

First Community Insurance Company
OIR Filing # 11-00972
Hearing of March 22, 2011

Stephen A. Alexander FCAS, MAAA, MBA
Actuary
Insurance Consumer Advocate's Office

s. 627.0613, F.S.: Consumer advocate.—The Chief Financial Officer must appoint a consumer advocate who must represent the general public of the state before the department and the office. The consumer advocate must report directly to the Chief Financial Officer, but is not otherwise under the authority of the department or of any employee of the department. The consumer advocate has such powers as are necessary to carry out the duties of the office of consumer advocate, including, but not limited to, the powers to:

(1) Recommend to the department or office, by petition, the commencement of any proceeding or action; appear in any proceeding or action before the department or office; or appear in any proceeding before the Division of Administrative Hearings relating to subject matter under the jurisdiction of the department or office.

(2) Have access to and use of all files, records, and data of the department or office.

(3) Examine rate and form filings submitted to the office, hire consultants as necessary to aid in the review process, and recommend to the department or office any position deemed by the consumer advocate to be in the public interest...

CERTIFICATION

- I, Stephen A. Alexander, Actuary with the Office of the Insurance Consumer Advocate do certify that, based on my knowledge, my recommendations are consistent with accepted actuarial principles and Florida law.



Stephen A. Alexander, FCAS, MAAA, MBA

Issues

- **Loss and Premium Trends**

Company's own experience is credible and should be used as basis for trending.

- **Expenses**

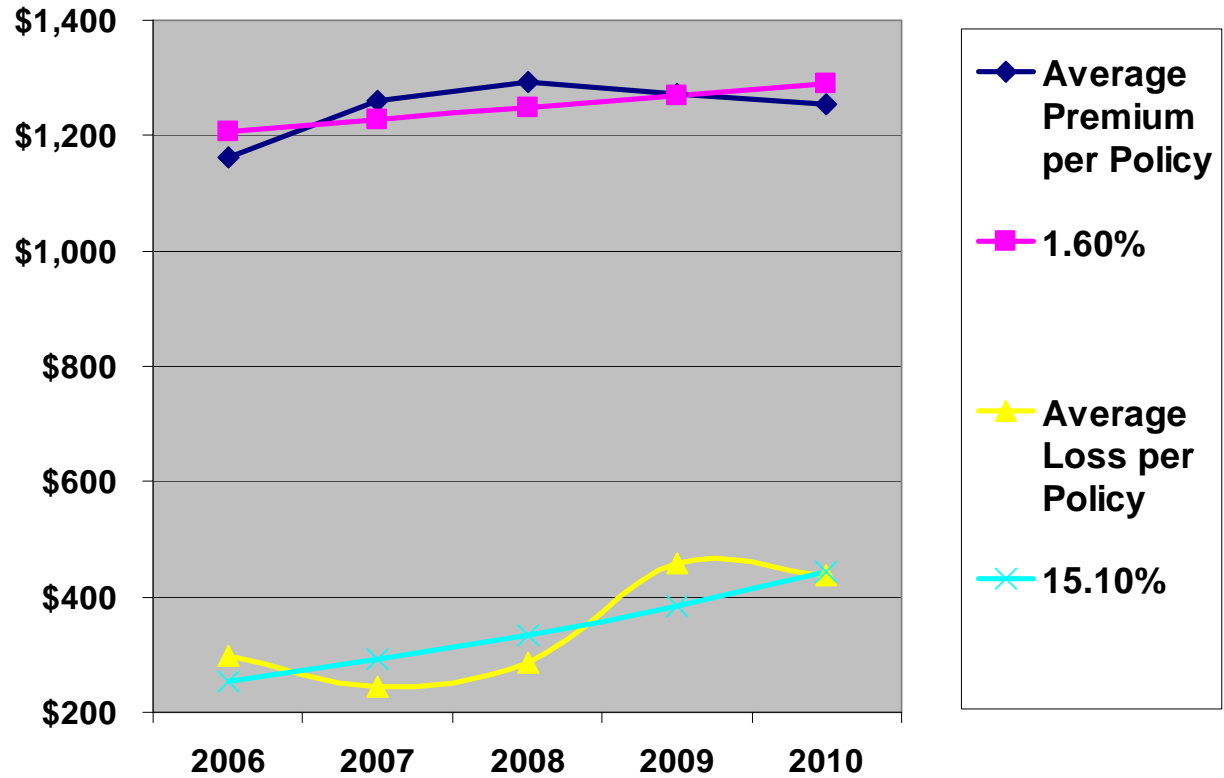
Should be reduced to match the lowest third of Florida domestic personal residential insurers and should be fixed fees rather than percentages of premium.

