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AIPSO
"Serving the Insurance Industry"

Caution! Assigned Risk: Changes Ahead

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Session Topics

- **Overview of Auto Residual Markets Mechanisms**

  Dust off those exam cobwebs!

- **Today's Assigned Risk Market Realities**

  Danger ahead!

- **Implications and Potential Solutions**

  Industry Circular

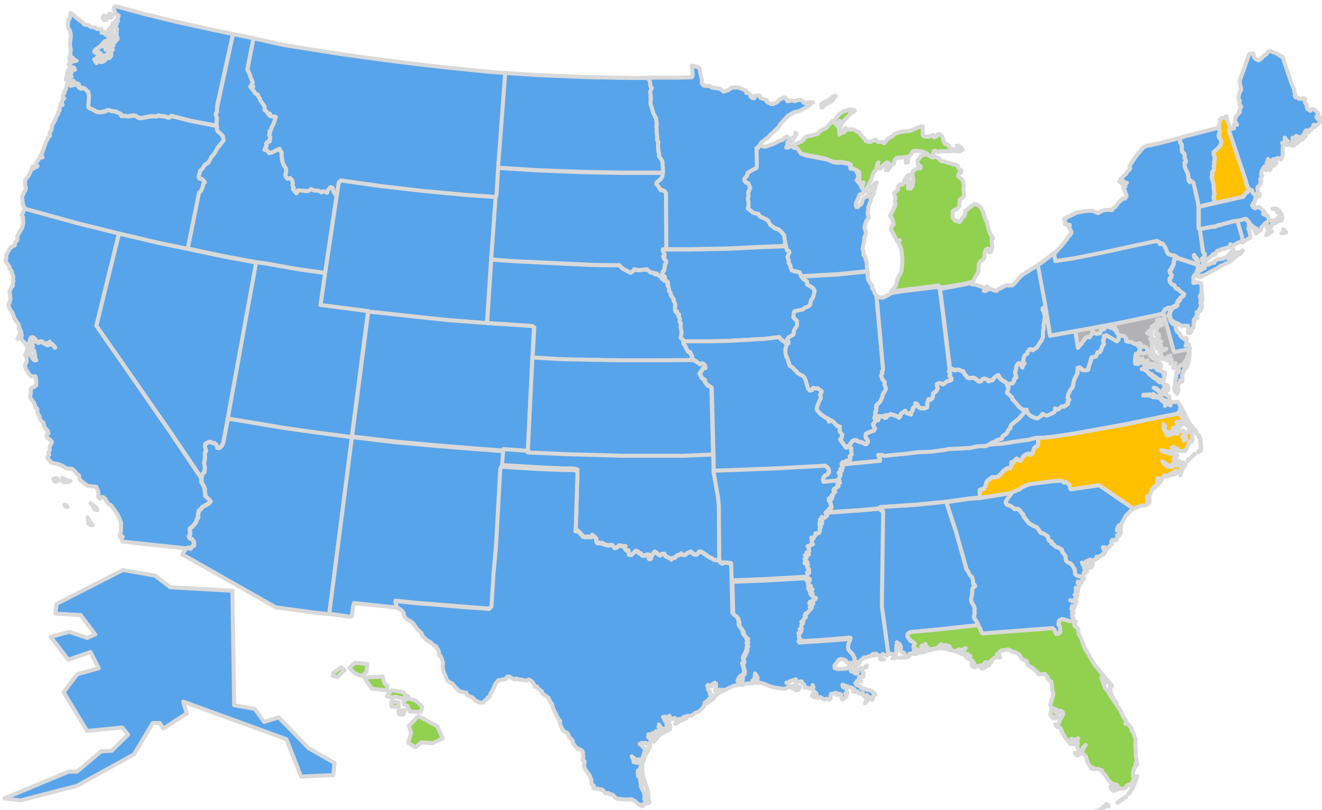
  What we heard

  Next steps

Some Useful Terms

- Types of auto residual market mechanisms
  - Assigned Risk Plans (AIPs)
  - JUA
  - Reinsurance Facility
  - State Fund
- AIPSO – Auto Insurance Plan Service Office
  - Industry funded
  - Administers the auto residual market on behalf of the industry
- LAD (Limited Assignment Distribution)
  - Option for company to buy out of all auto residual market obligations

Private Passenger Auto Plans – Countrywide View



AIP	JUA	RF	Other
45	3	2	1

Sources: APISO

What options does a company have to fulfill their auto residual market obligation?

