No. 07 -0145

Official Order
of the
Commissioner of Insurance
of the
State of Texas

Austin, Texas

Date: FEB 20 2007

Subject Considered:

RATES FOR PRIVATE PASSENGER AND COMMERCIAL AUTOMOBILE INSURANCE PROVIDED THROUGH THE TEXAS AUTOMOBILE INSURANCE PLAN ASSOCIATION

DOCKET NO. 2652
DOCKET NO. 2653

General remarks and official action taken:

On this day came on for consideration by the Commissioner of Insurance (Commissioner) the matter of the 2006 rate filing by the Texas Automobile Insurance Plan Association (TAIPA) with the Texas Department of Insurance (Department), as required by the TEX. INS. CODE ANN. Article 21.81 for private passenger and commercial automobile passenger insurance coverage. On August 29, 2006, TAIPA filed petitions for increases in the rates for private passenger and for commercial automobile insurance. Notice of the TAIPA rate filing was provided to the Secretary of State for posting in the *Texas Register* on September 15, 2006. On October 12, 2006, a hearing was convened in Room 100 of the William P.

Hobby, Jr. State Office Building, 333 Guadalupe, Austin, Texas 78701, to consider TAIPA's rate filing, allowing all interested persons to present written and oral testimony relating to TAIPA's rate filing. TAIPA was present and represented by Michael Jones and Richard S. Geiger of Thompson, Coe, Cousins & Irons, L.L.P. The Office of Public Insurance Counsel (OPIC) was present and represented by Dirk Johnson.

After considering TAIPA's rate filing, staff's analysis, and all written and oral testimony presented, the Commissioner adopts the following findings of fact and conclusions of law.

FINDINGS OF FACT

1. The TAIPA private passenger automobile rate filing was filed with the Department on August 29, 2006, and assigned Petition Number A-0806-17. TAIPA proposed an increase of 2.7 percent for the rates to be charged for private passenger automobile insurance provided through TAIPA.
2. The TAIPA commercial automobile rate filing was filed with the Department on August 29, 2006, and was given Petition Number A-0806-18. TAIPA proposed to adopt the latest Insurance Services Office, Inc. (ISO) loss costs, loaded for TAIPA's expenses, with an estimated rate

impact of a 20.5 percent increase for the rates to be charged for commercial automobile insurance provided through TAIPA.

3. TAIPA filed a revised actuarial report on October 12, 2006. TAIPA revised its proposal for commercial automobile insurance to reflect an increase of 17.8 percent.

4. On October 12, 2006, OPIC submitted to the Department calculations of its rate recommendations for private passenger automobile insurance provided through TAIPA. OPIC's calculation indicated a decrease of 24.4 percent.

5. On October 12, 2006, OPIC submitted to the Department rate recommendations for commercial automobile insurance provided through TAIPA. OPIC recommended that the rates not be changed.

6. The Commissioner shall determine and prescribe TAIPA rates that are just, reasonable, adequate, not excessive, not confiscatory, and not unfairly discriminatory for the risks to which they apply.

7. TAIPA rates shall be set in an amount sufficient to carry all claims to maturity and to meet the expenses incurred in the writing and servicing of the business.

8. The Commissioner can approve, disapprove, or modify a filing made by TAIPA.

9. Organizations providing testimony in the proceeding were TAIPA, represented by Richard S. Geiger, attorney; and the Office of Public Insurance Counsel (OPIC), represented by Dirk Johnson, Staff Attorney.

Private Passenger Automobile Insurance Rates

Actuarial Methodology

10. A loss ratio methodology is a reasonable methodology to fulfill the objectives set forth in Finding of Fact (FOF) Nos. 6 and 7.

11. The loss ratio method of setting rates considers reports of aggregated premiums earned and losses and expenses incurred in the writing of insurance through TAIPA.

12. Both TAIPA and OPIC used calendar-year premium data and accident-year loss data for each of three years ending December 31, 2002, 2003, and 2004, to calculate rates.

13. It is reasonable to use a three year loss ratio to calculate rate indications utilizing calendar-year premium data and accident-year loss data for each of three years ending December 31, 2002, 2003, and 2004, to calculate rates.

Premiums at Current Rate Levels

14. TAIPA calculated on-level factors from the actual distribution of its premiums in the calculation of premiums at current rate levels.

15. It is reasonable to use TAIPA's on-level factors to calculate historical premiums at current rate levels.

Loss Development

16. Loss development analyses are necessary to estimate the final settlement cost of claims because claims are not necessarily settled or even reported in the year they occur.

17. TAIPA selected loss development factors from the loss development patterns in prior years from prior TAIPA experience. OPIC agreed with these factors.

