

**Pretend Insurance Company
Homeowners Program
Rate and Rule Filing**

Explanatory Memorandum

Based on Pretend Insurance Company's (PIC's) Florida Homeowners program rate indication, PIC proposes to modify its rates and rules for its Homeowners program on a file and use basis. The proposed effective date for new and renewal business is August 1, 2012.

PIC proposes a +22.4% rate increase.

Background

PIC began writing Homeowners policies in 1990, and has experienced significant rate indications in the past five years, but only been implementing rate changes that are a portion of the indications in an effort to provide affordable insurance to policyholders in Florida. PIC is proposing to continue its effort to maintain affordable insurance by taking a 'stair step approach' to its indicated rate level.

Rate Proposals

The following are some of the key drivers of the Homeowners +46.0% rate indication:

- the rate indication in PIC's prior rate filing a year ago which was +21.0%, when only +9.0% was approved, resulting in a residual indication of $1.21/1.09-1.00=+11.0\%$
- the +19.6% loss trend, outstripping the +0.0% premium trend, resulting in an estimated loss ratio increase of +20.0% since the prior year's rate filing
- the continued +19.6% loss trend, and +0.0% premium trend.

The double digit loss trend is partially due to sinkhole losses which appear to be increasing in frequency as well as severity but also due to the loss trend all loss perils combined which is further outlined on Exhibit 9 - Pure Premium Trend Factor, enclosed with this filing.

Exhibit 8 – Selected Loss & ALAE Development Factors, enclosed with this filing, provides the loss and allocated loss adjustment expense (ALAE) development factors used to develop the losses and ALAE to ultimate prior to analyzing them in Exhibit 9.

The age to age loss development factors on Exhibit 8 significantly dropped in the most recent diagonal (calendar year development) for each accident year reviewed. We believe this may be a result of a change in reserving practices and will be in a better position to evaluate the potential impact of a change in reserving practices next year, after two years of data become available.

For now, we have selected the historical loss development factors without considering the most recent diagonal in the selection.

Enclosed Exhibits

The following exhibits support the enclosed rate indication and PIC's rate selections. Footnotes document the information sources and calculations.

The enclosed exhibits are organized as follows:

- Summary Exhibit – State Required Rate Indication Form (RIF)
- Exhibit 8 – Selected Loss & ALAE Development Factors
- Exhibit 9 – Pure Premium Trend Factors
- Exhibit 11 – Expense and Reinsurance Summary*
- Exhibit 1-7, 10, 12-15 - Not included in presentation but would have been included in filing

The exhibits included with the rate level indication support the selections and assumptions underlying the indicated and proposed rate changes. The following section describes each exhibit in more detail.

- Exhibit 8 loss development factors was based on the following sources:
 - Ø PIC's Homeowners Experience
 - Ø Industry Schedule P
 - Ø ISO Florida Homeowners

We relied on PIC's direct experience in our selections, supplemented with a review of industry and ISO data.

- Exhibit 9 shows estimated pure premium trends for the historical and prospective periods. They are based on a review of Florida Homeowners non-catastrophe data from PIC.

Please note that Exhibit 9, Page 2, HO-3 ISO quarterly trends for mid-2007 through 2009 were unusually high due to positive frequency trends, but have declined slightly since the beginning of 2010. Our prospective and historical loss trend selection for frequency recognizes the most recent lower frequency by selecting more recent point averages for ISO.

PIC's experience is shown on Page 3. PIC's pure premium trends are very high for the reasons outlined above. There are additional exhibits demonstrating the sinkhole frequency and severity trends (would be included in the filing but not included with this presentation).

- Exhibit 11, Page 1 summarizes PIC's variable and fixed expense selections. The expense ratios are a percent of premium. The expense selections include an underwriting profit provision of 3.7%, consistent with the OIR memorandum from June 2004 (which is the latest available).

Exhibit 11, Page 2 shows PIC's annual expense experience for the past three years, including the 2009 Insurance Expense Exhibit. Selections were based on the expected expenses in the proposed upcoming rate period rather than focused on the most recent lower results in 2009. We have included all the insurance agency contracts demonstrating the commission rates have not changed. In 2009 the commission rate reduced for with wind policies and a high volume of with wind policies were sold, relative to ex-wind policies, decreasing the average commission rate. In 2010 the commission contracts and rates have not changed from 2009. However, we expect to write a higher volume of ex-wind policies since we have tightened our underwriting criteria with respect to with wind policies. Therefore we expect the average commission rate to increase back to more historical levels.