Take own assignments on an in house policy administration system

- Build new or utilize existing IT platform for this line of business
    - Requires familiarity with and programming of Plan specific rules/rates/rating plans for all active states
        - Involuntary market rating plans are generally significantly different than voluntary market rating plans

- Need in-house expertise for effective management of this line of business (UW results flow directly to bottom line of company results)
    - Premium pursuit/correct classification efforts
    - Customer and producer service unit
    - Data/Statistical reporting functions, including credit mechanisms
    - Claims may need specialized handling

What options does a company have to fulfill their auto residual market obligation?

Take own assignments on third party policy administration system

- Outsource the IT platform for this business
- Effective management of the business is still required; may be available from the vendor
- Metrics to watch:
  - Average premium of assigned business relative to industry
  - Severities relative to industry (frequency differences to industry may be random)

What options does a company have to fulfill their auto residual market obligation?

Enter into a LAD agreement (LAD = “Limited Assignment Distribution”)

- Opportunity exists in most states (some restrictions if voluntary market share is >5%)
- LAD company assumes ALL responsibility/obligations arising from this market
  - Quota obligation
  - Underwriting gain/loss
  - Data/Statistical reporting

- Evaluation criteria:
  - Evaluate assigned risk combined ratio
    - Use fully loaded expenses for this line of business (IT costs, vendor costs, head counts, accounting, claims costs, etc.)
  - Compare CR to quoted LAD supplier cost to determine savings opportunity

Estimating Your Company's Financial Obligation

Auto Assigned Risk, A Framework

Cost Element	Taking Own Assignments	Currently in LAD
Premium from assigned buisness	$100,000	$100,000
Loss & LAE on assigned business	$80,000	N/A
Expense Considerations:		
IT Costs (or TPA costs if outsourced)	$45,000	N/A
Include:		
Project Costs (rate/policy changes)		
System Maintenance costs		
Customer/Producer Service Unit	$20,000	N/A
Data/Statistical Reporting	$10,000	N/A
Vendor Management (if TPA used)	$10,000	N/A
LAD Fee	N/A	50%
Combined Ratio	165%	150%
UW Loss	($65,000)	($50,000)
Incremental AIPSO Cost of "Single Entity"	$2,000,000	
AIPSO Assessment % for Your Company	1.5%	
Your Company Cost	$30,000	

What options does a company have to fulfill their auto residual market obligation?