18. Using TAIPA experience to calculate the loss development factors is reasonable.

19. It is reasonable to use TAIPA's loss development factors.

Loss Trend Factors

20. Loss trending accounts for expected changes in the number of claims per unit of exposure, referred to as claims frequency, and the average cost of claims, referred to as claims severity. The pure premium trend is the combined effect of claims frequency and claims severity trends.

21. Many of the economic, social, legal, and other forces that impact the TAIPA loss trend experience and the voluntary loss trend experience are similar.

22. TAIPA provided a comparison of trend in the accident year loss and loss adjustment expenses (LAE) ratio and the calendar year pure premium. TAIPA also provided an analysis of claims frequency, claims severity, and pure premium trends for TAIPA business as well as the voluntary market. TAIPA primarily based its trend selections on an analysis of the claims frequency and claims severity in the TAIPA market.

23. Based on its analyses, TAIPA utilized trends of 2.0 percent, 0.0 percent, 7.0 percent, and 4.0 percent for bodily injury liability (BI), property damage liability (PD), personal injury protection (PIP) and uninsured/underinsured motorist (UM) coverages, respectively. While trends over one, two, and three years for claims frequency and claims severity were considered, the longer term trends were tempered by the slight increase in the more recent one year trends.

24. OPIC reviewed three, five, six, eight, ten, and eleven year TAIPA loss ratio trend data as well as four, six, eight, twelve, sixteen, and eighteen point Fast Track trend data in determining trend selections. OPIC recommended trends of -4.0 percent, -1.0 percent, -3.0 percent, and -4.0 percent for BI, PD, PIP and UM, respectively.

25. Neither TAIPA's nor OPIC's testimony regarding their trend selections was entirely persuasive.

26. It is reasonable to use trend selections of 0.0 percent, 0.0 percent, 2.0 percent, and 0.0 percent for BI, PD, PIP and UM, respectively.

Loss Adjustment Expenses

27. Loss adjustment expenses (LAE) are costs incurred by insurers in resolving claims, such as legal fees, court costs, fees for independent claim adjusters and experts, company claim adjuster salaries, appraisals, and related rent and utilities.

28. Defense and cost containment expenses (DCCE) represent costs that can be associated with a particular claim, while adjusting and other expenses (AOE) cannot usually be associated with a particular claim.

29. No adjustment is necessary for DCCE because DCCE are included with the losses reported by insurers under the statistical plan.

30. TAIPA calculated adjusting and other expenses (AOE) factors based on rolling two year averages using the experience for each of the years 2001, 2002, and 2003. The factor for 2004 was set equal to the factor for 2003.

31. OPIC calculated AOE factors based on rolling two year averages using the experience for each of the years 2001, 2002, 2003, and 2004.

32. It is reasonable to use all available data.

33. It is reasonable to use the AOE factors calculated by OPIC.

Fixed and Variable Expenses

34. Variable expenses are commissions and taxes, licenses, and fees, which are costs that vary directly with premiums.

35. For variable expenses, it is reasonable to use a 10 percent provision for commissions, consistent with the actual commissions paid on TAIPA business.

36. TAIPA used a 1.9 percent provision for taxes, licenses, and fees based on the report of Texas premiums, losses, and dividends by company for calendar year 2004.

37. OPIC used a 2.0 percent provision for taxes, licenses, and fees based on an average of such from 2002, 2003 and 2004.

38. For taxes, licenses, and fees, it is reasonable to use a 2.0 percent provision.

39. Fixed expenses represent insurers' overhead expenses, also known as general and other acquisition expenses.

40. TAIPA and OPIC calculated general and other acquisition expenses as a dollar amount per policy, using combined voluntary and TAIPA experience.

41. TAIPA, as an insurer of last resort, has generally higher rates than the voluntary market.

42. It is reasonable to calculate general and other acquisition expense as a dollar amount per policy.

43. TAIPA based its calculations of fixed expenses on the data for 2003.

44. TAIPA included a provision in its calculation of fixed expenses for an amount equivalent to 100 percent of the amount allocated by insurers to both liability and physical damage coverage in determining TAIPA rates.

45. OPIC based its calculations of fixed expenses on the data for 2002-2004.

46. OPIC did not include any portion of the expenses allocated by insurers to physical damage coverage, using only the expenses allocated by insurers for liability coverage.

47. In the voluntary market, both liability and physical damage coverage are normally written on the same policy. Expenses for writing this combination policy are split between liability and physical damage.

48. It is reasonable to assume that the marginal costs of including physical damage coverage on a policy are not significant.