At the bottom of Page 2, we calculate the reinsurance expense ratios by form, based on level in force Wind premium on September 30, 2011. The reinsurance costs are from Page 3, discussed below (not included with the presentation).

RATE INDICATIONS

COMBINED

GROUP NAME:	Pretend Ins Co
PRODUCT TYPE:	Homeowners
PRODUCT SUB-TYPE:	None
STATE:	Florida Experience Only

PROGRAM NAME:	Homeowners
POLICY TYPE:	HO-3 Combined
COMPANY(IES):	Pretend Ins Co

(A) Latest Accident Year Ending Date:	03/31/10
(B) Annual Premium Trend:	Exhibit 3 0.0%
(C) Annual Loss Trend (Up-to-Date):	Exhibit 9 19.6%
(D) Annual Loss Trend (Projected):	19.6%
(E) Avg. Acc. Date for Proj. Rates:	03/14/12

PREMIUMS:

(1) Accident Year Ending	(2) Months of Maturity	(3) Earned House-Years Exhibit 1	(4) Written Premiums (\$000's) Exhibit 1	(5) Earned Premiums (\$000's) Exhibit 1	(6) Current Rate Level Factors Exhibit 2	(7) Premium Trend Factors Exhibit 3	(8) Trended Earned Premiums at C.R.L. (\$000's) Exhibit 1
3/31/2006	63	19,100	\$14,435	\$13,808	1.093	1.002	\$15,116
3/31/2007	51	14,156	23,730	18,445	0.967	1.001	17,853
3/31/2008	39	15,750	22,332	24,199	0.929	1.001	22,500
3/31/2009	27	22,500	22,556	21,624	1.107	1.001	23,963
3/31/2010	15	23,234	26,288	23,471	1.243	1.001	29,196
TOTAL		94,740	\$109,341	\$101,547			\$108,628

NOTES:

1. Individual large losses were capped in the territorial indications.
2. No adjustment for bad faith or punitive damage claims.
3. "Non-Hurricane Cat." contains all non hurricane catastrophe claims as identified by PCS code.
4. "Hurricane Cat." contains all hurricane catastrophe claims.
5. "Excl. Cats" contains all non-catastrophe claims.
6. The rate indication is an expected value estimate that lies within a range of reasonable estimates above and below the indication.
7. The hurricane losses are based on 6/30/10 exposures.

ACTUAL LOSSES:

(1) Accident Year Ending	(9) ACTUAL INCURRED LOSSES (\$000's) Exhibit 4				(11) ACTUAL INCURRED ALAE (\$000's) Exhibit 4				(13) INCURRED ULAE (\$000's) Exhibit 5				(21) Actual Incurred Loss & LAE Excl. Cats. (\$000's)
	Incl. Cats.	Non-Hurr. Cat.	Hurricane Cat.	Excl. Cats.	Incl. Cats.	Non-Hurr. Cat.	Hurricane Cat.	Excl. Cats.	Incl. Cats.	Non-Hurr. Cat.	Hurricane Cat.	Excl. Cats.	
3/31/2006	\$7,025	\$0	\$3,666	\$3,360	\$656	\$0	\$370	\$286	\$315	\$0	\$120	\$195	\$3,842
3/31/2007	3,225	188	0	3,037	226	24	0	202	185	11	0	174	3,413
3/31/2008	4,167	0	0	4,167	424	0	0	424	246	0	0	246	4,837
3/31/2009	7,616	381	0	7,235	653	38	0	614	443	22	0	421	8,270
3/31/2010	8,165	0	0	8,165	674	0	0	674	474	0	0	474	9,313
TOTAL	\$30,200	\$569	\$3,666	\$25,965	\$2,632	\$62	\$370	\$2,200	\$1,663	\$34	\$120	\$1,510	\$29,675

PROJECTED CATASTROPHE LOSSES:

(1) Accident Year Ending	(22) Losses Exhibit 6	(23) ALAE Exhibit 6	(24) ULAE Exhibit 6	(25) Losses & LAE Exhibit 6
3/31/2006	\$410	\$35	\$24	\$468
3/31/2007	306	26	18	350
3/31/2008	368	31	21	421
3/31/2009	537	45	31	613
3/31/2010	529	45	31	604
TOTAL	\$2,149	\$182	\$125	\$2,456

(26) POLICIES IN-FORCE	(27) POLICIES IN-FORCE	(28) PREMIUM AT C.R.L. (\$000's)	(29) IN-FORCE POLICIES (\$000's)	(30) Projected HURRICANE Losses (\$000's)	(31) Projected HURRICANE ALAE (\$000's)	(32) Projected HURRICANE ULAE (\$000's)	(33) Projected HURRICANE Loss & LAE (\$000's)
27,329	22,361	\$34,698	\$29,539	\$5,810	\$458	\$190	\$6,458

DEVELOPMENT OF PROJECTED LOSS & LAE RATIO:

(1) Accident Year Ending	(34) Actual Incurred Loss & LAE Excl. Cats. (\$000's)	(35) Loss & ALAE Development Factors Exhibit 8	(36) Loss Trend Factors Exhibit 9	(37) Trended & Developed Incurred Loss & LAE Excl. Cats. (\$000's)
3/31/2006	\$3,842	1.006	3.169	\$12,253
3/31/2007	3,413	1.012	2.651	9,159
3/31/2008	4,837	1.026	2.218	11,009
3/31/2009	8,270	1.047	1.854	16,050
3/31/2010	9,313	1.095	1.551	15,814
TOTAL	\$29,675			\$64,285

(38) Projected Incurred Loss & LAE Incl. Non-Hurr Cat (\$000's)	(39) Bad Faith/Punitive Loss & ALAE Incl. in (34) (\$000's)	(40) Projected Incurred Loss & LAE Incl. Non-Hurr Cat. Excl. BF/PD (\$000's)	(41) Adjustment Factor for Law Changes, Etc.	(42) Final Adjusted Expected Loss & LAE (\$000's)	(43) Projected Incurred Loss & LAE Non-Hurr Cat (\$000's)	(44) Selected Accident Year Weights Exhibit 10	(45) Weighted Proj. Incurred Loss & LAE Incl. Non-Hurr Cat Excl. BF/PD
\$66,741	\$0	\$66,741	1.000	\$66,741	\$66,741	61.4%	61.4%

PROSPECTIVE EXPENSE PROVISIONS (% OF PREMIUM):

(46) Category of Expected Expense	(47) Fixed Expense Loading * Exhibit 11	(48) Variable Expense Loading Exhibit 11	(49) Total Expense Loading
Commissions	0.00%	14.90%	14.9%
Other Acquisition	2.55%	2.55%	5.1%
General	3.75%	3.75%	7.5%
Premium Taxes	0.00%	1.75%	1.8%
Misc. Licenses & Fees	0.00%	0.25%	0.3%
Profit & Contingency	0.00%	3.70%	3.7%
Contingent Commissions	0.00%	0.00%	0.0%
Non-FHCF Reins. Cost***	14.46%	0.00%	14.5%
FHCF Reins. Cost	2.76%	0.00%	2.8%
Other Expense (Specify**)	0.00%	0.00%	0.0%
TOTAL EXPENSES	23.5%	26.9%	50.4%
PERMISSIBLE LOSS & LAE			49.6%

* - Must reflect trend and/or other adjustments since last filing
** - (Specify in detail here)
*** This cost must exclude the Cost of Reinsurance to Replace available TICL Coverage including the TICL Reduction. The Cost of Reinsurance to Replace available TICL Coverage including the TICL Reduction must be included in (59A).

