, there is no way to determine the fair worth of an executive that manages the company in a way that delivers a quality product at a low price. We should not penalize a well-managed insurer nor inhibit the ability of insurers to attract excellence in management.

No one knows what is meant by institutional advertising. Certainly the Department's definition is arbitrary and so general as to be unworkable. All advertising, institutional and otherwise, accounts for only two-tenths of a percent of every premium dollar. It is a waste of time to debate issues which have no measurable effect on the rate.

Corporate charitable contributions are a generally accepted part of a corporate enterprise in virtually every competitive industry, and there is no basis to treat the insurance industry any differently. California and federal tax laws allow such contributions as legitimate business expenses. Thus both California policy and federal policy are plainly designed to encourage this part of corporate behavior. There

is no basis for the Commissioner to adopt a contrary policy. Eliminating these expenses will have little or no impact on the rates, but may have an undesired impact on a variety of charitable functions that rely on corporate donations.

Finally, there should be no restrictions on lawful political contributions or lawful lobbying expenses. California has specific laws that govern both political contributions and lobbying expenses. That is an expression of California policy on this issue. There is no basis for the Commissioner to adopt her own separate and conflicting policy on these expenditures.

Sometimes an insurer's position on an issue may be at odds with the position of the regulator or some consumer group. There are also times when insurers stand shoulder-to-shoulder with the other parties, such as auto safety issues and anti-fraud measures. The great danger is that government will attempt to use rate restrictions to silence insurers in those cases when there are differences of opinion. I believe there should be no regulation on a citizen's right to politically express himself, herself or itself. It is my understanding, and hope, that political expression is protected by a higher law than the insurance rate regulatory statutes.

Q.16 Isn't it true that disallowing expenses such as political contributions and charitable contributions from the rate base will not restrict the right of insurers to make those expenditures, but rather that those expenditures must be made by investors rather than ratepayers?

A.16 **No, that is not true. It is naive to believe that some expenditures belong to investors and some belong to ratepayers. Investors do not make expenditures, they make investments. Investors are not compelled to invest, nor are they compelled to continue an investment. They are free to choose.**

If the regulator persistently promulgates an inadequate rate, either as a result of suppressing the expense or any other component of the rate, the long term economic consequences fall on the ratepayer, not the investor. Through the free market trading of stock, the value of the insurer's capital is bid down to the level where the percentage return on investments is what the investor demands. To attract capital, the ratepayers must either pay a rate increase so as to increase profits or accept a product that is less secure and of less value.

Q.17 Now, let's turn to the fourth and final cost component of the rate. Is this fourth component of the rate commonly

referred to as the profit provision?

A.17 **Yes. This final rate component encompasses two separate rate provisions, specifically the profit provision and the contingency provision. The profit provision is that element of the rate which, together with investment income, provides for an appropriate total return consistent with the cost of capital. The CAS Statement of Principles specifically provides that the profit provision include a "charge for the risk of random variation of the expected costs."**

The contingency provision is that element of the rate which provides for any systematic variation of the estimated costs from the expected costs.

The CAS Statement of Principles further states that these two provisions are to be calculated so that they "provide an appropriate total after-tax return."

Q.18 Addressing first the profit provision, will you identify the major items which an actuary must address when estimating the appropriate profit provision?

A.18 **The major items include the determination of expected investment income net of investment expenses; expected capital gains or losses; expected miscellaneous income;**

expected federal income taxes; and the appropriate total rate of return. The determination of the appropriate total return, if expressed as a percentage of surplus, will additionally involve issues of leverage and the relationship between GAAP and statutory accounting.

Q.19 Mr. Bacon and the Department of Insurance have proposed some generic rules with respect to the determination of the profit provision. Do you believe that it is necessary to adopt generic rules with respect to the profit provision?

A.19 No. The appropriate profit provision will vary from filer to filer because the degree of risk varies. There are risk differences in the form of legal organization of the company, types of risks insured, location of risks, catastrophe exposure, extent and reliability of reinsurance programs and the nature of the investment portfolio. All of these factors, among others, contribute to different degrees of risk between insurers and warrant different profit provisions.

The generic rules proposed by the DOI in this area appear to place all the focus on returns, and not on rates. Because of the great variety of capital structures, types of business and the other factors I have mentioned, there will always be companies providing insurance at quite low rates but earning

relatively high returns. Sound economic theory tells us that this should be encouraged, not discouraged. The DOI proposal would, in general, tend to have the opposite effect.

Q.20 Irrespective of sound economic principles, it appears that the Department of Insurance has proposed generic rules on at least some portions of the profit calculation. Would you describe your understanding of these proposed generic rules and tell us whether or not they are actuarially sound?

A.20 **There are five areas in the DOI proposal that warrant comment:**

1) **<u>Rate of Return on Equity</u>. Mr. Bacon and the DOI propose a generic standard for a fair and reasonable total rate of return in the range of 11.2% to 15%. This standard is not actuarially sound because it does not afford insurers the opportunity to earn a rate of return comparable to the return for other industries with commensurate degrees of risk.**

2) **<u>Leverage Norms</u>. Mr. Bacon and the DOI propose leverage norms which vary by line of insurance. The proposed leverage norms are an incomplete attempt to measure the differences in risk between lines of insurance, based primarily if not exclusively on the magnitude of loss reserves in relation to premium. The proposed leverage**

norms are not actuarially sound primarily because they do not truly measure differences in risk by line of insurance. In fact, there is no recognized or accepted method for measuring differences in risk by line. In addition, Mr. Bacon made no attempt to measure the difference in risk from state to state or from insurer to insurer.