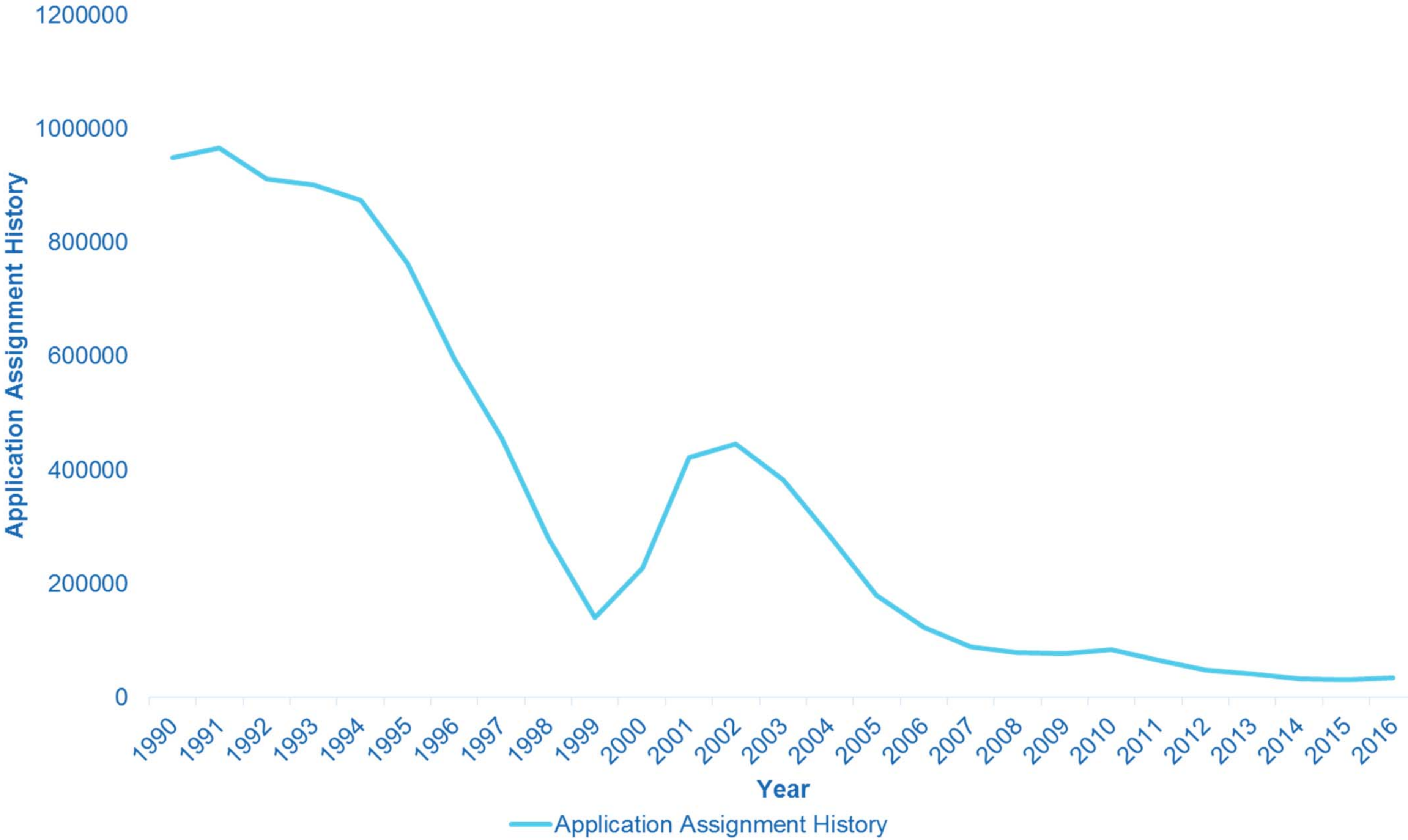
<u>The assigned risk mechanism is very costly to manage today</u>

- No opportunity to achieve scale in processing costs (even large carriers)
- Line expertise is present in only isolated pockets
- Per policy fixed costs in the industry today are estimated to be >$1000 (and growing), with UW losses additional

How Small is this Market Today?

