

CEO's Message

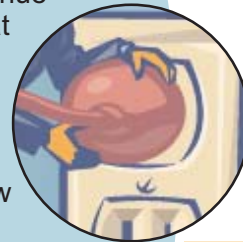
THE SHRINKING OF THE ASSIGNED RISK MARKET

Since the last issue of the AutoOne News, we executed our planned expansion of LAD (Limited Assignment Distribution) services to Arizona, Colorado, Montana, Nevada, New Mexico, Oregon, South Carolina, Idaho, Utah, Washington, West Virginia and Wyoming and CLAD (Commercial Limited Assignment Distribution) services in South Carolina. As a result, AutoOne now offers an Assigned Risk solution in 21 states, plus the District of Columbia, covering 26 programs, offering a complete array of Assigned Risk services to meet our clients' needs across the country.

AutoOne's services have grown in direct response to the demand from our business partners, who want an Assigned Risk servicing carrier and a solid business partner for their long-term needs. To continue to earn your business, we have built an organization that delivers what you need: Ability, Stability and Dependability. Within this newsletter, you will see what makes AutoOne different from its competition, how we strive to meet the highest of expectations for your organization.

Also included in this edition is a report on Assigned Risk trends in New York and other major AIP state programs. With the continuing soft personal auto market nationally, 2006 is looking like the low point of the cycle for Assigned Risk plans in virtually every state. Many Assigned Risk plans are shrinking, with the largest state programs down over 30% compared to 2005. A lot of marketplace factors are contributing to this downward AIP volume trend, which continues even after various rate decreases were implemented by state Governing Committees.

Nonetheless, we have to be aware of the likelihood that the smaller AIP plans will be composed of the core, "worst of the worst," risks with loss ratios expected to deteriorate from current levels as the "better" business is finding a home in the voluntary market. In response to this additional volatility, we are consistently looking for creative solutions that will benefit our clients. Notably, this is where AutoOne's outstanding Claims Management capabilities really make a difference, as our specialized tools and talent can



- Assigned Risk Services 2**
Ability. Stability. Dependability.
- Actuarial 3**
NYAIP Future Plan Size –
Upturn or new dynamic?
- Underwriting 6**
Expansion and Contraction
- Claims Management 6**
AutoOne Claims Services
- Finance 7**
Assigned Risk Invoicing 101

- CEO's Message 1**
- AutoOne In The News 8**

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(Cont'd on back)



assigned risk services

ABILITY. STABILITY. DEPENDABILITY.

AutoOne's Assigned Risk Services (LAD/CLAD) are designed to remove uncertainty from the residual market segment of our clients' business. We've also recently launched an additional service, AutoOne Claim Services, providing one more reason to partner with us! (See *Claims Management* article for more on this service.)

As the Assigned Risk resource for companies both large and small, AutoOne consults with clients and prospects on the options available with the goal of offering the most cost effective solution for each and every client. We are interested in developing long-term relationships built around trust, providing financially sound results for our partners.

How do we gain your confidence and provide the best solutions? With the **ability** to deliver as a **stable** partner built on strong financials that you can always **depend** on.

ABILITY

- Our actuaries focus their attention on each state's loss ratios, claim counts, volume trends and more, allowing for the most accurate fee proposal, providing for a very efficient transfer of a client's Assigned Risk quota.
- We recognize emerging trends in the Assigned Risk business and react to those trends such as the advantages of the New York Take-out Credit changes and the economic advantages for our client companies which has been enormous.
- Our processors efficiently manage workflow within the variations of Assigned Risk Plan application volume resulting in reduction of underwriting expense ratios coupled by the lowest possible fees for our clients.
- Our underwriters aggressively pursue rates through cost effective reports on garaging, licensing and household driver counts, ensuring AutoOne's profitability and long-term viability.
- We represent subscriber companies in the management of important state auto insurance plans such as New York.
- AutoOne's expansion of its LAD and CLAD services, totaling 21 states plus the District of Columbia, is in response to demand from our clients and testimony to their faith in our ability.