3) Federal Income Taxes. Mr. Bacon testified that the taxes included in the rate formula should be those that the insurer "expects to actually pay." In the Preliminary Prayer the Department of Insurance refers to projected taxes. I completely agree that the federal taxes should be the expected taxes. This means the taxes the insurer expects to pay if the profits projected in the rate calculation were to be actually realized. If the DOI wants to call this a generic rule, it has accomplished nothing because this practice has long been required by sound actuarial ratemaking principles.

4) Miscellaneous Income. Mr. Bacon proposes a generic rule for miscellaneous income which requires that all such income be included in the ratemaking process. The Preliminary Prayer makes it clear that the miscellaneous income included should be the projected amount. Once again, this is nothing more than a restatement of what

is already required by actuarially sound ratemaking principles.

5) Capital Gains. Mr. Bacon's proposed generic rule for capital gains requires that only realized capital gains or losses be included in the rate calculations. The DOI goes further in its Preliminary Prayer and requires that the capital gain amount be the average of the actual realized capital gains for the immediately preceding three years. I disagree with this generic rule. A three year data base is insufficient to determine an actuarially sound estimate of projected capital gains.

Q.21 I would like to focus in more detail on three areas: (1) total return targets, (2) leverage norms, and (3) capital gains. Turning first to the total return target, why do you disagree with the Insurance Department's proposed standard for a fair and reasonable total rate of return in the range of 11.2% to 15%?

A.21 The range of returns proposed by the DOI is not actuarially sound because it does not provide a reasonable opportunity to earn a return comparable to the returns for other industries with comparable degrees of risk. It is a basic principle of economics that there is an opportunity cost associated with capital. In other words, capital is not free

and its cost is based on expected future returns for alternate investments. It is not relevant whether the stockholders or mutual owners of an insurance company currently desire or plan to make alternate investments, only that they could do so. As such, the opportunity cost of capital supporting a mutual organization can be determined in the same manner as for a stock organization. A very important benchmark for determining the cost of capital is the standard set forth in Federal Power Commission v. Hope Natural Gas Co. and cited in California Insurance Company v. Deukmejian.

Q.22 As I understand your testimony, it is your opinion that the Department of Insurance has not properly applied the Hope Gas standard in determining its range of returns. What range of returns do you believe is actuarially sound and why?

A.22 The data indicates that an actuarially sound return is a minimum operating return of 5.4% which is equivalent to a total return of 16% expressed as a return on GAAP equity.

A commonly used measure of risk is the variation in returns from year to year. The greater the swing in likely results for a specific industry, the greater is the risk of investment. A statistical measure of variation is the standard deviation. Based on rates of return published by

Business Week and the Insurance Services Office for the years 1981 through 1988, I have calculated the standard deviations to be 0.9% for the public utilities industry, 3.9% for the property/casualty insurance industry and 1.6% for all U.S. industries combined. These data mean that approximately two-thirds of the time we can expect the returns for the public utilities industry to be within plus or minus 0.9% of the average return. For the property/casualty insurance industry the comparable band is 7.8% wide (plus or minus 3.9% from the average.)

The data clearly shows that rates of return for the property/casualty insurance industry have significantly more variation than either the utility industry or U.S. industries on average. This greater variation in results implies greater risk. This indicates that the rate of return allowed the property/casualty insurance industry should be higher than the return allowed public utilities and higher than the return expected to be realized by the average U.S. industry.

The property/casualty insurance industry is one of the few that is subjected to the compound risks of rate regulation, the pressures of the competitive marketplace, and unknown future costs. In comparison, utilities generally operate in monopolistic markets with costs that are reasonably foreseeable.

The minimum rate of return on GAAP equity which is selected for the property/casualty insurance industry should satisfy three conditions:

a) The selected minimum return should be sufficiently higher than the return allowed monopolistic public utilities in California so as to compensate for the higher degree of risk attendant to the insurance industry;

b) The selected minimum rate of return should be sufficiently higher than the return achieved by the average U.S. industry to reflect the greater variability in the property/casualty insurance returns from year to year; and

c) The selected minimum rate of return should reflect the added regulatory risk which has been introduced in California by Proposition 103.

Recent decisions in California have granted returns of 13% to 14% on GAAP equity to some portions of the monopolistic public utility industry. The insurance industry returns are more volatile than the public utility returns because the insurance industry is subject to competition and does not enjoy a guaranteed customer base.

The fact that the insurance industry is subject to greater

regulatory risk since the passage of Proposition 103 should not be debatable. Mr. Bacon, in his testimony, agreed that greater uncertainty now exists in the California insurance marketplace.

According to Business Week the return on GAAP equity for the average U.S. industry was approximately 15% in 1988. Dr. Irving Plotkin, a recognized economist with substantial expertise in insurance industry issues, has testified in this proceeding that the average return for non-regulated U.S. industries is in the 15% to 16% range.

Based on these considerations, the minimum rate of return on GAAP equity for the property/casualty insurance industry of 16% is fair and reasonable at this time. Such a return is sufficiently higher than the returns allowed public utilities in California. It is about the same, or slightly higher, than the average return for all U.S. industries and sufficiently recognizes the added regulatory risk in California. Based on this analysis, a minimum 16% return on GAAP equity is a reasonable application of the Hope Gas standard.

Q.23 If an operating return of 5.4% of premium equivalent to a 16% return on GAAP equity is the bottom of the range of fair returns, then what return would constitute the top of the

range?