49. It is reasonable to assume that some of the expenses necessary for any policy, whether written with or without physical damage expenses, are included as physical damage expenses, since the expenses allocated to liability are approximately equal to the expenses allocated to physical damages on a percentage of premium basis.

50. It is therefore reasonable to include some portion of fixed expenses allocated to physical damage by insurers even though TAIPA does not provide physical damage coverage.

51. The marginal costs of including physical damage coverage on a policy should not be included in expense calculations for TAIPA as TAIPA only

provides liability coverage. It is therefore not reasonable to include 100 percent of expenses allocated to physical damage.

52. It is reasonable to include 50 percent of fixed expenses allocated to physical damage by insurers.

53. Some insurance companies in the private passenger automobile insurance voluntary market utilize their own employees to write and service their business. Such costs are normally characterized as other acquisition expense.

54. It is reasonable to assume that agents writing TAIPA business perform some of the services normally carried out by insurance company employees in the voluntary market.

55. To the extent that insurers utilize their employees to perform some of the services, other acquisition expense tends to be overstated as compared to expenses needed in servicing involuntary business.

56. OPIC reduced fixed expenses by 0.5 percentage points to account for the overstatement of other acquisition expense in the voluntary market as compared to the involuntary market.

57. It is reasonable to reduce fixed expenses by 0.5 percentage points to account for the overstatement of other acquisition expense in the voluntary market as compared to the involuntary market.

58. General expense data as reported by insurers in the Insurance Expense Exhibit (IEE) contain some expenses that are disallowed under Texas law.

59. TAIPA reduced fixed expenses by 0.2 percentage points to account for the disallowed expenses included in general expense data.

60. TAIPA's adjustment for disallowed expenses of 0.2 percentage points is reasonable and should be used.

61. Other acquisition expenses reported by insurers contain advertising expenses.

62. Advertising expenses are not applicable to TAIPA business.

63. TAIPA reduced other acquisition expenses by 0.5 percentage points to account for the advertising expenses that are not applicable to TAIPA business.

64. TAIPA's adjustment for advertising expenses is reasonable and should be used.

65. TAIPA used an expense trend based on an average of the trend in the fitted 36 month Consumer Price Index (CPI) and the trend in the average weekly wage of property and casualty employees. Using data through November 2005, this resulted in an annual trend selection of 4.1 percent.

66. Using data through June 2006, OPIC utilized an annual expense trend of 1.7 percent. This is based on an average of the 24 month CPI trend, an average weekly wage trend in the number of employees of Countrywide Direct Property and Casualty Insurers, and a 2 percent adjustment for productivity.

67. While there may well be improvements in productivity, OPIC did not justify its selection of a 2 percent adjustment for productivity.

68. It is reasonable to use data through June 2006.

69. It is reasonable to use TAIPA's methodology utilizing 36 month trends.

70. Based on FOF Nos. 68 and 69, a 3.4 percent expense trend is reasonable and should be used.

71. OPIC reduced the fixed expense ratio by half to account for the policy length difference between the voluntary market which typically sells six month policies and the TAIPA market which sells annual policies.

72. There was insufficient evidence to support a reduction of the fixed expense by 50 percent as proposed by OPIC.

73. There may be some marginal expense savings due to issuing one annual policy compared to two six month policies per year due to reduced postage, copying, processing and record-keeping costs.

74. It is reasonable to make a minor adjustment to account for the annual duration of the TAIPA policy by subtracting $3.00 from the fixed expenses to reflect the fact that there may be some marginal expense savings.

75. In the voluntary market, an average 93.6 percent of the premium originally written is ultimately earned, compared to TAIPA, where 86.0 percent of the premium originally written is ultimately earned, meaning that relatively fewer premium dollars are actually available on TAIPA business to cover expenses.

76. It is reasonable to adjust the TAIPA expense ratio upward by a factor of 1.088 (93.6/86.0) based upon the ratio of premiums earned in the voluntary market as compared to premiums earned in the TAIPA market.

Installment Fees

77. Installment fees paid by TAIPA insureds are a source of revenue to insurers that are not included as part of premium income.

78. It is reasonable to account for installment fees as a deduction from fixed expenses.

79. TAIPA's estimate of installment fee income is based on the following assumptions:

    a. An average of 1.1 cars per policy;

    b. An average installment fee revenue per policy of $28.00;

    c. 90 percent of TAIPA policies are purchased on an installment basis; and

    d. The average premium per policy is $639.56.