- We are a unified company with underwriting, processing, claims and billing all under one roof. This ability to control all the moving parts of Assigned Risk, gives our clients peace of mind to manage their business while we manage their assignments.

STABILITY

- We are proud of our A.M. Best financial rating of A ('Excellent').
- AutoOne is backed by nearly \$4 billion of assets from our strong parent company, White Mountains Group.
- Our promise to deliver the maximum number of Take-out Credits to our clients for the last three years has remained unbroken, significantly reducing or virtually eliminating client Assigned Risk quotas.
- Year after year, we have been able to offer renewal contracts to every existing buy-out client, which fosters the confidence and assurances for planning and directing their resources back to their core business operations.

DEPENDABILITY

- On behalf of clients, we can, and will, interact, or intercede, with the management and staff of Automobile Insurance Plans across the country.
- The year-end "true-up" of fees and refunds is timely, efficient and understandable, eliminating potential problems in accounting and reconciliations for our clients.
- We have an Assigned Risk Services staff, dedicated to our clients' and prospects' needs and inquiries, often responding to them in less than one working day, providing answers, proposals and contracts designed to eliminate clients' residual market concerns.

AutoOne is here to help ease the Assigned Risk burden as your **able, stable and dependable** partner.

~Pete Treutlein
Director, Assigned Risk Services



actuarial

NYAIP FUTURE PLAN SIZE – UPTURN OR NEW DYNAMIC?

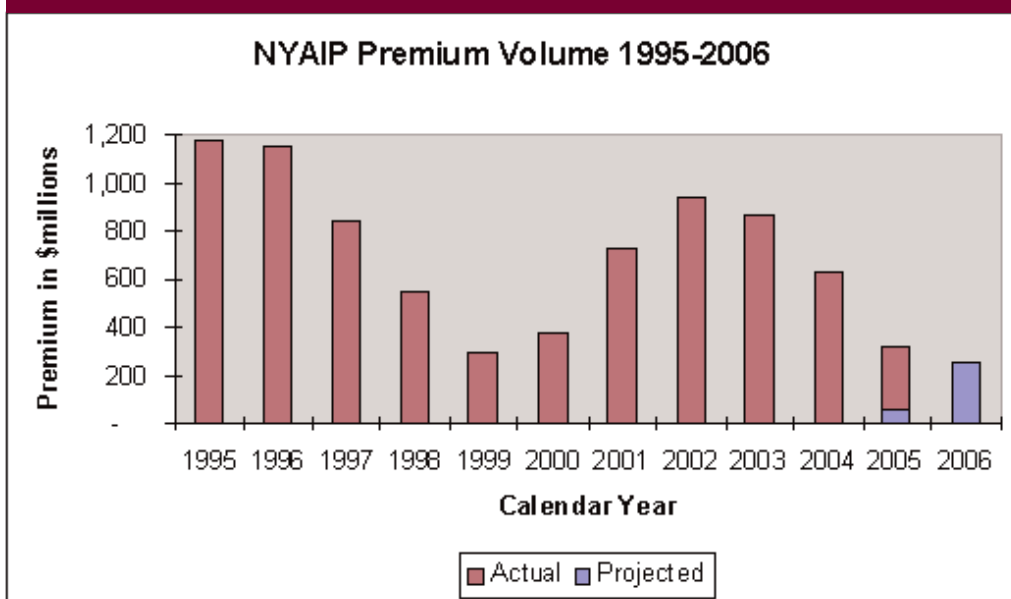
Since 2003, NYAIP volume has been steadily declining despite back-to-back rate decreases effective in late 2004 (-2%) and early 2006 (-6%). Historically, NYAIP volume has fluctuated in cycles lasting 3 to 7 years. However, the forces that drive the Assigned Risk cycle are now changing and there are new factors that may cause the current down-turn in the NYAIP cycle to persist longer, and not rebound as rapidly, as we have seen in past cycles.

policies to generate premium volume in excess of \$1 billion than it would at today's rate levels. Nevertheless, the cycle of vehicles insured in the NYAIP would follow a similar pattern but with an even greater relative difference between peak and trough.