A.23 An arbitrary ceiling on rate of return is not desirable. Whether a rate is excessive because it produces too high a return should be made on a case-by-case basis. There are significant differences between insurers related to ability to attract capital, legal structure and the type of business insured. Differences in capital structures are positive and pro-competitive and should be encouraged, rather than discouraged. A generic rule dictating a maximum return, without regard for these differences in capital structure, would tend to discourage diversity. It would also create an ironic situation in which a rate that is lower than other approved rates may be disapproved as excessive, for the single reason that it generates a higher than average return based upon the capital structure of an individual insurer. A ceiling rate of return should, therefore, be approached with great caution and it would be wiser, in my view, not to engage in this effort at all.

It is also not clear that a maximum need be specified in a competitive market. If an insurer prices its product to a return that is in excess of what the market is allowing, it will lose its customer base. The customers are free to choose their insurer and they will choose the low cost providers no matter what profit provision is factored into

the rate.

Further, the regulatory standard of excessiveness applies to the rate charged, not the total rate of return. If an insurer, either through efficiency or for some other reason, is able to provide a below average rate which happens to include a relatively high profit provision, then no one is harmed. In that case, both the insurer and the customer will benefit.

If the Commissioner determines to use the top end of a target return range as a hard and fast ceiling on returns in California, then the most appropriate benchmark would be higher than the 21% return level which has been adopted by the New York Insurance Department. The New York Insurance Department, after a lengthy review of what would constitute an "excess" profit, has concluded that excess profits are not earned until the industry exceeds 21% averaged over a six year period. There is no reason to believe that any lower figure for what would constitute "excess" should exist in California.

If on the other hand, the Commissioner seeks to use the top end of the range not as the basis for absolute disapproval of rates but rather simply as a benchmark to determine when further review of a rate application is warranted, then a

return of 19% would be sufficient. Economist James Vander Weide has calculated the correct return for a property/casualty insurer of average risk to be 18.25%. A 19% return, used as a benchmark for further rate application review, would appropriately incorporate Vander Weide's calculations.

However, I believe that each insurer should be able to present evidence based on unique circumstances which would justify a higher return. It would not be appropriate for the Commissioner to automatically disapprove rates which were relatively low merely because they happened to include a profit provision greater than my recommended range. The rate approval process must adequately reward the low cost providers.

Q.24 Now let's turn to the issue of leverage ratios. Why are leverage ratios important to the ratemaking process?

A.24 The leverage ratio is important in ratemaking because it is used to translate any target rate of return expressed in terms of statutory surplus or GAAP net worth to a return expressed as a percentage of premium. Every provision that goes into a rate must necessarily be expressed as a percentage of premium.

Q.25 Is it appropriate to impose a single set of leverage norms line by line on all insurers, as set forth in the DOI Preliminary Prayer?

A.25 **No. In order to understand why different insurers maintain different premium to surplus ratios, it is important to consider the reasons for the existence of surplus.**
One of the most important reasons for maintaining surplus is to protect the company's ability to pay claims to its insureds in the event of an unusually large claim(s) occurrence. Property/casualty insurers are exposed to potentially large claims from a variety of sources. Two of the most important sources are earthquakes and hurricanes.

Many companies protect their customers from the risk of insolvency due to a particularly large catastrophic occurrence through the use of reinsurance. Other companies rely upon their own capital/surplus base. Either is a valid approach, but all other things being equal, it is more cost effective to protect against insolvency by means of owned capital and surplus rather than through reinsurance.

Many companies write a significant portion of their commercial lines business on retrospectively rated programs. Under these programs, if losses exceed the original expected amount, some of the difference is recovered from the insured

through the retrospective rating mechanism. Thus, all other things being equal, a company writing retrospectively-rated business has a lesser need for surplus than a company which does not.

For these reasons, as well as those pointed out by Mr. Bailey, who has testified previously, the leverage ratio will necessarily vary from insurer to insurer and should, therefore, not be generically treated but rather should be left to review as part of company specific rate hearings.

Q.26 Are the leverage norms proposed by Mr. Bacon and in the DOI Preliminary Prayer actuarially sound?

A.26 No.

Surplus is indivisible and exists in its entirety to protect all lines of insurance in all jurisdictions in which the insurer does business. Given the indivisibility of surplus, it is only appropriate to calculate a total rate of return for all lines of insurance combined. That is the reason why the NAIC calculates an operating profit by line rather than a total return by line.

Mr. Bacon testified that he intended to selected his leverage norms so that they would average to approximately 2 to 1 for

all lines combined. Mr. Bacon's premium to surplus ratios, however, do not in fact average to 2 to 1. The use of a 1.3 to 1 ratio for workers compensation distorts Mr. Bacon's average substantially. If a more appropriate ratio for workers compensation were used, Mr. Bacon's overall average would be in excess of 2.7 to 1. This illustrates the distortion that can be created by attempting to create line by line leverage norms. The 2 to 1 overall premium to surplus ratio has been standard in the industry and has served well for a long time. As set forth in Exhibit D attached hereto, the overall industry average premium to surplus ratio over the past twenty years has been approximately 2 to 1; for each of the past ten years, the average has actually been below 2 to 1.

This amount of leverage represents the collective judgment of those who have actually been responsible for dealing with the risks faced by the industry and thus is entitled to great weight. If an insurer is adequately reinsured and has a typical exposure to catastrophe, a 2 to 1 premium to surplus ratio is appropriate and is a sound practice. The 2 to 1 ratio is the only ratio that has broad acceptance among insurers and regulators and thus, the proper approach is to use a uniform leverage ratio of 2 to 1 across all lines for prospective rate regulatory purposes. To the extent that a company has an extraordinary exposure to catastrophic loss

or otherwise significantly different from average, it should be allowed the opportunity to justify a lower leverage than 2 to 1.

