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**BEFORE THE INSURANCE COMMISSIONER
OF THE STATE OF CALIFORNIA**

In the Matter of the Private Passenger Rate
Application of the California Automobile
Assigned Risk Plan for the California Low
Cost Automobile Insurance Program,

Applicant.

FILE NO. RH05050092

DECISION AND ORDER

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

BACKGROUND

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

1 2006 rate recommendation on February 8, 2006 for an overall rate increase of seven percent and
2 no change to the 25 percent surcharge on certain drivers. Subsequently, CAARP submitted a
3 supplemental proposal on June 22, 2006, applying the overall seven percent increase to additional
4 expansion counties.

5
6 Legislation involving the California Low Cost Automobile Insurance Program extended
7 the program to Alameda, Fresno, Orange, Riverside, San Bernardino and San Diego counties,
8 commencing on April 1, 2006. The bill further authorized expansion of the program to all
9 counties in California at the discretion of the Commissioner, subject to specified procedures. The
10 legislation did not specify a rate, but authorizes the Commissioner to adopt regulations
11 establishing a rate, in consultation with CAARP, in order to implement the expansion of the
12 program to these counties, as emergency regulations. Previous legislation mandated the
13 availability of optional uninsured motorists bodily injury and medical payments coverages to
14 policyholders at additional premium.

15
16 In consultation with CAARP, the Commissioner proposed rates, effective April 1, 2006,
17 for Alameda, Fresno, Orange, Riverside, San Bernardino and San Diego counties for adoption on
18 an emergency basis, which were approved by the Office of Administrative Law on March 24,
19 2006 and approved for readoption on July 24, 2006. Following statutory procedures, the
20 Commissioner further expanded the program to eight additional counties of Contra Costa,
21 Imperial, Kern, Sacramento, San Joaquin, San Mateo, Santa Clara, and Stanislaus. In
22 consultation with CAARP, the Commissioner proposed rates, effective June 1, 2006, for adoption
23 on an emergency basis, which were approved by the Office of Administrative Law on May 18,
24 2006 and approved for readoption on October 2, 2006.

25
26 The low cost automobile insurance basic liability policy provides bodily injury liability
and property damage liability coverage at limits of \$10,000 for bodily injury or death to one

1 person/\$20,000 cumulative liability for bodily injury or death per accident/\$3,000 liability for
2 property damage. Optional coverage for uninsured motorists bodily injury is available at limits of
3 \$10,000/\$20,000 and optional medical payments coverage is available at a limit of \$1,000.

4 Currently, the annual premiums for the liability policy are \$355 per vehicle for Los
5 Angeles county and \$322 for the city and county of San Francisco. As approved by emergency
6 regulations, the annual premiums are \$322 for Alameda; \$317 for Contra Costa; \$299 for Fresno;
7 \$210 for Imperial; \$239 for Kern; \$312 for Orange; \$246 for Riverside; \$383 for Sacramento;
8 \$283 for San Bernardino; \$268 for San Diego; \$295 for San Joaquin; \$307 for San Mateo; \$290
9 for Santa Clara; and \$359 for Stanislaus counties. A 25 percent surcharge is added to the base
10 rate for unmarried male drivers ages 19 through 24 years of age.

11 Annual premiums for optional uninsured motorists bodily injury coverage are currently
12 \$65 for Los Angeles and \$39 for the city and county of San Francisco. As approved by
13 emergency regulations, the annual premiums are \$32 for Alameda; \$28 for Contra Costa; \$51 for
14 Fresno; \$32 for Imperial; \$30 for Kern; \$37 for Orange; \$32 for Riverside; \$49 for Sacramento;
15 \$40 for San Bernardino; \$26 for San Diego; \$35 for San Joaquin; \$25 for San Mateo; \$24 for
16 Santa Clara; and \$44 for Stanislaus counties.

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

23 At the public hearing, John Winkleman, Vice President of Actuarial Services for AIPSO,
24 CAARP's manager, commented on written testimony updating trend data available since CAARP
25
26

1 submitted its proposal in February 2006. Mr. Winkleman explained that, incorporating the
2 updated information, the indicated overall rate change would decrease from 7.0 percent to 4.5
3 percent.

4 At the hearing, Allan Schwartz of AIS Risk Consultants (AIS), on behalf of the
5 Foundation for Taxpayer and Consumer Rights, (FTCR),¹ recommended an overall decrease of
6 -2.4 percent, based on its analysis, a copy of which is available for public review in the
7 rulemaking file. Mr. Schwartz commented that the AIS analysis differs from that of CAARP in
8 four key areas – loss development, loss trends, underwriting expenses, and investment yield.