The NYAIP cycle has traditionally been highly correlated to results in the voluntary non-standard market. During soft cycles when non-standard

companies write more business and compete for market share, the size of the Plan decreases. In hard market cycles when non-standard companies have experienced poor results, underwriting criteria are tightened, rates are increased, and more of that business flows back into the AIP. In 1996, New York first allowed for tiered pricing within the

TABLE 1.1 : NYAIP PREMIUM VOLUME LAST 12 YEARS



As an overview, **Table 1.1** displays the 12-year cycle in NYAIP premium volume.

We observe two peaks of the NYAIP cycle in this chart, 1995 and 2002. Two troughs in the cycle appear in 1999 and 2006. The blue bars show projected volumes for the last quarter of 2005 and 2006 – we will discuss those in more detail later in this article. Please note that this chart displays premium volume and not policies or vehicles in force. In the mid-90s, average premium per policy was significantly lower than it is today, so it took a much larger number of

voluntary market. This spurred the depopulation of the Plan seen from 1997-1999, as insurance carriers were now able to price and underwrite more selectively for risks deemed non-standard. Carriers at that time (many new to the New York non-standard market) perceived that they would be able to write a significant amount of prior AIP business at profitable levels. Just when the Plan had been depopulated to its lowest levels in recent history (1999), New York experienced a dramatic increase in insurance fraud, primarily related to PIP in downstate regions. Shortly



thereafter (2000-2001), as companies realized that their new tiered pricing structures were severely underpriced, rates were increased and eligibility curtailed to stem mounting losses. This resulted in a quick and dramatic repopulation of the NYAIP market, which also had highly inadequate rates. The NYAIP then became either the only available market or the lowest priced market for many non-standard risks. Three successive rate increases, close to 20% increase for each, were approved in the NYAIP from 2001 to 2003. Additionally, the New York Insurance Department approved new rules to provide incentives for companies to depopulate the Plan in exchange for Take-out Credits that could be sold or used to reduce a carrier's Assigned Risk burden. These actions combined to turn the AIP cycle again in 2003 and volume has been dropping ever since.

Based on past history, it would be logical to conclude that very soon the NYAIP market cycle will again turn and volume will begin to increase. However, several key dynamics are different this time and will likely result in a much longer 'down' cycle and a slower repopulation when the cycle does turn.

First, pricing segmentation in the voluntary market is much more granular than it was when the last round of repopulation occurred in 2000. Back then, many companies simply used flat percentage tier deviations in conjunction with tier eligibility to price and/or place risks into tiers. Since then, pricing models have become much more complex. Insurance scoring (based on credit) is much more widely used now than it was in 2000 and is certainly a key pricing element in the non-standard market.

...it would be logical to conclude that very soon the NYAIP market cycle will again turn and volume will begin to increase.

The number of pricing tiers now is much greater than it was in 2000. It was common at that time to only offer 3 pricing tiers (non-standard, standard, and preferred). At present, many

companies are writing with 15 or more pricing tiers. The combination of more tiers and more rating elements to place risks into pricing cells make today's pricing models much more refined. Many companies have literally thousands or millions more rating combinations than were in existence six years ago. These refined pricing models should result in at least the perception of more precision in the rating process.

Companies are now much more willing to write risks that previously would have been deemed unacceptable, because risks are rated based on more refined characteristics than were available in the past. This should cause the non-standard market to be willing to accept more risks than it could previously, and keep the size of the Plan small.