DEVELOPMENT OF RATE LEVEL INDICATIONS:

(50) 18.6% Projected Hurricane Loss & LAE ratio = (33) / (28)
(51) 80.1% Proj. Incurred Loss & LAE Ratio (Incl. all catastrophes)
(52) 23.5% Expected Fixed Expense Ratio
(53) 26.9% Expected Variable Expense Ratio
(54) 41.7% Rate Level Indication (Before Credibility)
(55) 1.00 Credibility Exhibit 12
(56) 19.5% Expected Annual Net Trend (i.e., Projected Loss Trend Net of Premium Trend)
(57) 1.00 Assumed Number of Years Since Last Rate Review
(58) #N/A Expected Net Trend Since Last Rate Review (Value receives complement of credibility)
(59) 41.7% Credibility-Weighted Rate Level Indication
(59A) 4.3% Cost of Reinsurance to Replace available TICL Coverage including the TICL Reduction Exhibit 11
(59B) 46.0% Rate Level Indication including (59A)
(60) 22.4% Company Selected Rate Change Exhibit 14

**Pretend Insurance Company
Homeowners
HO-3 Wind and All Other Perils Non-Catastrophe**

Selected Loss & ALAE Development Factors

(As of June 30, 2010)

	(1)	(2)	(3)	(4)	(5)
Fiscal Accident Year	Accident Year Age as of 6/30/10	Pretend Ins. Co. Experience (Page 2)	Schedule P Industry Homeowners (Page 3)	ISO Homeowners (Page 4)	Selected = (2)
2006	63	1.006	1.010	1.003	1.006
2007	51	1.012	1.018	1.007	1.012
2008	39	1.026	1.029	1.013	1.026
2009	27	1.047	1.056	1.033	1.047
2010	15	1.095	1.175	1.114	1.095

Note:

1. Fiscal accident years are the twelve months ending March 31st of the year displayed.

**Pretend Insurance Company
Homeowners
HO-3 Wind and All Other Perils Non-Catastrophe**

Reported Loss & LAE Development Factor

(As of June 30, 2010)

Fiscal Accident Year	Months of Development				
	<u>15</u>	<u>27</u>	<u>39</u>	<u>51</u>	<u>63</u>
2005	\$3,955	\$4,130	\$4,211	\$4,255	\$4,280
2006	3,671	3,836	3,908	3,950	3,952
2007	3,250	3,400	3,469	3,480	
2008	4,350	4,568	4,591		
2009	7,800	7,849			
2010	8,839				

Fiscal Accident Year	Development Factors				
	<u>15 - 27</u>	<u>27 - 39</u>	<u>39 - 51</u>	<u>51 - 63</u>	<u>63 - Ult.</u>
2005	1.044	1.020	1.010	1.006	
2006	1.045	1.019	1.011	1.001	
2007	1.046	1.020	1.003		
2008	1.050	1.005			
2009	1.006				

<u>Age-to-Age</u>					
Simple Average	1.038	1.016	1.008	1.003	
Weighted Average	1.033	1.015	1.008	1.003	
Schedule P Homeowners LDF	1.113	1.026	1.011	1.008	1.010
ISO Homeowners	1.079	1.019	1.006	1.004	1.003
Selected	1.046	1.020	1.014	1.006	1.006
Age-to-Ult	1.095	1.047	1.026	1.012	1.006

Notes:

1. Data provided by Pretend Insurance Company.
2. Loss data based on non-catastrophe both Wind and AOP HO-3 in \$000s.
3. Losses have been adjusted to reflect legislative reform related to sinkhole losses.
Sinkhole losses and LAE occurring prior to 10/1/06 have been reduced by 14.4%.
4. Selections based on average of Industry and ISO for ages 51-63 and 63-Ult, and based on a smoothed average of ISO and company data for earlier ages.

**Pretend Insurance Company
Homeowners
HO-3 Wind and All Other Perils Non-Catastrophe**

Pure Premium Trend Factor

Accident Year	(1)	(2)	(3)	(4)	(5)	(6)
	Average Experience	Trend Dates		Trend Periods (Years)		Loss Trend Factor (Note 2)
		Latest AY Average Experience	Average Experience	Average Proposed	to Latest Avg AY Experience	
2006	9/29/2005	9/29/2009	3/14/2012	4.000	2.456	3.169
2007	9/29/2006	9/29/2009	3/14/2012	3.000	2.456	2.651
2008	9/29/2007	9/29/2009	3/14/2012	2.000	2.456	2.217
2009	9/29/2008	9/29/2009	3/14/2012	1.000	2.456	1.854
2010	9/29/2009	9/29/2009	3/14/2012	0.000	2.456	1.551

