

**State Farm Florida Insurance Company
OIR Filing # 10-21378
Hearing of February 15, 2011**

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Issues

- **What level of operating and selling expenses is appropriate?**
- **How much contingent capital should be provided by State Farm Mutual?**
- **What should be the average sinkhole discount per policy?**

**State Farm Florida Insurance Company
2009 Calendar Year**

**All Lines Income Statement
(\$000s)**

	<u>Direct</u>	<u>%</u>	<u>Ceded</u>	<u>%</u>	<u>Net</u>	<u>%</u>
Premiums Written	1,059,282		570,908		488,374	
Premiums Earned	1,149,677	100.0%	656,941	100.0%	492,736	100.0%
Losses	553,774	48.2%	18,306	2.8%	535,468	108.7%
Defense & Cost Containment Expenses	58,237	5.1%	7,705	1.2%	50,532	10.3%
Other Loss Adjustment Expenses	81,200	7.1%	4,752	0.7%	76,448	15.5%
Commission and Brokerage Expenses	137,897	12.0%	4,316	0.7%	133,581	27.1%
Taxes, Licenses and Fees	13,538	1.2%	0		13,538	2.7%
Other Acq., Field Super. and Coll. Expenses	118,617	10.3%	0		118,617	24.1%
General Expenses	28,441	2.5%	0		28,441	5.8%
Other Income Less Other Expenses	136,867	11.9%	0		136,867	27.8%
Pre-tax Profit or Loss	294,840	25.6%	621,864	94.7%	-327,024	-66.4%
Investment Gain on Policyholder Supplied Funds					36,049	7.3%
Profit or Loss					-290,975	-59.1%
Investment Gain on Surplus					31,259	6.3%
Profit or Loss					-259,716	-52.7%

**State Farm Florida Insurance Company
2009 Calendar Year**

**Reinsurance Ceded
(\$000s)**

	Direct Written Premiums	Premiums Ceded	%
State Farm Florida	1,059,282		
State Farm Mut Auto Ins Co		322,280	30.4%
Florida Hurricane Catastrophe Fund		88,947	8.4%
Other Private Reinsurers		159,680	15.1%
		570,907	53.9%

**Homeowners Insurance
Average Premiums and Expenses per Policy**

Countrywide	2006	2007	2008	Average	Est 2011
Average Premium	712	721	694	709	709
Loss Adjustment Expense	60	59	71	63	63
General Expense	33	32	32	32	32
Selling Expense	149	152	146	149	149
Total Expenses	241	243	250	245	245

Florida	2006	2007	2008	Average	Est 2011
Average Premium	1,164	1,330	1,224	1,239	1,720
Loss Adjustment Expense	63	63	71	65	91
General Expense	54	59	56	56	78
Selling Expense	230	265	246	247	343
Total Expenses	347	386	373	369	512

Notes:

- (1) Average premium sources are the NAIC reports for 2006, 2007 and 2008 titled: "Dwelling Fire, Homeowners Owner-Occupied, and Homeowners Tenant and Condominium/Cooperative Unit Owner's Insurance, Market Distribution and Average Cost by Policy and Amount of Insurance". Average premiums are for the following policy forms: DW, HO-1, HO-2, HO-3, HO-4, HO-5, HO-6 and HO-8 .
- (2) Expense sources are the NAIC 2007, 2008 and 2009 Profitability Reports for the 2006, 2007 and 2008 calendar years.

**State Farm Florida Insurance Company
Homeowners Policies**

Average Operating and Selling Expenses per Policy

	2009 Calendar Year	2011/2012 SFF Proposed	% Change
Premiums Earned	1,225	2,516	105.4%
Loss Adjustment Expense	148	118	-20.7%
General Expenses	29	30	3.2%
Selling Expense	275	376	36.7%
Total Operating and Sales Expenses	452	523	15.7%

**State Farm Florida Insurance Company
Homeowners Policies**

Average Operating and Selling Expenses per Policy

	<u>Countrywide</u>	2011/2012 SFF Proposed	<u>% Difference</u>
Premiums Earned	709	2,516	254.8%
Loss Adjustment Expense	63	118	85.5%
General Expenses	32	30	-8.0%
Selling Expense	149	376	152.1%
Total Operating and Sales Expenses	245	523	113.8%

**State Farm Companies Combined
Homeowners**

Hypothetical Surplus Sharing Adjustment

	250 Year PML	
	\$Billions	
	100%	0%
	Covariance	Covariance
Texas	2.00	0.78
Louisiana	1.00	0.39
Mississippi	1.00	0.39
Alabama	1.00	0.39
Florida	5.30	2.08
Georgia	0.50	0.20
South Carolina	1.00	0.39
North Carolina	1.00	0.39
Virginia	0.50	0.20
Maryland	0.50	0.20
Delaware	0.25	0.10
New Jersey	0.50	0.20
New York	2.00	0.78
Total Required Surplus	16.55	6.49

Notes:

This is a hypothetical illustration of the covariance effect on required surplus. A multistate analysis of State Farm's business should be performed to estimate the appropriate covariance adjustment for the state of Florida.