Another consequence of increased segmentation is that it will take insurers longer to realize if certain segments are underperforming, since credibility within each cell will be smaller and reaction times may be extended before pricing is adjusted. This could result in a more protracted 'down' cycle for AIP volume.

A second consequence related to pricing segmentation is that voluntary carriers may be able to more effectively 'cherry pick' the best risks out of the Plan. At first blush, we may say that NYAIP rates are 22% inadequate overall, (based on AIPSO's recently developed Pre-Stewart formula rate indication) and that insurers would be foolish to write any of this business in their non-standard programs at rates that are competitive or lower than the Plan. However, the AIP rating structure remains simplistic relative to today's sophisticated voluntary pricing models. There are undoubtedly many pricing cells within a voluntary rating structure where rates are being set individually, whereas the same rate is used across all risks written within the Plan. Prime examples include; class and territory.

Because the AIP charges one rate for all drivers age 30-64, the voluntary market may have individual rates for each age within this band, and would be able to more effectively 'cherry pick' individual ages where the Plan rate is actually adequate, while avoiding individual ages where the Plan rate is inadequate. It is theoretically possible for voluntary carriers to



write at least a portion of AIP risks at lower than Plan rates and still generate a profit by appropriately segmenting their pricing to identify cells where Plan business can be written profitably. Adding insurance score to the mix of variables that insurers can draw on, makes this even more possible, since the AIP does not recognize insurance score at all in rating.

Third, Take-out programs continue to take more mature new business (at least six months in the Plan) and renewal business out of the Plan. Even as the Plan has depopulated over the last three years, some insurers continue to find it beneficial to take policies out of the Plan to reduce their Assigned Risk burdens or sell credits to generate revenue to subsidize the policies taken out. The 2-for-1 credit multiple appears to still be sufficient incentive for insurers to find this financially beneficial.

Because of the factors cited above, we now project that the NYAIP cycle will remain at the low end for at least the next year. The most recent data available, through third quarter, shows NYAIP Plan volume at \$316 million through September 2005. With new applications in the fourth quarter down 21% relative to the to third quarter, we expect final premium volume for 2005 to come in close to \$375 million, a 40% decline from 2004 volume of \$628 million. New applications in 2005 were down 36% relative to 2004, and a -2% rate decrease was taken late in 2004 that further contributed to lower premium volume in 2005. In addition, Take-out activity continued at high levels relative to available renewals, meaning that the proportion of renewal business remaining in the Plan remained small in 2005. In 2006, we see more of the same. One might have expected that the -5.6% rate decrease effective January 15, 2006 would slow the decline in new applications relative to 2005, but new application data through February 2006 shows that this has not occurred. New applications for the last three months came in 28% below

the corresponding period in 2005. Further, an analysis of the change in new applications by New York State region indicates that depopulation continues across all regions, despite the rate decrease. This is an indication that voluntary carriers continue to take risks that would have normally gone into the Plan even in regions of New York where the AIP rates are perceived to be more inadequate than others.

Table 1.2 displays the February through April new application trend by region relative to 2005.

The depopulation of the NYAIP continues in all regions even after the -5.6% rate decrease. This is a strong indication that Plan volume may

TABLE 1.2 : NEW APPLICATION TREND IN FEBRUARY THROUGH APRIL

Region	New Applications		
	Feb-Apr 05	Feb-Apr 06	Change
NY City	20,462	12,907	-37%
Metro (incl. LI)	18,198	12,871	-29%
Upstate Urban	9,871	7,466	-24%
Other	10,108	7,429	-27%
Total	58,639	40,673	-31%

be more strongly impacted presently by the soft non-standard voluntary market continuing to fight for market share. With increased pricing sophistication, voluntary carriers may feel that they can

write much of the business that previously went into the Plan at an adequate rate (at least until they can gather credible data to determine otherwise).

Additional factors may be contributing to the continued depopulation, such as the ineligible applicant program that prevents some of the 'churning' seen in the past. There is also anecdotal evidence that more NYC drivers are purchasing insurance out of state while still garaging and operating their vehicles in New York.