- **Profit and Contingency Provision**

In tandem with expense reduction, should be increased to attract and retain more investment capital in the company instead of shifted to its affiliates or up-streamed to its parent through excessive expenses.

Issue #1 – Loss and Premium Trends

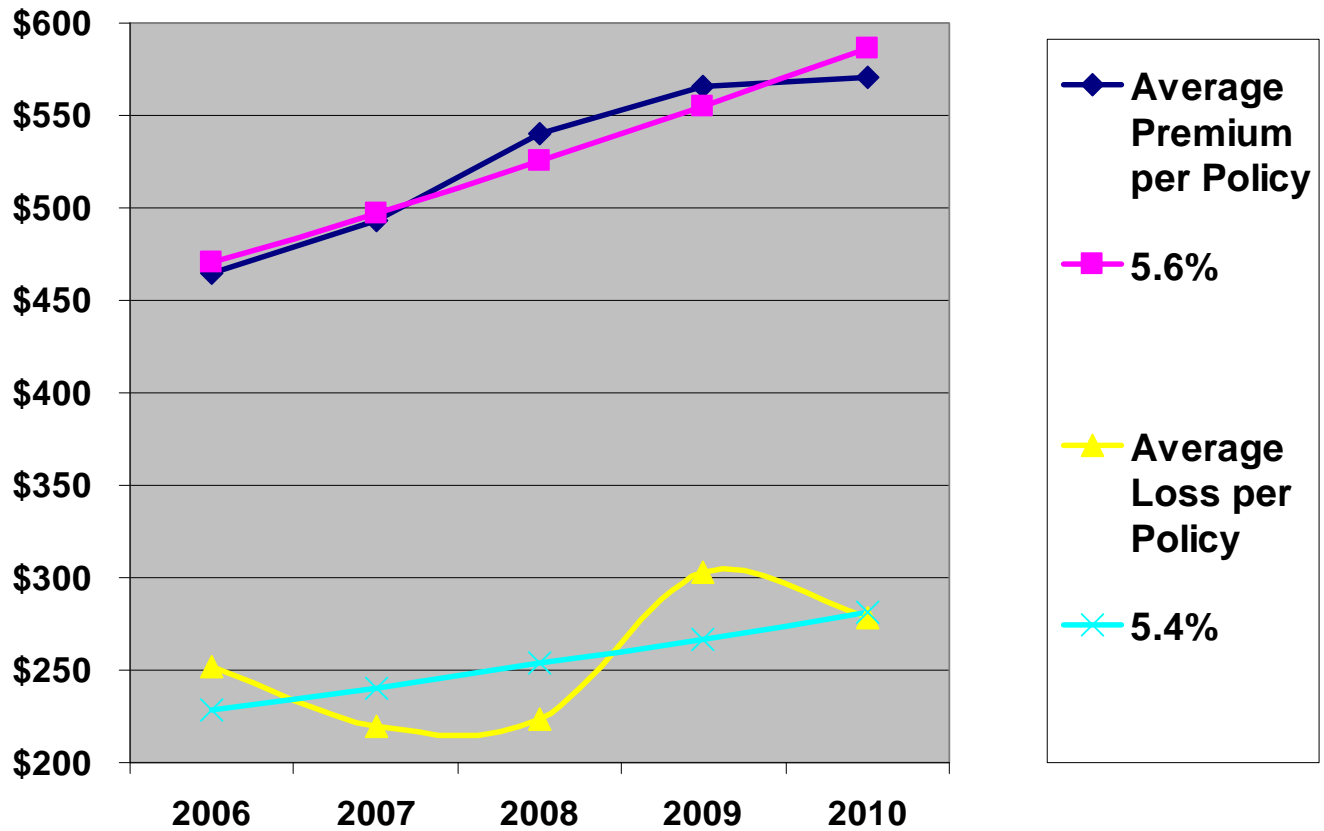
First Community Insurance Company HO - 3 Policies