Q.27 Is there any generally accepted way of measuring differences in risk by line of insurance?

A.27 No. No one either within the industry or outside the industry has ever been able to develop a generally accepted method of measuring hypothetical differences in risk between different lines of insurance.

According to Mr. Bacon, the DOI has selected their proposed leverage norms primarily on the ratio of loss reserves to premium for each line. Apparently this was an attempt to measure the uncertainty surrounding the calculation of loss reserves.

The uncertainty of the loss reserving process may well be one appropriate consideration, but it certainly does not represent the totality of the risk differences. In fact, an analysis of industry loss reserves over the last five years suggests the significant uncertainty in estimating loss reserves exists only for the medical malpractice and other liability lines of insurance. (See Attachment E, attached hereto.) Even this potential uncertainty for medical

malpractice and other liability lines may be explained by the fact that some of these loss reserves are initially established at a discounted level. In any case, the significance of this data is that for the industry as a whole -- which was the apparent basis of the DOI's analysis -- the relationship between loss reserves and risk is far weaker than Mr. Bacon hypothesized.

Q.28 Are there other measures of risk?

A.28 Yes. Another measure of the risk can be determined by analyzing the variability of the operating profits over a period of years. Under this analysis, the greater the variation in operating profits, the greater the indicated risk. The variation in operating profits provides somewhat different, but in some ways more complete, measure of risk by line. The variation in operating profits approach is not solely dependent upon loss reserve levels, but includes variation in loss reserves among the things it measures. Based on this measure, the personal lines appear somewhat less variable than the commercial lines. This approach has drawbacks as well. For example, it is likely that, prior to 1989, the variability in operating profits for the earthquake line would not have indicated the true measure of risk inherent in that line.

Yet another approach to evaluating the risk of individual lines of insurance is to review the actual leverage ratios used by insurers which specialize in particular lines of insurance. A.M. Best and Company categorizes insurers based on the lines which they predominantly write. Using the top ten writers in each category, I determined that the actual leverage ratios were:

Property Insurers	1.0:1
Commercial Casualty Insurers	1.9:1
Auto Physical Damage Insurers	2.1:1
Medical Malpractice Insurers	1.7:1
Commercial Auto Insurers	1.6:1
Fidelity & Surety Insurers	1.2:1
Personal Lines Insurers	1.6:1

The determination of risk is a classic example of where perception is 100% of reality. That is the reason for considering the actual leverage ratios used by insurers in writing the various lines of insurance. The actual ratios reflect the professional assessment of risk by the insurers who specialize in particular lines of business and regulators throughout the United States. This approach indicates that personal lines is viewed as no less risky than many of the other lines. No matter what level of risk we finally determine to be "right", it will be the perception of risk

by the insurers which dictate their actions in the marketplace.

In Exhibit F attached hereto (page 1), I have ranked the lines of insurance based on four criteria: (1) the Department of Insurance estimations; (2) the ratio of loss reserves to premiums; (3) the variations in operating profits; and (4) the assessment of professional risk managers for insurers who specialize in certain lines.

The DOI's leverage norms illustrate the fallacy of relying so heavily on loss reserves for risk assessment. Earthquake is a classic example of a low frequency, high severity coverage that is risky but has a relatively low level of loss reserves. This was an obvious example of a case where the DOI's methodology failed and they arbitrarily assigned a different norm to earthquake than that indicted by loss reserves. But the failures in the methodology were not limited to earthquake. The DOI has ignored the risk inherent in other lines, such as fire insurance, which is not reflected in the level of loss reserves.

Finally, the difference between the risk assessments made by professional risk managers and the hypothetical risk assessments produced by any or all of the three approaches discussed above tends to show that the professional judgments

of risk managers -- who have to live with and stand behind their judgments on a day to day basis -- differ markedly from the hypothetical results generated by any theoretical model or approach. This makes one skeptical of artificial leverage norms generated by loss reserve calculations or any other theory that purports to estimate risk by line of insurance.

Q.29 Using the approaches you have described, what conclusions can you reach about premium to surplus ratios?

A.29 The only valid conclusion that can be reached is that there are a variety of approaches to the issue of risk determination, those analyzing the issue vary widely on the approaches used, and there is no single approach that is generally accepted as reliable. The only tested and reliable standard is an industry-wide overall 2 to 1 premium to surplus ratio. It would be a mistake for the Commissioner to attempt to impose any other standard. Attempts to create line by line ratios will be, by definition, arbitrary. Line by line premium to surplus ratios, therefore, should not be adopted.

Q.30 Having determined a range of reasonable total returns, how would you recommend that the Commissioner apply those factors in regulating prior approval of rates?

A.30 A reasonable approach and one that would be easy to administer is to convert the range of total returns to the resulting range of operating returns for use as guidelines in administering California's prior approval law. In the attached Exhibit B, I have mathematically converted the range of total returns I recommend to a range of operating returns of 5.4% to 7.0% of premium.

In translating the total returns to operating returns I have used industry-wide data. It is to be expected that the projected investment income and the ratio of GAAP equity returns to statutory surplus returns will vary materially from insurer to insurer. These are examples of unique situations which can be handled in the filings on a case-by-case basis.