Based on these trends, we foresee a further decline of approximately 30% in Plan volume during 2006 relative to 2005. This would result in expected 2006 Plan volume close to \$250 million.

An obvious consequence of this dramatic depopulation will be **if voluntary carriers can truly 'cherry pick' the best risks out of the Plan, loss costs in the Plan will dramatically increase.** Since the remaining distribution of



risks in the Plan will include only those risks that voluntary carriers perceive they cannot write at rate levels that are competitive with the Plan, **the risks remaining in the Plan will carry a much higher combined ratio.** If non-standard carriers are properly selecting the best risks from the Plan, deterioration in NYAIP results should be observed relatively soon, when accident year 2005 or 2006 data becomes available to AIPSO for analysis.

Similar trends are being observed in virtually all the other large Assigned Risk states such as New Jersey, California, Texas and Pennsylvania. We believe similar dynamics are also affecting these markets.

underwriting

EXPANSION AND CONTRACTION

The significant decrease in our NYAIP assignments could prove difficult to manage for other organizations as they find themselves in under or overstaffed positions based on the fluctuating Plan size. These periods of Plan expansion and contraction could lead to high employee turnover during the low points in the cycle, and deterioration of service during the cycle peak times.

To ensure that we are prepared for variations in volumes across our product lines, our Underwriting teams are continually engaged in cross-training initiatives to hone their skill sets across multiple products and functions. This allows us to shift resources as volumes fluctuate with the changes inherent in our business.

In summary, New York Plan volume continues to decline in 2006 and there is evidence that the downturn in the AIP volume cycle may not be bottoming out yet. In addition, when the cycle does turn, the volume shift may not be nearly as dramatic as was witnessed the last time the cycle turned, due to delayed reaction time as carriers slowly gather enough credible data in their highly segmented pricing cells to react to individual rate inadequacies that may emerge.

*~Ben Walden
VP, Chief Actuary*

Employee feedback related to our many training initiatives has been very positive. These programs allow our Underwriting staff to grow and develop, while gaining the business expertise that leads to improved customer service. Our unique ability to manage the ebbs and flows of our business cycles allows both our customers and employees to be confident in AutoOne's stability and continued growth.

Our ability to manage our resources while enhancing our market expertise makes our environment dynamic and exciting. AutoOne is an evolving organization and our flexibility to meet the challenges of a changing environment is just "business as usual" at AutoOne!

*~Myra Rakosky
VP, Underwriting*

claims management

LAUNCHES AUTOONE CLAIM SERVICES

As we prepare for yet another marketing season and the opportunity to manage your AIP business, our Claims Management team is hard at work conceptualizing and launching a brand new service offering, AutoOne Claim Services (**AOCS**).

AOCS is another arm of the Claims Management branch that provides outsourced

claim services to companies who do not currently have an employee presence in the New York market or who need assistance in managing overflow Special Investigations (SIU) and Material Damage vehicle appraisal operations. AOCS will provide timely and accurate information to clients, aiding them in making the right business decisions and allowing them to



concentrate on their core claims missions.

Special Investigative services will include all forms of claims investigations with an expertise in handling complex No-Fault cases, specialized vehicle theft investigations, development of state mandated fraud prevention plans, signed or recorded statements and general hourly rate investigations tailored to each clients specific needs. Additional Material Damage services will include property and casualty automobile vehicle appraisals and contracted third party administrative claim adjusting services.

Our resources are already in place with the technology to service these accounts. We offer experienced personnel and equipment that other firms would need to go outside to purchase. AutoOne continuously searches for

new and innovative ways to serve the automobile insurance industry, further complementing our broad service offerings.

If you or someone in your organization is interested in learning about our exciting new Claims Services, please contact Harvey Aloni, via e-mail at: HAloni@AutoOneIns.com or by telephone: 631-547-2011.