ISO Historical Annual Trend (Page 2)	19.7%
Company Historical Annual Trend (Page 3)	19.6%
Selected Historical Trend from Experience to Evaluation (Note 4)	19.6%
ISO Prospective Annual Trend (Page 2)	19.7%
Selected Prospective Trend from Evaluation to Proposed (Note 5)	19.6%

Notes:

- Column (3) based on annual policies with rates in force for a 1 year period beginning 3/15/2011.
- Column (6) = $(1 + \text{Selected Historical Trend})^{(4)} \times (1 + \text{Selected Prospective Trend})^{(5)}$.
- Fiscal accident years are the twelve months ending March 31st of the year displayed.
- The selected historical trend is based on company data.
- The selected prospective loss trend = selected historical + change in ISO = $[19.6\% = 19.6\% + 19.7\% - 19.7\%]$.

**Pretend Insurance Company
Homeowners
HO-3 Wind and All Other Perils Non-Catastrophe**

Homeowners Pure Premium Trend Based on Company Data

(As of June 30, 2010)

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Accident Year	Non-Cat Reported Loss (Exh 4, Pg 1)	Reported ALAE (Exh 4, Pg 6)	Reported Loss & ALAE (1) + (2)	Loss Development Factor (State Page)	Ultimate Loss & ALAE (3) x (4)	Pure Premium (5) / (11) x 1000	Change in Pure Premium
2006	\$3,360	\$592	\$3,952	1.006	\$3,977	\$208	
2007	3,037	443	3,480	1.012	3,523	249	19.5%
2008	4,167	424	4,591	1.026	4,712	299	20.2%
2009	7,235	614	7,849	1.047	8,216	365	22.1%
2010	8,165	674	8,839	1.095	9,678	417	14.1%
Total	\$25,965	\$2,747	\$28,712		\$30,107		18.9%
					Estimated Trend (Note 5)	4-Year 3-Year 2-Year 1-Year	18.9% 18.7% 18.0% 14.1%
						Implied Annual Historical Trend (Note 6)	16.8%
						Selected Annual Historical Trend (Note 7)	19.6%
						Selected Annual Prospective Trend (Note 8)	19.6%

	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)
	Reported Claim Count (Exh 8, Pg 5)	Claim Development Factor (Exh 8, Pg 5)	Ultimate Claim Count (8) x (9)	Earned Exposures (State Page)	Frequency (10) / (11) x 1000	Change in Frequency	Severity (5) / (10) x 1000	Change in Severity
2006	448	1.000	448	19,100	23.455		\$8,877	
2007	371	1.000	371	14,156	26.208	11.7%	9,496	7.0%
2008	461	1.004	463	15,750	29.376	12.1%	10,184	7.2%
2009	745	1.012	754	22,500	33.508	14.1%	10,898	7.0%
2010	841	1.039	874	23,234	37.620	12.3%	11,073	1.6%
Total	2,866		2,910	94,740		12.5%		5.7%
					Estimated Trend (Note 5)	4-Year 3-Year 2-Year 1-Year	12.5% 12.8% 13.2% 12.3%	5.7% 5.3% 4.3% 1.6%
						Implied Annual Historical Trend (Note 6)	12.7%	3.6%
						Selected Annual Historical Trend (Note 7)	11.7%	7.0%

Notes:

- Dollar amounts in Columns (1), (2), (3) and (5) are in thousands.
- Data includes non-catastrophe, both wind and AOP HO-3.
- Losses have been adjusted to reflect legislative reform related to sinkhole losses. Sinkhole losses and ALAE occurring prior to 10/1/06 have been reduced by 14.4%.
- Because of the significant growth from year to year, the company trends are subject to distributional shifts that may distort the results.
- Trend for each year is calculated as the nth-root of the ratio between historical pure premium and the current pure premium. For example, the 4-year trend for pure premium = $(417 / 208)^{(1/4)} - 1$. Same formula applies to the trends for frequency and severity.
- Implied Annual Historical Trend is the weighted average of the 1-year through 4-year trends using Column (5) as weights.
- Frequency selected annual historical trend based on implied trend. Selected severity trend judgementally excludes anomalous effect of 2008 severity. Pure premium selection = $(1 + \text{frequency selection}) \times (1 + \text{severity selection}) - 1$.
- Prospective trend selected to equal historical trend.