There are several advantages to using operating returns as guidelines. Eventually any return must be converted to a return on premium in order to introduce it into the ratemaking formula. Operating returns are widely used by regulators in administering prior approval laws. The NAIC uses operating profits to evaluate results by line of insurance. Most importantly, operating returns are more understandable to the public because they focus solely on the profits arising from the insurance operation and tell

the consumer what percentage of his or her premium dollar goes to profit.

The use of operating returns would satisfy the requirement of Proposition 103 because, as shown in Exhibit B, all income is mathematically reflected in their determination.

Filers should have the opportunity, on a case-by-case basis, to prove the necessity of any exceptions to any guidelines so as to reflect any unique circumstances.

Q.31 The third generic rule proposed by the DOI with which you have disagreed relates to the treatment of capital gains. Why is the three year experience period recommended in the DOI proposal insufficient to determine projected capital gains?

A.31 Three years is insufficient because of the substantial fluctuations which exist in capital gains from year to year. An experience period of ten to twelve years is necessary to develop a reliable estimate of expected capital gains. To see this more clearly I would ask you to refer to my Exhibit C, page 1, column 5. Note how the results fluctuate and also keep in mind that we are looking at industry-wide data. When individual insurer data is used, the fluctuations will be much more dramatic. The DOI's approach will result in

undesirable instability in the rates for each insurer.

Q.32 Having determined the appropriate profit provision are their any other components of the rate which must be considered?

A.32 Yes. One final provision in the rate which must be included for prospective ratemaking is the contingency provision. As I stated earlier, this is the charge for any systematic variation of the estimated costs from the expected costs.

We can expect the actual costs to vary randomly from year to year around the expected costs. If the variation is random and not biased, then over a period of time the actual results will average to the expected. However, if there is some bias or systematic variation in the rate setting process, then the average actual results will not equal the average expected results. It is this potential systematic variation which the contingency provision is intended to measure.

The contingency provision is not just another name for profit. The profit provision reflects the risk of random variation around the expected costs. The greater the degree of random variation, the greater is the risk and, therefore, there is a need for a higher profit provision. The contingency provision has nothing to do with the degree of random variation, it merely measures the bias, or systematic

variation, in the results.

Suppose one calculates rates each year with a 0% profit provision which one expects to produce a break-even profit level. Further assume that despite our best efforts the actual results average over time to a 5% loss. In this situation, there is some sort of bias in the rate setting process. One can no longer realistically expect to realize a break-even profit level with a 0% profit provision in the rates. The history tells us that we should expect a 5% loss when a 0% profit provision is included in the rates. The 0% provision becomes a pro forma amount and the true expectation becomes minus 5%. The contingency provision corrects for this bias and, to the extent possible, makes the profit provision in the rate formula the true "expected profit", rather than just a pro forma provision.

The contingency provision provides for any losses or expenses which have not been anticipated in the rate formula. If we knew what those contingencies were going to be next year, we would just include them in the loss and expense provisions. We only know that losses and expenses beyond those reflected in the rates have occurred in the past and will likely arise again. Some contingencies just cannot be included in the loss and expense projections, no matter how sophisticated the actuarial process.

For example, the rate regulatory process itself gives rise to contingencies. In any rate filing, there are many assumptions and judgments which must be made. Around each judgment there is a range of reasonable judgments which could be exercised. If some judgments were made on the high side of the range of reasonableness and others on the low side, then we would expect the total judgments and the resulting indicated rate level to be unbiased. Sometimes in the rate regulatory process there is a tendency to make all judgments at the low end of the range of reasonableness. When all the individual judgments are compounded, we no longer have an unbiased estimate of the true rate level needs.

Like the other rate components, the value of the contingency provision varies from insurer to insurer, line to line, state to state, and over time. The actual quantification must be left to the individual filing, as it is in all other prior approval states.

Q.33 Are there any other aspects of prospective ratemaking upon which you would like to comment?

A.33 Yes. Despite my discussion of a range of rates of return and ranges of leverage norms, which are intended to introduce a measure of flexibility and reality into the DOI's "generic

methodology" approach, I would like to reiterate that prior approval rate regulation has worked best in those states where the regulator has attempted to emulate the competitive market. Prior approval regulators have long recognized that prospective ratemaking is not mechanical and that both sound judgment and reasonable flexibility is required if rates for individual insurers are to satisfy the regulatory standards and coverage is to be widely available to the public. It remains my view that the quest for "generic standards" is, in reality, an effort to substitute a mechanical formula developed without the concrete facts of a specific insurer. In the long run, it remains my opinion that generic formulas will serve more to hamstring the ability of the administrator to develop and exercise informed judgment than to aid in efficient administration of California insurance regulation. We should not confuse the bureaucratic desire to easily process the paper associated with the rate filings with the need for the efficient administration of the rate standards in the law.

Q.34 Does this conclude your direct testimony?

A.34 Yes.

EXHIBIT B

TARGET OPERATING RETURNS

		Col. A	Col. B
1.	Total Rate of Return, after tax (% GAAP Equity)	16.0%	19.0%
2.	Ratio of GAAP Equity Return to Statutory Surplus Return*	1.10	1.10
3.	Total Rate of Return, after tax (% Statutory Surplus)	17.6%	20.9%
4.	Expected Investment Income on Capital/Surplus, after tax	6.9%	6.9%
5.	Target Operating Return, after tax (% Statutory Surplus)	10.7%	14.0%
6.	Standard Premium to Surplus Leverage Ratio	2:1	2:1
7.	Target Operating Return, after tax (% Premium)	5.4%	7.0%

* Source: Insurance Facts, published by Insurance Information Institute.