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

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

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

20 DECISION

21 After carefully considering all comments and written testimony and exhibits submitted
22 during the public hearing period, the Commissioner has declined to accept CAARP's
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¹ The FTCR petitioned to participate in this proceeding August 29, 2006, which was granted.

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

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

	<u>CAARP's Proposal</u>	<u>Department's Indicated Rate Change</u>
8 Liability	6.0%	-1.4%
9 Uninsured Motorists	9.4%	2.9%
10 Medical Payments	54.6%	28.0%

11 Loss Development

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

19
 20 For the 21 month and 33 month to ultimate factors, CAARP relied exclusively on the
 21 interpolated CAARP data. For the nine month to 21 month factor, CAARP first multiplied the
 22 low cost auto factor by .75, to account for the reduction of the full year back to a partial year, then
 23 averaged the result with the nine month to 21 month CAARP factor based on the interpolation.

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

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

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

9
10 To the second criticism, CAARP says that the .75 factor was approved in the previous
11 decision and order.

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

16
17 For the full year to partial year reduction factor, we agree with Mr. Schwartz that the
18 additional refinement to reflect the growth in exposures is reasonable and so we reject CAARP's
19 .75 factor and accept his .69 factor.

20 Loss Trends

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

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

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

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

12 Underwriting Expenses

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

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

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

25 The differences between AIS's and CAARP's numbers are small and ultimately they
26 derive from the same source, insurers' statutory annual statements. On the whole, we find that
the NAIC numbers are somewhat more California-specific because the numbers for companies
doing more business in California are given more weight than they are in Best's. Therefore, as

1 we did in our last decision, we reject CAARP's numbers and replace them with those of AIS.

2 Investment Yield

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

9
10 AIS calculates yield using a method that the Department has proposed for prior approval
11 ratemaking. It is a prospective method, considering the distribution of assets and current yields,
12 while the current method is historical and is actuarially preferable.

13
14 The low cost automobile insurance statute and regulations are silent on the specifics of a
15 yield calculation. The proposed change to the yield calculation in the prior approval regulations
16 has not been finalized. However, public comment has mostly been favorable. Therefore, we
17 reject CAARP's calculation and replace it with that of AIS.

18 County Relativities

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

24
25 The primary focus is on the bodily injury and property damage rate for the city and county
26 of San Francisco. CAARP proposes an increase in the relativity of San Francisco to Los Angeles
county from .907 (322 divided by 355) to 1.027. Thus, while program rates would generally be
decreasing, San Francisco would see a substantial increase. The concern is that the actual
experience from the program shows a considerably lower loss ratio in San Francisco than in Los

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

3 We adopt a credibility-weighted relativity for San Francisco. This still results in an
4 increased relativity for the city and county of San Francisco, but it is a somewhat smaller increase
5 than that proposed by CAARP.
6

7 **ORDER**

8 For the reasons stated above, it is hereby ORDERED that the statutory rates for the low
9 cost automobile liability policy be decreased to \$350 for Los Angeles; \$318 for Alameda; \$313
10 for Contra Costa; \$295 for Fresno; \$208 for Imperial; \$236 for Kern; \$308 for Orange; \$243 for
11 Riverside; \$378 for Sacramento; \$280 for San Bernardino; \$265 for San Diego; \$292 for San
12 Joaquin; \$303 for San Mateo; \$286 for Santa Clara; \$354 for Stanislaus; and increased to \$336
13 for the city and county of San Francisco, and that the current 25 percent surcharge for unmarried
14 male drivers between the ages of 19 and 25 years of age be maintained.
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16 It is further ORDERED that the annual premiums for uninsured motorists bodily injury
17 coverage be increased to \$67 for Los Angeles; \$33 for Alameda; \$29 for Contra Costa; \$53 for
18 Fresno; \$33 for Imperial; \$31 for Kern; \$39 for Orange; \$33 for Riverside; \$50 for Sacramento;
19 \$41 for San Bernardino; \$27 for San Diego; \$36 for San Joaquin; \$26 for San Mateo; \$25 for
20 Santa Clara; \$46 for Stanislaus counties; and decreased to \$25 for the city and county of San
21 Francisco.
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23 In addition, it is ORDERED that the annual premiums for medical payments coverage be
24 increased to \$37 for Los Angeles; \$23 for Alameda; \$22 for Contra Costa; \$44 for Fresno; \$23
25 for Imperial; \$24 for Kern; \$31 for Orange; \$18 for Riverside; \$30 for Sacramento; \$23 for San
26 Bernardino; \$19 for San Diego; \$29 for the city and county of San Francisco; \$30 for San

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

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3 Dated: November 13, 2006.

4 **JOHN GARAMENDI**
5 **INSURANCE COMMISSIONER**

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