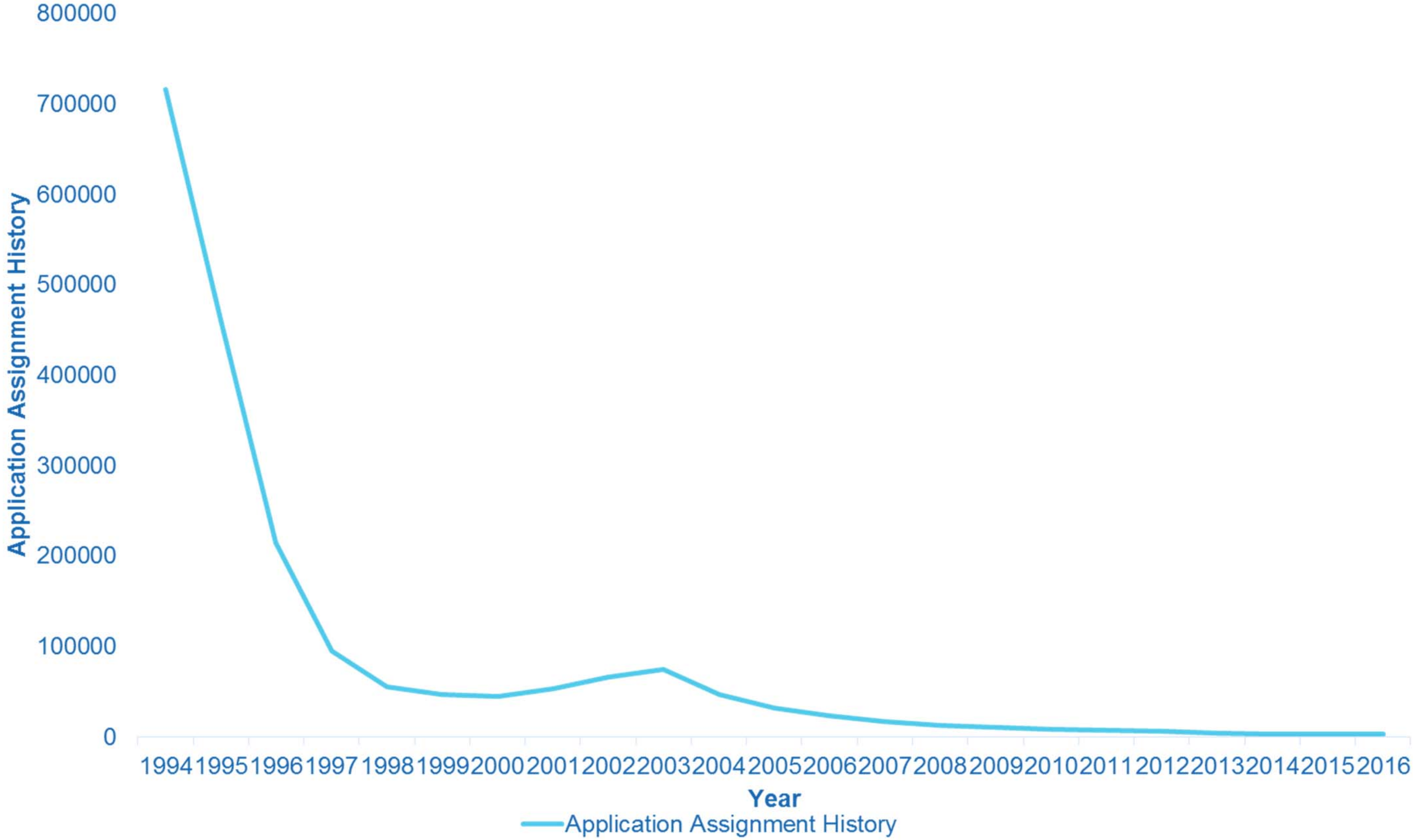
- In 2016, 33 states had fewer than 100 policies enter the residual market
- 29 states had ten or fewer assignments
- 12 states had 0 assignments during the year
- However, companies must be prepared to deal with an assignment, if they happen to receive one
  - Extremely cost ineffective

New York AIP Application Volume History



New Jersey PAIP Application Volume History

Texas AIP Application Volume History



It is time for a new paradigm

How can the industry work together to decrease the costs to service this market?

Given today's realities, the AIPSO Board of Directors is exploring alternative ways to manage the involuntary auto residual market in a more cost-effective manner. Two primary options are being discussed

What is AIPSO?

AIPSO is a voluntary, unincorporated, non-profit association of insurers serving all companies writing automobile insurance and the Automobile Insurance Plans throughout the country, both as a rating bureau, a statistical agent and for other purposes as provided in its Articles of Association.

- Owned by the Insurance Industry
- Thirteen major insurers constitute the Board of Directors
- The composition is such that the Board represents companies writing most of the automobile insurance in the United States
- www.aipso.com