Summary of Investment Returns
Before Federal Taxes
Industry Data

(000) omitted

Source: Best's Aggregate & Averages

Year	(1) Mean Cash & Invested Assets	(2) Net Inv. Income	(3) Return % (2)/(1)	(4) Real. Cap. Gains	(5) Return % (4)/(1)
1979	$139,965,071	$ 9,116,816	6.51%	$ 273,097	0.20%
1980	160,286,360	10,920,656	6.81	532,650	0.33
1981	175,152,171	13,220,318	7.55	284,581	0.16
1982	187,420,307	15,007,069	8.01	594,731	0.32
1983	202,755,088	15,986,825	7.88	2,112,290	1.04
1984	215,205,968	17,659,729	8.21	3,063,213	1.42
1985	239,224,353	19,507,866	8.15	5,483,244	2.29
1986	286,540,656	21,924,445	7.65	6,874,220	2.40
1987	337,512,616	23,959,981	7.10	3,335,320	0.99
1988	381,264,322	27,723,269	7.27	2,725,466	0.71
			7.53		1.09

Year	(6) Unreal. Cap Gains	(7) Return % (6)/(1)	(8) Extra. Taxes Misc. Income	(9) Return % (8)/(1)
1979	$2,334,013	1.67%	$ -659,264	-0.47%
1980	4,049,429	2.53	-595,076	-0.37
1981	-2,661,842	-1.52	201,798	0.12
1982	2,957,163	1.58	-814,463	-0.43
1983	1,348,944	0.67	-258,714	-0.13
1984	-2,859,447	-1.33	302,635	0.14
1985	5,227,344	2.19	37,303	0.02
1986	2,026,770	0.71	89,952	0.03
1987	-3,026,471	-0.90	-327,249	-0.10
1988	2,703,298	0.71	- 67,038	-0.02
		0.52		-0.09

Sources:
Col. 1 - Annual Statement, page 2, line 8a
Col. 2 - Annual Statement, page 4, line 8
Col. 4 - Annual Statement, page 4, line 9
Col. 6 - Annual Statement, page 4, line 19
Col. 8 - Annual Statement, page 4, lines 29 & 30

Net Investment Income - 1988
After Federal Taxes

(000) omitted

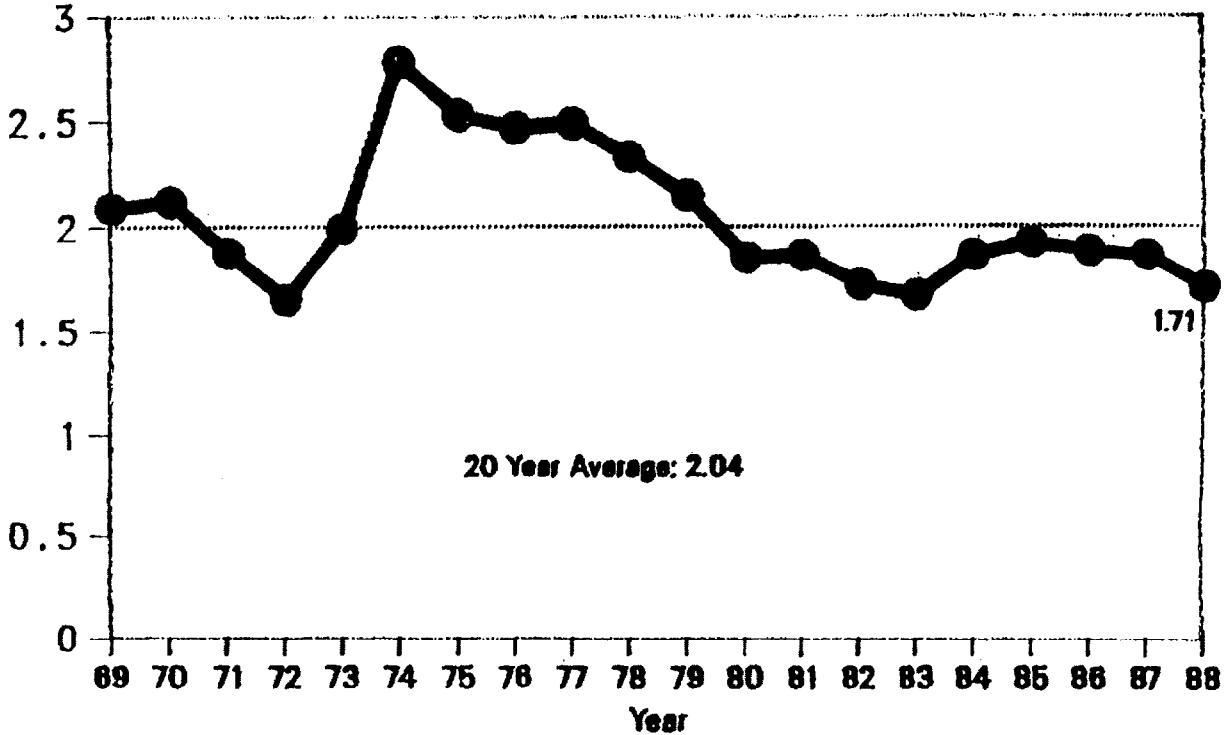
a) Investment Income (A.S. Part 1, Page 6, Col. 8, Line 10)	$ 29,553,082
b) Tax Exempt Interest (A.S. Part 1, Page 6, Col. 8, Line 1.1)	$ 10,261,775
c) Dividends (A.S. Part 1, Page 6, Col. 8, Lines 2.1 + 2.11 + 2.2 + 2.21)	$ 3,103,971
d) Tax Rate [.34 x (a - b - .80c) / a]	.193
e) Net Investment Income (A.S. Page 4, Line 8)	$ 27,723,269
f) Net Investment Income, after taxes [e x (1 - d)]	$ 22,372,678
g) Mean Invested Assets	$381,264,321
h) Return % (f/g)	5.87%