	3/31/2006	3/31/2007	3/31/2008	3/31/2009	3/31/2010
◆ Average Premium per Policy	1,163.44	1,259.45	1,292.93	1,271.18	1,255.83
■ 1.60%	1,207.94	1,227.67	1,247.77	1,268.15	1,288.86
▲ Average Loss per Policy	298.04	244.06	285.58	459.62	438.88
× 15.10%	252.49	290.60	334.59	385.10	443.23

Data Source: OIR Filing # 11-00972, RIF Exhibit. Average Premium = 1,000 x (8)/(7)/(3) and Average Loss = 1,000 x (37)/(36)/(3)

First Community Insurance Company HO - 6 (Condo) Policies



	3/31/2006	3/31/2007	3/31/2008	3/31/2009	3/31/2010
◆ Average Premium per Policy	464.75	493.23	540.06	566.10	571.06
■ 5.6%	470.65	497.23	525.39	555.06	586.41
▲ Average Loss per Policy	251.86	219.93	223.64	303.14	278.66
× 5.4%	228.30	240.55	253.49	267.10	281.43

Data Source: OIR Filing # 11-00972, RIF Exhibit. Average Premium = $1,000 \times (8)/(7)/(3)$ and Average Loss = $1,000 \times (37)/(36)/(3)$

Issue #2 - Expenses

Excessive Expenses = Excessive Rates

- “Rates shall be deemed excessive if they are likely to produce a profit from Florida business that is unreasonably high in relation to the risk involved in the class of business or if expenses are unreasonably high in relation to services rendered.” (s. 627.062(2)(e)1., F.S.)

**Homeowner, Tenant and Condo Policies
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	1,520
Loss Adjustment Expense	63	63	71	65	81
General Expense	54	59	56	56	69
Selling Expense	230	265	246	247	303
Total Expenses	347	386	373	369	452

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.

(3) Florida data for 2006 through 2008 excludes Citizens Property Ins. Corp. Estimate for 2011 includes Citizens Property Ins. Corp.

(4) Excludes commercial residential policies.

Florida Exclusive Residential Property Insurers
In-Force Direct Written Premium Greater Than \$20 Million
2009 Calendar Year
Homeowners, Mobile Homeowners, Tenants and Condos

Discretionary Expenses per Policy
(Loss Adjustment, Commission and Brokerage, General and Other Acquisition Expense)

Rank	Company	In-Force Direct Written Premium @ 12/31/09	Number of Policies	Average Premium	Total Expense Ratio	Average Expense Per Policy	MGA
1	Privilege Underwriters Recp Exch	25,247,413	2,719	9,286	37.9%	3,522	No
2	Argus Fire & Cas Ins Co	41,724,028	20,388	2,046	42.4%	868	Yes
3	Gulfstream Prop & Cas Ins Co	49,290,346	25,747	1,914	39.5%	757	Yes
4	United Prop & Cas Ins Co	137,795,663	84,207	1,636	43.5%	712	Yes
5	First Home Ins Co	33,098,769	20,933	1,581	41.8%	661	Yes
6	Federated Natl Ins Co	86,185,770	52,606	1,638	37.1%	608	Yes
7	Florida Peninsula Ins Co	172,125,038	107,050	1,608	37.3%	600	Yes
8	Olympus Ins Co	73,143,476	48,384	1,512	39.3%	594	Yes
9	Homewise Ins Co	34,760,936	26,346	1,319	44.3%	585	Yes
10	Fidelity Fire & Cas Co	36,900,199	20,381	1,811	32.1%	582	Yes
11	Sunshine State Ins Co	96,359,986	60,279	1,599	36.2%	579	Yes
12	First Protective Ins Co	77,353,956	42,268	1,830	31.2%	570	No
13	Security First Ins Co	94,526,310	60,467	1,563	34.1%	533	Yes
14	Universal Ins Co of NA	115,162,014	80,628	1,428	35.8%	512	Yes
15	American Integrity Ins Co of FL	60,611,369	39,720	1,526	32.1%	489	Yes
16	State Farm FL Ins Co	992,753,679	765,998	1,296	37.7%	488	No
17	St Johns Ins Co Inc	278,047,508	194,527	1,429	34.1%	488	Yes
18	ASI Preferred Ins Corp	42,464,552	37,463	1,134	40.5%	459	Yes
19	Edison Ins Co	50,482,581	26,161	1,930	23.3%	449	Yes
20	Homewise Preferred Ins Co	154,486,866	108,003	1,430	31.3%	447	Yes
21	Southern Fidelity Ins Co Inc	71,697,047	52,536	1,365	32.2%	439	Yes
22	Tower Hill Select Ins Co	70,373,731	44,704	1,574	27.4%	432	Yes
23	Royal Palm Ins Co	158,767,264	96,233	1,650	25.6%	423	Yes
24	Peoples Trust Ins Co	36,394,650	30,965	1,175	35.7%	420	Yes