80. Based on FOF No. 79, the average installment fee revenue as a percentage of premium is 3.6 percent.

81. OPIC provided a similar estimate for installment fee income of 3.7 percent.

82. TAIPA's installment fee income assumption is reasonable and should be used.

Underwriting Profit and Contingencies Provision

83. TAIPA used an underwriting profit and contingencies provision of 0.0 percent but did not provide supporting data.

84. OPIC used a calendar year accounting model in conjunction with cost of equity capital estimated using a capital asset pricing model and a discounted cash flow model analyses to calculate an underwriting profit and contingencies provision of -2.2 percent.

85. Neither recommendation is entirely persuasive. The underwriting profit and contingencies provision of -1.0 percent was approved for use in 2005. The -1.0 percent underwriting profit and contingencies provision is reasonable and should be used.

Commercial Automobile Insurance Rates

Methodology

86. TAIPA recommended that rates for commercial automobile insurance written through TAIPA be based on the ISO loss costs.

87. TAIPA did not propose to include private passenger type commercial automobile or zone rated automobile risks in the conversion to ISO loss costs. Rather, TAIPA clarified that they recommend that private passenger type commercial automobile risks continue to be rated using

the TAIPA private passenger automobile rates and that the zone rated risks remain unchanged at this time.

88. A two-step conversion process is required to make use of ISO's loss costs as the basis for TAIPA rates. First, the ISO $100,000 combined single limit (CSL) loss costs must be converted to the BI and PD split limits offered by TAIPA of $20,000 per person, $40,000 per occurrence bodily injury and $15,000 property damage (20/40/15). Second, the resulting loss costs are converted to rates by multiplying them by a loss cost multiplier to reflect expense needs.

89. Several methods could be used to adjust the $100,000 CSL to the 20/40/15 split limits offered by TAIPA.

90. TAIPA relied on an ISO method to convert combined single limits loss costs to the 20/40/15 split limits offered by TAIPA. Under this method, the 20/40/15 limits used by TAIPA would be approximately equivalent to a CSL of $30,250. The $30,250 CSL is then split 55 and 45 percent between BI and PD, respectively.

91. TAIPA utilized increased limits factors from the Texas Automobile Rules and Rating Manual previously promulgated by the Department to determine a factor of 0.832 to adjust the $100,000 CSL to the 20/40/15 split limits offered by TAIPA.

92. Substituting various ISO increased limits factors in the calculations used by TAIPA yields increased limits adjustment factors of 0.80 for light and medium trucks; 0.76 for heavy trucks and truck-tractors; 0.73 for extra

heavy trucks and truck-tractors; 0.72 for trucks, tractors, and trailers zone-rated; and 0.79 for all other risks.

93. Texas has historically converted from split limits to CSL by adjusting the BI and PD rates to the limit corresponding to the CSL and then adding 90% of the smaller of the resulting rates to 100% of the larger. This approach produces a factor of 0.753 to adjust the $100,000 CSL to the level of 20/40/15 split limits offered by TAIPA.

94. Factors of 0.414 for BI and 0.339 for PD (0.753 x 0.55 and 0.753 x 0.45 respectively) are reasonable and should be applied to the $100,000 CSL loss cost to produce loss costs corresponding to the 20/40/15 split limits offered by TAIPA.

Loss Cost Multiplier

95. TAIPA used 5 and 10 percent provisions for commissions, consistent with the actual commissions paid on TAIPA commercial insurance for motor vehicles of the truck type operating beyond a radius of 200 miles from the limits of the city or town of principal garaging and public passenger carrying vehicles (zone and publics) and for all other vehicles (trucks and special types), respectively.

96. Provisions of 5 and 10 percent for commissions for zone and publics, and trucks and special types, respectively, are reasonable and should be used.

97. TAIPA used a 6.5 percent of earned premium provision for AOE based on an average for such expenses in 2001, 2002, and 2003.

98. AOE data is available for 2004 and should be used.

99. The three year average of such expenses using 2002, 2003, and 2004 for AOE is 6.2 percent of earned premium.

100. A provision of 6.2 percent for AOE is reasonable and should be used.

101. TAIPA used a 2 percent provision for taxes, licenses, and fees, but did not provide supporting documentation.

102. A 2 percent provision for taxes, licenses, and fees is reasonable and should be used.

103. TAIPA used an underwriting profit and contingencies provision of 0.0 percent but did not provide supporting documentation.

104. OPIC did not provide a recommended underwriting profit and contingencies provision.

105. The same underwriting profit and contingencies provision as used for private passenger automobiles, -1.0 percent, is reasonable and should be used.

106. TAIPA calculated general and other acquisition expenses as a dollar amount per policy, using combined voluntary and TAIPA experience for the years 2001-2003.