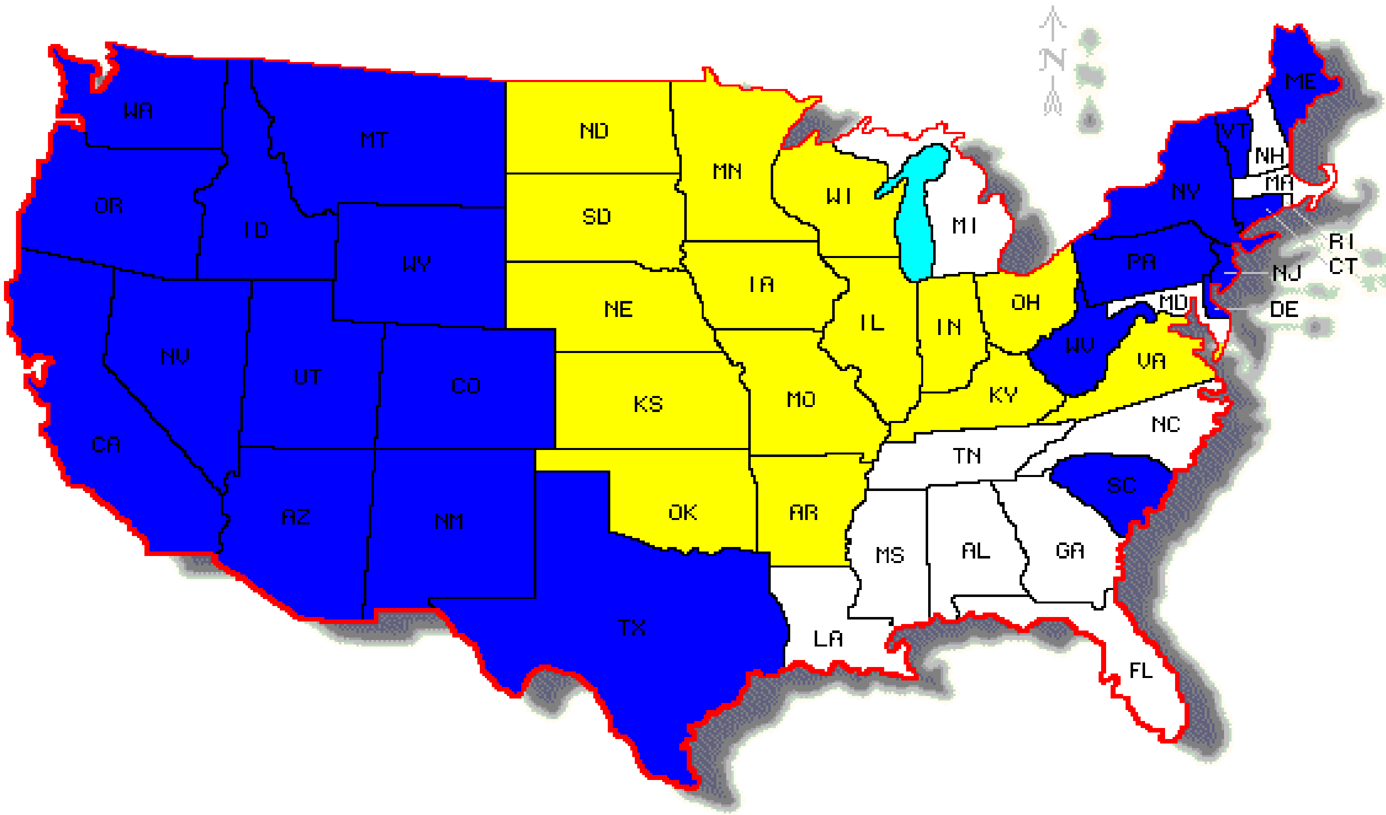
Creation of Industry Circular/White Paper

A proposal now under consideration by AIPSO's Board of Directors is an alternative LAD service option for AIPSO-administered LADs. Under this option, AIPSO itself would serve as the primary LAD service provider for AIPSO-administered LADs.

For complete circular, go to AIPSO.com

Two Types of LAD Programs:

Blue = negotiated LAD States (22)   Yellow = AIPSO administered LAD (15)