Florida Exclusive Residential Property Insurers
In-Force Direct Written Premium Greater Than \$20 Million
2009 Calendar Year
Homeowners, Mobile Homeowners, Tenants and Condos

Discretionary Expenses per Policy
(Loss Adjustment, Commission and Brokerage, General and Other Acquisition Expense)

Rank	Company	In-Force Direct Written Premium @ 12/31/09	Number of Policies	Average Premium	Total Expense Ratio	Average Expense Per Policy	MGA
25	Cypress Prop & Cas Ins Co	53,728,330	48,206	1,115	37.6%	419	Yes
26	Florida Family Ins Co	66,953,053	59,459	1,126	37.1%	418	Yes
27	Tower Hill Preferred Ins Co	72,302,817	45,081	1,604	24.8%	399	Yes
28	American Strategic Ins Corp	72,315,227	61,397	1,178	33.4%	393	Yes
29	First Floridian Auto & Home Ins Co	37,175,636	25,656	1,449	26.8%	389	No
30	Tower Hill Prime Ins Co	92,851,726	63,406	1,464	26.0%	381	Yes
31	First Community Ins Co	30,246,387	28,957	1,045	34.5%	361	Yes
32	Northern Capital Ins Co	68,729,375	48,622	1,414	25.2%	357	Yes
33	Nationwide Ins Co Of FL	131,122,614	112,723	1,163	29.7%	346	No
34	Florida Farm Bureau Cas Ins Co	65,485,825	53,738	1,219	28.2%	344	No
35	Universal Prop & Cas Ins	524,180,864	479,807	1,092	31.1%	340	Yes
36	Southern Oak Ins Co	65,817,681	40,783	1,614	20.4%	329	Yes
37	ASI Assur Corp	88,212,313	73,668	1,197	27.4%	328	Yes
38	Modern USA Ins Co	26,383,109	30,589	863	36.5%	315	Yes
39	Citizens Prop Ins Corp	774,727,709	518,846	1,493	20.8%	310	No
40	Florida Farm Bur Gen Ins Co	34,928,159	33,745	1,035	25.4%	263	No
41	American Traditions Ins Co	39,189,923	47,939	817	30.0%	246	Yes
42	Castle Key Ins Co	141,790,449	150,094	945	25.8%	243	No
43	Capitol Preferred Ins Co	32,767,638	31,407	1,043	21.6%	226	Yes
44	Hillcrest Ins Co	25,302,462	16,177	1,564	14.0%	219	Yes
45	Omega Ins Co	38,436,766	37,300	1,030	18.2%	188	Yes
46	Homeowners Choice Prop & Cas Ins Co	137,648,255	75,630	1,820	10.1%	184	No
47	Castle Key Ind Co	46,585,212	76,536	609	29.5%	180	No
	Grand Total	5,656,634,681	4,208,479	1,344	31.2%	420	

**Florida Exclusive Residential Property Insurers
In-Force Direct Written Premium Greater Than \$20 Million
2009 Calendar Year
Homeowners, Mobile Homeowners, Tenants and Condos**