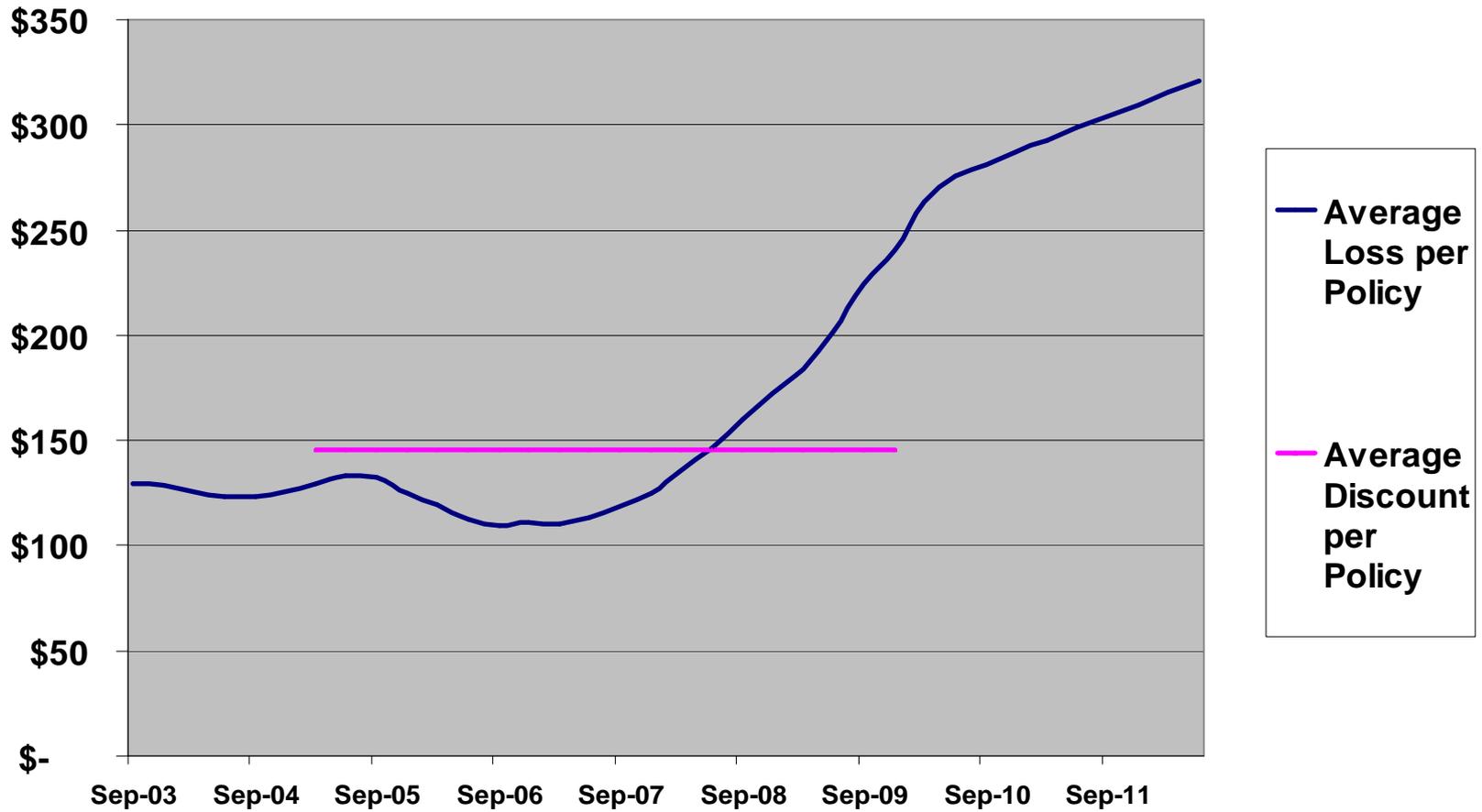
Total required surplus for 0% covariance is determined as the square root of the sum of the squares of the 250 year PMLs for each state.

**State Farm Florida Insurance Company
Homeowners**

**Non-Hurricane Losses
Projected Paid and Incurred per Policy**

Fire Other Than Lightning	84.24
Lightning	18.33
Wind / Hail	21.26
Other Coverages (Includes Sinkholes)	414.08
Crime	30.49
Liability	39.48
Subtotal	<u>607.88</u>
Paid to Incurred Adjustment	<u>22.67</u>
Total Non-Hurricane Incurred Losses	630.55

State Farm Florida Insurance Company Homeowners Estimated Average Sinkhole Losses per Policy



**State Farm Florida Insurance Company
Homeowners**

Surplus to Premium Ratio Operating and Selling Expenses *	4 to 1 \$523	3.5 to 1 \$430	3 to 1 \$338	2.5 to 1 \$245
State Farm Indicated Rate Increase	27.7%	27.7%	27.7%	27.7%
Surplus Sharing Adjustment	0%	-6.0%	-11.7%	-16.1%
Expense Adjustment	0%	-3.6%	-7.2%	-11.1%
Revised Rate Increase	27.7%	15.8%	4.6%	-4.8%

Note:

* Expenses per policy for non-catastrophe loss adjustment; other acquisition, field supervision and collection; general; and commission and brokerage. Excludes private reinsurance expense, surplus note and taxes, licenses and fees.

Recommendations

- **The contingent capital allocated to Florida should be reduced based upon a surplus sharing (covariance) analysis.**
- **State Farm should voluntarily reduce expense levels from the proposed \$518 per policy back to the countrywide average of approximately \$245 per policy.**
- **The average sinkhole discount should be approximately doubled to be consistent with the average sinkhole charge built into the projected loss costs.**