Net Investment Income - 1988
After Federal Taxes

(000) omitted)

a) Net Investment Income, after taxes	5.87%
b) Realized Capital Gains, before taxes	1.09%
c) Realized Capital Gains, after taxes (.66 x b)	0.72%
d) Unrealized Capital Gains, before taxes	0.52%
e) Unrealized Capital Gains, after taxes (.66 x d) (per NAIC tax formula)	0.34%
f) Extraordinary Taxes plus Miscellaneous Gains, before taxes	-0.09%
g) Extraordinary Taxes plus Miscellaneous Gains, before taxes (per NAIC tax formula with tax rate applied only to Miscellaneous Gains)	-0.06%
h) Total Investment Return, Expected for 1988 (a + c + e + g)	6.87%
i) Selected Investment Return on Mean Invested Assets for 1989, after taxes	6.9%

Property Casualty Insurers
Historial Ratios of Net Written Premium to
Policyholder Protection Funds
1969-1988



Source: A.M. Best Company's 'Aggregates and Averages', 1989.

EXHIBIT E

RETROSPECTIVE TEST OF RESERVE ACCURACY

LINE OF BUSINESS	AVERAGE CHANGE IN LOSS RESERVE ESTIMATES
Medical Malpractice	38.3%
Other Liability	20.4%
Workers Compensation	5.4%
Multi-Peril Lines	4.6%
Automobile Liability	1.3%
Summary of "P" Lines	4.1%
Summary of "O" Lines	3.0%

Source: Bests Aggregates and Averages
Schedule P, Part 2, 6 year development averaged over 4 years
Schedule O, Part 2, 2 year development averaged over 3 years

Lines of Insurance
Grouped by Degree of Risk

Insurance Department	Ratio of Loss Reserves to Premiums	Variation in Operating Profits	Risk Managers Assessment
Medical Mal.	Medical Mal.	Fidelity	Property
Umbrella/Excess	Other Liab.	Comm. Multi-Peril	Fidelity/Surety
Prof. Liab.	Aircraft	Other Liab.	Comm. Auto
Earthquake	Auto Liab.	Medical Mal.	Personal
Product Liab.	Comm. Multi-Peril	Burg. & Theft	Medical Mal.
Surety	Fidelity	Comm. Auto P.D.	Comm. Cas.
Other Liab.	Surety	Comm. Auto Liab.	Auto Phys. Dam.
Auto Liab.	Boiler & Mach.	Allied	
Farmowners	Fire	Boiler & Mach.	
Comm. Multi-Peril	Farmowners	Other Lines	
Aircraft	Homeowners	Surety	
Fidelity	Allied	Inland Marine	
Business Owners	Inland Marine	Farmowners	
Spec. Multi-Peril	Burg. & Theft	Fire	
Auto Phys. Dam.	Glass	Aircraft	
Homeowners	Auto Phys. Dam.	P.P. Auto Liab.	
Fire	Earthquake	Homeowners	
Allied		P.P. Auto Phys. Dam.	
Inland Marine			
Glass			
Burg. & Theft			
Boiler & Mach.			

RATIO OF UNPAID LOSSES
TO
NET WRITTEN PREMIUMS

LINE	RATIO UNPAID LOSSES TO PREMIUMS WRITTEN
Medical Malpractice	4.179
Other Liability	2.672
Reinsurance	2.290
Workers' Compensation	1.929
Aircraft	1.513
International	1.459
Auto Liability	1.215
Ocean Marine	1.168
Group Accident/Health	1.091
Credit	1.012
Commercial Multi-Peril	.988
Fidelity	.817
Other	.762
Surety	.761
Financial Guaranty	.673
Boiler & Machinery	.470
Fire	.470
Credit Accident/Health	.464
Other Accident/Health	.432
Farmowners	.397
Homeowners	.386
Allied Lines	.369
Inland Marine	.316
Burglary & Theft	.288
Glass	169
Auto Physical Damage	130
Earthquake	108
AVERAGE	.983

SOURCE: Best's Aggregates and Averages 1989
Pages 62 and 64

POSITIONS ON DETERMINATION OF THE FOUR ELEMENTS OF AN INSURANCE RATE

	COST OF CLAIMS (Claim Losses Paid and Incurred)	CLAIM SETTLEMENT EXPENSES (Expenses Associated with the Claims Settlement Process)	OPERATIONAL ADMINISTRATIVE EXPENSES (Sales and Administrative Expenses)	COST OF CAPITAL (Provisions for Profit and Contingencies)
BACON	Any Generally Accepted Actuarially Sound Methodology	Any Generally Accepted Actuarially Sound Methodology	Exclude Specified Expenses Any Generally Accepted Actuarially Sound Methodology	11.2 to 15% Target Total Return With Line By Line Leverage Norms
DOI PRAYER	Generic Cost Trend Factors (As Yet Undeveloped)	Capping of Expenses at "Three Year Average Expense Level"	Exclude Specified Expenses Capping of Remaining Expense At "Three Year Average Expense Level"	11.2 - 15% Target Total Return With Line By Line Leverage Norms
FIREMAN'S FUND	Any Generally Accepted Actuarially Sound Methodology	Any Generally Accepted Actuarially Sound Methodology	Any Generally Accepted Actuarially Sound Methodology	Risk Free Discounted Cash Flow Methodology
MILLER	Any Generally Accepted Actuarially Sound Methodology	Any Generally Accepted Actuarially Sound Methodology	Any Generally Accepted Actuarially Sound Methodology	5.4 to 7% Operating Return Based on 16 to 19% Target Total Return At Industry Average Leverage