**Discretionary Expenses per Policy
(Loss Adjustment, Commission and Brokerage, General and Other Acquisition Expense)**

Company	In-Force Direct Written Premium @ 12/31/09	Loss Adjustment Expense	Number of Policies	Average Premium	Total Expense Ratio	Average Expense Per Policy	MGA
Grand Total	5,656,634,681	7.6%	4,208,479	1,344	31.2%	420	36
Top Third (ex #1)	2,101,791,539	8.5%	1,455,402	1,621	37.6%	610	13
Middle Third	1,288,287,375	4.5%	922,754	1,378	31.4%	432	14
Lowest Third	2,241,308,353	5.7%	1,827,604	1,182	24.6%	291	9
	<u>5,631,387,268</u>		<u>4,205,760</u>				<u>36</u>

**First Community Insurance Company
Homeowner, Tenant and Condo Policies**

Average Expense per Policy

	(1) 2009 Calendar Year	(2) 2011 First Community Proposed	% Change
Premiums Written	1,045	1,474	41.1%
Loss Adjustment Expense	50	96	89.6%
General Expense	79	100	27.3%
Selling Expense	232	288	24.2%
Total Operating and Sales Expense	361	483	34.0%

Notes:

- (1) Sources are: QUASR data as of 12/31/09 and 2009 Insurance Expense Exhibit
- (2) First Community rate filing OIR # 11-00972

First Community Insurance Company

Average Operating and Selling Expenses per Policy

	(1) 2009 Estimated Florida Lowest Third	(2) 2011 First Community Proposed	Ratio
Premiums Written	<u>1,182</u>	<u>1,474</u>	<u>124.6%</u>
Loss Adjustment Expense	68	96	141.3%
General Expense	26	100	388.0%
Selling Expense	<u>198</u>	<u>288</u>	<u>145.4%</u>
Total Operating and Sales Expenses	291	483	166.0%

Notes:

(1) Exhibit 1, Sheet 1

(2) First Community rate filing OIR # 11-00972

Issue #3 - Profit

Excessive Profit = Excessive Rates

- “Rates shall be deemed excessive if they are likely to produce a profit from Florida business that is unreasonably high in relation to the risk involved in the class of business or if expenses are unreasonably high in relation to services rendered.” (s. 627.062(2)(e)1., F.S.)

First Community Insurance Company
Total Return Analysis

(1)	Number of HO 3, 4 & 6 Policies	27,236	
(2)	Earned Premium at Current Rate Level		\$32,543,859
(3)	Earned Premium at Current Rate Level after 23.3% Rate Increase		40,126,578
(4)	Underwriting Profit @ 3.7%		1,484,683
(5)	Investment Income @ .8%		321,013
(6)	First Community Proposed Average Expense per Policy	483	
(7)	Florida Lowest Third Average Expense per Policy	<u>291</u>	
(8)	Excess Average Expense per Policy	192	
(9)	Excess Expense		<u>5,231,479</u>
(10)	Total Return		7,037,175
(11)	Allocated Policyholder Surplus		\$7,031,176
(12)	Total Return on Surplus		100.1%

Notes:

- (1) & (2) First Community Rate Filing OIR # 11-00972
- (3) (2) x 1.279
- (4) (3) x .037
- (5) (3) x .008
- (6) Exhibit 4
- (7) Exhibit 1, Sheet 2
- (8) (6) - (7)
- (9) (1) x (8)
- (10) (4) + (5) + (9)
- (11) First Community statutory annual statement policyholders' surplus as of 12/31/2010 allocated based on direct written premium:
\$19,969,533 x (\$31,470,267 / \$89,379,999).
- (12) (10) / (11)

Financial Strength Ratings

Demotech			AM Best			Weiss		
Rating	Description	Risk of Ruin	Rating	Description	Risk of Ruin	Rating	Description	Risk of Ruin
A"	Unsurpassed	0.00%	A+	Excellent	0.06%	A+	Excellent	0.06%
A'	Unsurpassed	1.00%	A	Excellent	0.19%	A	Excellent	0.19%
A	Exceptional	3.00%	B	Good	0.75%	B	Good	0.75%
S	Substantial	5.00%	C	Fair	2.06%	C	Fair	2.06%
M	Moderate	10.00%	C-		2.74%	C-		2.74%
L	Licensed	not available	D +	Weak	3.41%	D +	Weak	3.41%
NR	Not Rated	not available	D & D-	Weak **	6.02%	D & D-	Weak	6.02%
N/A	Ineligible	not available	E +	Very Weak	7.27%	E +	Very Weak	7.27%
			E & E-	Very Weak	not available	E & E-	Very Weak	not available
			F	Failed	not available	F	Failed	not available