107. General and other acquisition expense data is available through 2004 and should be used.

108. General expense data as reported by insurers in the IEE contain some expenses that are disallowed under Texas law.

109. Advertising expenses are not applicable to TAIPA business.

110. TAIPA reduced fixed expenses by 0.4 percentage points to account for the disallowed expenses included in general expense data and the advertising expenses that are not applicable to TAIPA business.

111. TAIPA's adjustment for disallowed and advertising expenses of 0.4 percentage points is reasonable and should be used.

112. In the voluntary market, a higher percent of the premium originally written is ultimately earned, compared to TAIPA, meaning that relatively fewer premium dollars are actually available on TAIPA business to cover expenses. To adjust for this difference, TAIPA adjusted the expense ratio upward by a factor of 1.104.

113. It is reasonable to adjust the TAIPA expense ratio upward by a factor of 1.104.

114. Installment fees paid by TAIPA insureds are a source of revenue to insurers that are not included as part of premium income.

115. It is reasonable to account for installment fees as a deduction from fixed expenses.

116. TAIPA reduced the fixed expenses by -4.0 percentage points to account for installment fees.

117. TAIPA's adjustment for installment fees is reasonable and should be used.

118. TAIPA calculated loss cost multipliers as the reciprocal of one minus the sum of the provisions for commissions; AOE; taxes, licenses, and fees; underwriting profit and contingencies; and general and other acquisition expenses.

119. Based on FOF Nos. 96, 100, 102, 105, 107, 111, 113, 117, and 118, a loss cost multiplier of 1.497 and 1.618 is reasonable for zone and publics, and trucks and special types, respectively, and a lost cost multiplier of 1.565 is reasonable for trucks and publics combined.

Loss Costs

120. While TAIPA did not directly specify which version of the ISO loss costs was to be used, in its exhibits TAIPA utilized the loss costs as updated by ISO's filing CA 2005-BRLA1 with an edition date of July 2006.

121. On October 7, 2006, ISO made a new filing with the Department, CA 2006-BRLA1, to revise the July 2006 loss costs.

122. ISO's filing CA 2006-BRLA1 was accepted by the Department on January 23, 2007.

123. It is reasonable to adopt ISO's most current accepted loss costs.

124. ISO's loss costs as modified by its filing CA 2006-BRLA1 should be used.

Capping

125. There would be certain sharp changes in some individual base rates due to the change from benchmark rates that were adopted in previous years to ISO loss costs.

126. TAIPA recommended capping the change in individual base rates at +/-25 percent.

127. TAIPA's capping recommendation is reasonable and should be used.

128. Based on FOF Nos. 94, 119, 124, and 127, the estimated overall rate change for commercial automobile insurance provided through TAIPA is 9.8%.

CONCLUSIONS OF LAW

1. The Commissioner has jurisdiction over this matter pursuant to TEX. INS. CODE ANN. art. 21.81 §5.

2. Proper and timely notice of the hearing was given pursuant to TEX. INS. CODE ANN. art. 21.81 §5.

3. The setting of rates in accordance with these findings of fact and conclusions of law is in compliance with the provisions of TEX. INS. CODE ANN. art. 21.81 §5(a). This section provides that the Commissioner shall determine and prescribe TAIPA rates that are just, reasonable, adequate, not excessive, not confiscatory, and not unfairly discriminatory for the risks

to which they apply. This section also provides that TAIPA rates shall be set in an amount sufficient to carry all claims to maturity and to meet the expenses incurred in the writing and servicing of the business.

IT IS THEREFORE THE ORDER of the Commissioner of Insurance that the above findings of fact and conclusions of law are adopted.

IT IS FURTHER ORDERED that the 2006/2007 rate filing for private passenger automobile rates for policies to be written through TAIPA be modified consistent with the findings and conclusions set forth in this order.

IT IS FURTHER ORDERED that the rates to be charged by TAIPA for private passenger automobile insurance be increased by 0.9 percent for bodily injury liability, decreased -6.6% for property damage liability, decreased -19.6 percent for personal injury protection, and decreased by -5.5% for uninsured/underinsured motorists coverage in accordance with TEX. INS. CODE ANN. art. 21.81.

IT IS FURTHER ORDERED that the 2006/2007 rate filing for commercial automobile rates for policies to be written through TAIPA be modified consistent with the findings and conclusions set forth in this order.

IT IS FURTHER ORDERED that the TAIPA's rates as modified in this order become effective June 1, 2007.

AND IT IS SO ORDERED.

TEXAS DEPARTMENT OF INSURANCE

Mike Geeslin

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COMMISSIONER OF INSURANCE