California Dwelling Changes In Replacement Cost - Indexed Area Adjustment Factors

Indexed Area Adjustment Factors

	5/15/86	5/15/87	6/1/88	6/1/89
Southern Los Angeles County	1.000	1.007	1.044	1.074
San Diego County	1.000	1.024	1.056	1.200
Fresno	1.000	1.026	1.061	1.010
San Francisco Area 940 Zip Code	1.000	1.021	1.070	1.112
Marin County	1.000	1.028	1.069	1.118
Del Norte & Humboldt Counties	1.000	0.936	1.008	1.048
Sacramento	1.000	1.040	1.072	1.104
Siskiyou, Trinity, Shasta & Tehama Cos.	1.000	0.832	0.936	0.960

Area Adjustment Factors are indexed to the 5/15/86 factor.

Source: E.H. Boeckh

NONRECURRING EXPENSES EXCLUDED BY ACTUARIAL PRINCIPLES

Bad Faith/Punitive Damage Judgments

Fines and Penalties

Employee Discrimination Judgments

RECURRING EXPENSES NOT EXCLUDED BY ACTUARIAL PRINCIPLES

Charitable Contributions

Political Contributions

Lobbying Expenses

Institutional Advertising

INSOLVENCIES OF CALIFORNIA P-C INSURERS
UNDER THE CONTROL OF THE CALIFORNIA INSURANCE
COMMISSIONER AS OF JUNE 1989

Name	Date of First Legal Action	Last Year of Date Filed Before Action	Premium To Surplus Ratios 1st Year Prior	2nd Year Prior	3rd Year Prior	4th Year Prior	5th Year Prior
Signal Ins. Co.*	09-23-75	1974	3.2	1.2	1.1	1.7	1.5
Imperial Ins. Co.*	09-23-75	1974	5.7	2.2	1.8	3.3	2.5
Eldorado Ins. Co.	08-02-78	1977	9.4	9.9	7.7	14.1	6.1
Independent Indemnity Co.	02-28-84	1982	5.4	3.9	2.1	3.1	5.1
Surety Ins. Co.	05-23-84	1983	1.5	1.4	2.3	3.2	1.6
S&H Ins. Co.	01-28-85	1983	5.1	2.1	1.5	1.7	2.8
Mission Ins. Co.**	10-31-85	1984	5.7	0.9	0.8	1.0	1.5
Mission National Ins. Co.**	11-25-85	1984	3.4	0.8	0.7	1.0	0.1
Enterprise Ins. Co.**	11-26-85	1984	1.5	0.9	0.7	0.9	0.7
TMIC Ins. Co. (formerly Ticor Mortgage Co.)	04-10-86	1985	0.7				
Mission American Ins. Co.** (formerly Transport Indemnity Co.)	02-02-87	1985	1.2	1.6	1.3	0.9	1.5
Homeland Ins. Co.	05-06-87	1985	6.0	3.7	4.5	2.3	2.1
COMPAC Ins. Co.**	04-07-88	1987	0.1	0.7	0.1	0.0	1.0
Great Falls Ins. Co.	05-25-88	1987		3.9	2.1	1.0	2.3
Coastal Ins.	02-02-89	1987	1.7	2.8	1.8	0.9	0.5
No. Companies			14	14	14	14	14
No. under 2.0			6	7	9	9	8

Sources: NAIC Report (June 1989) "Multi-State Departmental Supervisions, Conservatorships, Rehabilitations and Liquidations", A.M. Best

* Imperial Ins. Co. is a wholly-owned subsidiary of Signal Ins. Co.

** Member of the Mission Insurance Group.

Private Passenger Auto Insurance
Premiums* and Leverage** (Adult Good Driver)
California

Company	12/31/88 Group Premium To Surplus Ratio	Inglewood, CA	Menlo Park, CA	Eureka, CA
1	1.5 to 1	$ 1,319	$ 626	$ 516
2	2 to 1	1,541	768	605
3	2.5 to 1	2,168	822	683
4	3 to 1	1,771	699	600
5	4 to 1	1,602	636	614

* Premium Data Obtained From May 2, 1988 DOI Premium Survey based on Full Coverage with BI/PD coverage of 100,000/300,000/50,000 and comparable medical payment, uninsured motorist, comprehensive and collision coverage.

** Premium to Surplus Ratios are the 12/31/88 Ratios (rounded to nearest 0.5) for each Insurer Group as stated in A.M. Best Reports.

CALIFORNIA HOMEOWNERS INSURANCE
PREMIUMS AND LEVERAGE
AS OF 9/15/88

Company	12/31/88 Group Premium to Surplus Ratio	Torrance $200,000	San Mateo $200,000	Eureka $200,000
1	1.5 to 1	$ 566	$ 552	$ 610
2	1 to 1	566	533	566
3	2 to 1	682	699	621
4	2 to 1	588	542	590
5	3 to 1	576	611	650
6	3 to 1	550	576	584

SOURCE: DOI Homeowner Premium Survey Draft of 10/14/88 and A. M. Best Co.

Note: Premium to surplus ratios rounded to nearest 1/2.