Statement of Principles Regarding Property and Casualty Insurance Ratemaking

(Adopted by the Board of Directors of the Casualty Actuarial Society, May 1988)

Risk -

- ✓ The rate should include a charge for the risk of random variation from the expected costs.
- ✓ *This risk charge should be reflected in the determination of the appropriate total return consistent with the cost of capital and, therefore, influences the underwriting profit provision.*

First Community Insurance Company
Insurance Consumer Advocate Selected
Underwriting Profit and Contingency Provision

(1)	Equity Risk Premium	5.20%
(2)	Risk of Ruin	2.00%
(3)	Risk Charge	10.00%
(4)	Risk Free Rate	0.50%
(5)	Required Return on Surplus after Federal Income Tax (FIT)	17.70%
(6)	Average FIT Rate	20.00%
(7)	Required Return on Surplus before FIT	22.13%
(8)	Earned Premium at Current Rate Level	\$32,543,859
(9)	Allocated Policyholder Surplus	\$7,031,176
(10)	Required Return on Premium before FIT	4.78%
(11)	Net Investment Income before FIT	0.60%
(12)	Indicated Underwriting Profit & Contingency Provision before FIT	4.18%

Notes:

- (1) "Market Risk Premium Used in 2010 by Analysts and Companies: A Survey with 2,400 Answers", Pablo Fernandez and Javier del Campo
- (2) Exhibit 6 and actuarial judgment
- (3) Based on actuarial judgment
- (4) Estimated one year Treasury Bill yield
- (5) (1) + (2) + (3) + (4)
- (6) Based on actuarial judgment
- (7) (5) / (1 - (6))
- (8) & (9) First Community statutory annual statement policyholders' surplus as of 12/31/2010 allocated based on direct written premium: \$19,969,533 x (\$31,470,267 / \$89,379,999).
- (10) ((9) / (8)) x (7)
- (11) Based on actuarial judgment
- (12) (10) - (11)

Summary

First Community Insurance Company

Assumption Changes

	First Community	Insurance Consumer Advocate
Loss Trend: HO 3	19.6%	15.0%
Loss Trend: HO 6	4.4%	5.0%
Premium Trend: HO 3	0.0%	1.5%
Premium Trend: HO 6	-0.1%	5.0%
Loss Adjustment, General and Selling Expense	21.2% Variable & 14.3% Fixed	24.4% Fixed
Profit and Contingency	3.7%	4.2%

First Community Insurance Company

Indicated and Selected Overall Average Rate Changes

Policy Type	On-Level Earned Premium (\$000's)	Company Indicated	Company Selected	ICA Indicated & Selected
HO- 3	30,265	46.0%	23.9%	12.8%
HO- 4	181	0.0%	0.0%	4.0%
HO- 6	2,098	29.5%	16.8%	6.1%
	32,544	44.7%	23.3%	12.3%

First Community Insurance Company
HO-3, HO-4 & HO-6 Policies

Issue Impacts on Rate Indications

Company Indication	44.7%
Loss Trends	-6.9%
Expenses	-14.3%
Profit Provision	0.5%
Premium Trends	-3.3%
ICA Preliminary Indication	12.3%

Note:

$$(1+.447) \times (1-.069) \times (1-.143) \times (1+.005) \times (1-.033) - 1 = .123$$

Recommendations and Conclusions

- **Approve average rate increase of 12.3% subject to the following:**
 - ✓ **Restrict commissions, general and other acquisition expense to a fixed fee of \$195 per policy (16.4% of current premiums of \$1,195 per policy).**
 - ✓ **This assumes the company will spend \$96 per policy on loss adjustment expense and total expenses per policy will be \$291, which will match the lowest third of comparable insurers in the state of Florida.**
 - ✓ **Increase Profit and Contingency Provision from 3.70% to 4.20%.**
- **The above changes will provide an expected after-tax return on surplus of 17.7%, which will accrue to First Community Insurance Company rather than its affiliates or parent.**