At the time of this writing, we were in the process of filing the necessary paperwork to make **AOCS** available in New Jersey.

AutoOne Claim Services is a full-service claim operation, managed by AutoOne Management Company, Inc.

*~Ralph Marinello, Jr.
VP, Claims*

finance

ASSIGNED RISK INVOICING 101

Our LAD and CLAD clients are sometimes uncertain as to when they will receive their Assigned Risk invoices. We want to take this opportunity to 'demystify' our billing procedures, so that the process is as clear as possible.

Our Assigned Risk invoices are based upon receipt of the quarterly AIPSO and TAIPA circulars. In states with Assigned Risk Plans that are managed by AIPSO, (all states other than Texas), we bill on the 'off quarter' which lags the calendar quarter by one month. For example, the AIPSO second quarter is May – July, so our invoices are issued soon after we receive the AIPSO quota circular in May.

In Texas, the Assigned Risk Plan is managed by TAIPA. TAIPA circulars are on a calendar quarter, and are therefore billed separately from the other states. For example, the TAIPA second quarter is April – June 2006, so our invoices are issued soon after we receive the TAIPA quota circular in April.

New York Take-out Credit fees are billed when the Take-out Credits are applied to and impact our client quotas, which is usually a two quarter lag. For example, Take-out Credits generated from policies effective in the first quarter of 2006 are reported to AIPSO in the second quarter 2006.

Credit fees due to AutoOne will be billed in the third quarter when the August AIPSO circular is received. This circular verifies that the credits have been applied to impact a company's AIP quota.

Quota years are kept separate for billing purposes so that during the first half of any particular calendar year clients receive two invoices; a quarterly 'true-up' invoice for the prior year and another invoice for the current year's quota. The final 2005 quota year invoice is issued soon after we receive the August AIPSO circular. Payment terms are 30 days with a due date reflected on the invoice.

Billing periods in all states except Texas are on a year-to-date basis as of current circular period. The Texas invoices are based on the estimated premium for that given quarter. In September, following the close of the prior calendar year, the final year-end TAIPA reports are mailed and any Assigned Risk fees for the prior year would be adjusted at that time.

We realize this is a unique process and as a part of our commitment to our valued clients, we are happy to answer any questions. Please contact: [Lisa Tancredi](mailto:Lisa.Tancredi) at: **631-547-2053**.



AutoOne in the News

Phil Gibson, Senior Vice President at AutoOne, was quoted in a recent news release on our partnership with Duck Creek Technologies' rating and policy administration platform tool, EXAMPLE; *"By lessening the time to implement rate changes, AutoOne increases response time necessary for the ever-changing auto insurance market."*

To read the full release, ***"Proof of concept success key to AutoOne's Duck Creek decision"***

please visit: www.DuckCreekTech.com, May 2006

Our own AVP of Claims, Adam Karol, contributed to *Insurance & Technology's* virtual roundtable article focused on improving claims management. They discussed tapping technologies such as GIS, GPS and business intelligence to leverage relevant customer and incident information.

To read the full article, ***"Claims to Tame"***

please visit: www.InsuranceTech.com, February/March 2006 issue

In that same issue, Dennis Termotto (AVP, Claims) and Harvey Aloni (AVP, SIU) were interviewed on the launch of AutoOne Claim Services.

To read the full article, ***"Outsourced Claims Services"***

please visit: www.InsuranceTech.com, February/March 2006 issue

(Cont'd from cover)

be brought to bear to drive Assigned Risk costs down even with this difficult market. You'll gain valuable insight regarding AutoOne's specialized business processes throughout this newsletter. I hope you find this information interesting and useful.

We also want to thank our clients and friends for their business support. We look forward to continuing our great relationships and reaching out to new clients. If you have any questions or thoughts on how we could serve you better, please don't hesitate to let us know.

*~Carey D. Benson
President & CEO*

Questions? Contact Us.

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