AIPSO Administered LADs in Danger
LAD Programs

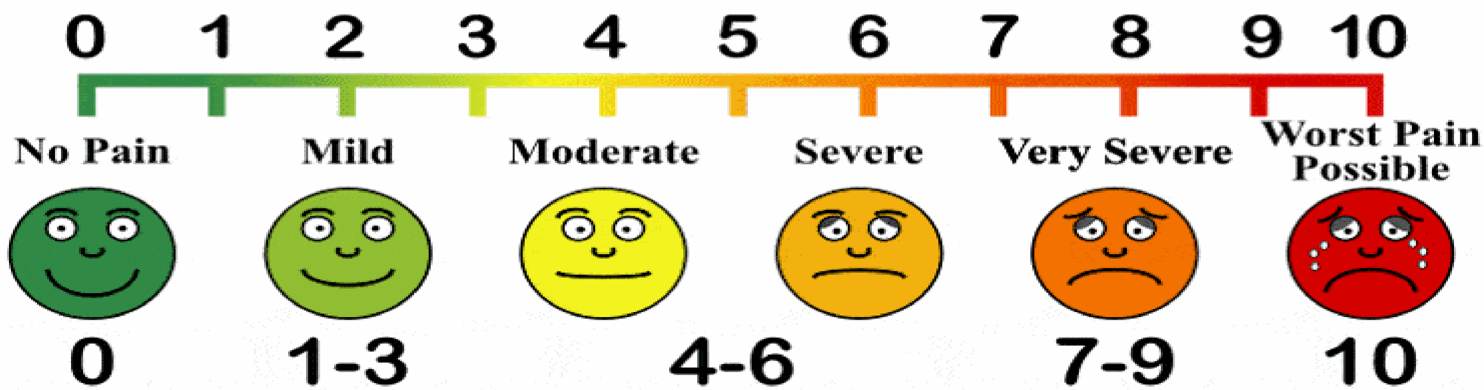
Two Types of LAD Programs:	Negotiated LAD	AIPSO Administered LAD
Buy-Out company contracts with:	Servicing Company	State Plan
Fee amount set by:	Servicing Company	State Plan (formula in Manual)
Billing and collection of fees done by:	Servicing Company	AIPSO (on behalf of the Plan)

AIPSO Administered LADs in Danger
Parallel Paths with CAIP

	CAIP	Negotiated LAD	Administered LAD
Peak Number of Servicing Carriers	Over 20	11	6
Current day Servicing Carrier	1	2	4 (3 service one state only)

Implications of Lack of a Servicing Company

PAIN



Direct Assignment - 6

Reduced/Poor Service - 8

Regulatory Intervention – 10 OUCH!!

White Paper Industry Response

The responses represented companies with approximately 70% of the countrywide voluntary market share. Approximately half of the respondents supported the proposal with no other comment. The remaining supported the concept but have some questions primarily as to cost.

Risk of Status Quo

- Inefficient
- No Serving Company
- Change Imposed Upon Industry

Benefits of moving forward

- More efficient
- Stability
- Change Driven by Industry

Questions?

Appendix - Glossary

Residual Market	The Residual Market consists of consumers who are unable to purchase auto insurance through the voluntary market due to a variety of factors such as driving history or first time drivers
AIPSO	**Automobile Insurance Plan Service Office**. AIPSO is a nonprofit, **industry funded** organization that provides an array of services (actuarial, legal/regulatory, quota determination and administration, etc.) that ensures that various states' assigned risk plans operate effectively and efficiently
AIP	**Auto Insurance Plan**. An assigned risk plan, the most common type of auto residual market mechanism, currently found in 45 jurisdictions, including DC. It is generally administered through an office created or supported by the state and governed by a board representing insurance companies licensed in the state. This mechanism assigns risks (policies) to each insurance company on a rotation based primarily on voluntary market share.
JUA	**Joint Underwriting Associations.** JUAs are state-mandated pooling mechanisms through which all companies doing business in the state share the premiums, losses, and expenses associated with the residual market of that state. A servicing carrier is typically hired to issue and service the policies.
RF	**Reinsurance Facility.** This is a pooling mechanism whereby each auto insurer is required to provide coverage and service the claims for any applicant, but is permitted to cede the premiums and losses of identified policies to the Reinsurance Facility. The profits or losses on Facility business are shared equitably among all auto insurance companies licensed in the state in proportion to their share of the market.

Appendix – Glossary (cont.)

Assigned Risk

LAD	**Limited Assignment Distribution**. It is the mechanism by which automobile insurance companies can pay a *servicing carrier* to accept and manage their entire personal auto assigned risk obligation. Generally, automobile insurance companies don't have the AIP (Automobile Insurance Plan) specialization required to manage AIP business effectively. They are unfamiliar with the claims, service and pricing complexities of dealing with Assigned Risk and would rather focus their resources on managing their core business initiatives.
Servicing Carrier	An insurance company contracted to service shared market policyholders, under either pooling mechanisms or LAD arrangements.
Servicing Carrier Agreement	A contract between an auto insurance residual market mechanism and an insurance company that sets forth duties and responsibilities of the mechanism and an insurance company for processing assigned risk plan business.
Service Fees	Allowances to servicing carriers, in excess of operating fees, generally expressed as a percentage of written premiums, to compensate for services performed on behalf of pooling arrangements.