**Pretend Insurance Company
Homeowners
HO-3 Combined**

Fixed and Variable Expense Ratios - to Apply to Combined Premium

Expense	(1)	(2)	(3)
	Fixed	Combined Variable	Total
A. Commissions	0.00%	14.90%	14.90%
B. Other Acquisition	2.55%	2.55%	5.10%
C. General	3.75%	3.75%	7.50%
D. Premium Taxes	0.00%	1.75%	1.75%
E. Misc Licenses & Fees	0.00%	0.25%	0.25%
F1. Reinsurance - Private Costs (Excl. FHCF and TICL Repl.)	14.46%	0.00%	14.46%
F2. Reinsurance - FHCF	2.76%	0.00%	2.76%
F3. Reinsurance - TICL Replacement Expense	4.35%	0.00%	4.35%
G. Profit & Contingency	0.00%	3.70%	3.70%
H. Total Expense and Profit	27.87%	26.90%	54.77%
I. Total Expense and Profit Excluding TICL Repl.	23.52%	26.90%	50.42%
J. Permissible Loss & LAE Ratio			49.58%

Notes:

1. Sources of Columns (1) and (3): (A) - (F) - Page 2; and (G) - OIR June 2004 memorandum.
2. Item (D) based on 1.75% premium tax; Item E = Page 2 Total Taxes, Licenses & Fees less Item (D)
3. Item (H) = sum of Items (A) to (G).
4. Item (I) = Item (H) - Item (F3)
5. Item (J) = 100.0% - Item (I).

**Pretend Insurance Company
Homeowners
HO-3 Combined**

Summary of Expense Information

	(1) 2007 IEE	(2) 2008 IEE	(3) 2009 IEE	(4) Average	(5) Total Selected	(6) Fixed Selected
(1) Written Premium (ex Fees)	\$26,779	\$23,877	\$29,690			
(2) Earned Premium (ex Fees)	26,442	24,276	26,738			
(3) Commission and Brokerage (ex Fees) (3) / (1)	\$3,765 14.1%	\$3,579 15.0%	\$2,807 9.5%	12.80%	14.90% [a]	0.00%
(4) Other Acquisition Expense (4) / (1)	\$1,550 5.8%	\$1,573 6.6%	\$800 2.7%	5.00%	5.10% [b]	2.55% [c]
(5) General Expenses (5) / (2)	\$1,906 7.2%	\$1,851 7.6%	\$500 1.9%	5.60%	7.50% [b]	3.75% [c]
(6) Taxes, Licenses & Fees (6) / (1)	\$530 2.0%	\$413 1.7%	\$388 1.3%	1.70%	2.00% [d]	0.00%
(7) Other Expenses (7) / (1)	\$50 0.2%	(\$33) -0.1%	(\$37) -0.1%	0.00%	0.00% [b]	0.00%
(8) Total of (3) - (7) Ratios	29.2%	30.8%	15.2%	25.10%	29.50%	
(9) Reinsurance Cost (Page 3)	Total				21.57%	21.57%
	Fixed, FHCF				2.76%	2.76%
	Fixed, TICL Replacement Expense				4.35%	4.35%
	Fixed, Private (Total excl. FHCF & TICL)				14.46%	14.46%

Notes:

1. Source of Columns (1) - (3): Pretend Company Homeowners IEEs, premiums and commission and brokerage excluding policy fees.
2. Dollar amounts are in thousands.
3. Selections in Columns (5) and (6) provided by Pretend Company, based on the following:
 - [a] Selection based on three year average guaranteed commission excluding contingent commission (10.9%) + 4% MGA agreement.
 - [b] Selections based on three year average, rounded to one decimal point.
 - [c] Selections for Column (6) fixed expenses assume half of Row (4) and Row (5) are fixed and half are variable.
 - [d] Selection based on 1.75% Florida premium tax rate + 0.25% for miscellaneous licenses and fees, totalling 2.00%.