MARTIN O'MALLEY
Governor

ANTHONY G. BROWN
Lt. Governor

THERESE M. GOLDSMITH
Commissioner

KAREN STAKEM HORNIG
Deputy Commissioner

MARYLAND
INSURANCE ADMINISTRATION

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April 4, 2012

Honorable Thomas V. Mike Miller, Jr.
Senate of Maryland
H-107 State House
State Circle
Annapolis, MD 21401

Honorable Thomas M. Middleton
Chairman
Senate Finance Committee
3 East Miller Senate Building
Annapolis, MD 21401

Honorable John C. Astle
Vice-Chairman
Senate Finance Committee
123 James Senate Office Building
Annapolis, MD 21401

Honorable Michael E. Busch
House of Delegates
H-101 State House
State Circle
Annapolis, MD 21401

Honorable Dereck E. Davis
Chairman
Economic Matters Committee
Room 231, House Office Building
Annapolis, MD 21401

Honorable David D. Rudolph
Vice-Chairman
Economic Matters Committee
Room 231, House Office Building
Annapolis, MD 21401

Gentlemen:

Pursuant to the Memorandum of Understanding dated November 14, 2008 between the Maryland Insurance Administration and the Maryland Automobile Insurance Fund, enclosed please find the Maryland Insurance Administration's 2011 Report on the Study of the Surplus of the Insured Division of the Maryland Automobile Insurance Fund.

Very truly yours,

Therese M. Goldsmith

Therese M. Goldsmith
Commissioner

Enclosure

cc: Victoria L. Gruber, Esq.
Kristin F. Jones, Esq.
Tami Burt
Robert Smith, Esq.

Study of the Surplus of the Insured Division of the Maryland Automobile Insurance Fund

MARYLAND
INSURANCE
ADMINISTRATION

April 4, 2012

For further information concerning this document contact:

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This document is available in alternative format upon request
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I. Report Background

On November 14, 2008, the Maryland Insurance Administration (MIA) and the Maryland Automobile Insurance Fund (MAIF) entered into a Memorandum of Understanding (MOU) (See **Exhibit A**) to formalize a process to review MAIF's surplus annually for a period of five years. The parties entered into the MOU as a result of the Joint Chairmen's report of the 2008 Session, which directed them to work together to identify options on methods of determining the reasonableness of MAIF's surplus. Pursuant to the MOU, on October 25, 2011 MAIF filed with the MIA a report on the results of its analysis of surplus, and its conclusion as to whether its surplus is excessive (the 2010 Surplus Analysis Report - see **Exhibit B**). The MIA is required to review MAIF's analysis and conclusion and determine whether MAIF's surplus is excessive in light of its statutory purpose, market conditions and economic climate. What follows is the result of the MIA's analysis regarding the reasonableness of MAIF's surplus level as of December 31, 2010.

This is the third analysis since the execution of the MOU. The last analysis of MAIF's surplus was performed as of December 31, 2009. The results and conclusion of the review were communicated in a report dated January 7, 2011 to the Presiding Officers of the General Assembly and the Chair and Vice Chair of the Senate Finance and House Economic Matters Committees. The report concluded that due to the current economic uncertainty and recent declines in MAIF's surplus, MAIF's surplus level as of December 31, 2009 was not excessive. The MIA suggested that due to MAIF's unique status as Maryland's automobile insurer of last resort, which makes MAIF unable to control its premium volume, it should undertake a comprehensive analysis of its operations and the various factors that impact its operating results, with a goal of establishing a range within which its surplus would reasonably be considered to be neither excessive nor deficient. On May 2, 2011, MAIF requested from the MIA and was granted an extension of the deadline for filing its 2010 Surplus Analysis Report in order to engage an expert to assist in determining the surplus range. MAIF subsequently determined that engaging an expert would be cost prohibitive. On October 25, 2011, MAIF filed its 2010 Surplus Analysis Report with the MIA.

II. Factors Review

Part of our review of MAIF's 2010 Surplus Analysis Report involved analyzing and verifying the data it contained. Additionally, the MOU requires the MIA to evaluate MAIF's surplus based upon the following factors:

a. the ratio of the surplus to the assessment trigger;
b. the surplus as measured by RBC;
c. the ratio of premium to surplus;
d. external economic factors, including the overall financial climate;
e. trends in the automobile insurance market nationally and in Maryland; and

f. financial projections including projected premium and surplus levels for the next twenty-four months.

A. Ratio of surplus to the assessment trigger

If MAIF's surplus were to fall below two statutorily designated triggers, Section 20-404 of the Insurance Article provides an assessment mechanism. The first of these is the private passenger auto assessment limit, which requires an assessment when the year-end surplus is less than 25% of the average of MAIF's net direct written private passenger auto premiums for the three immediately preceding calendar years. The second is the commercial auto assessment limit, which requires an assessment when the year-end "commercial auto surplus"[1] is less than 25% of the average of MAIF's net direct written commercial auto premiums for the three immediately preceding calendar years. Because MAIF's private passenger auto premiums are significantly higher than its commercial auto premiums, the private passenger auto assessment limit is significantly greater than its commercial auto assessment limit. We therefore limited our review to the private passenger auto assessment limit.

Presented below is the five-year historical trend in MAIF's private passenger auto assessment limits:

Private Passenger Auto

	2010	2009	2008	2007	2006
Surplus	124,271,479	128,749,019	138,701,647	184,753,525	178,308,496
Direct Prem Written	102,336,300	98,268,674	103,855,069	113,918,008	135,758,331
Average Three Year Direct Prem Written	101,486,681	105,347,250	117,843,803	141,115,306	178,424,289
Assessment Trigger (Avg. prem * 25%)	25,371,670	26,336,813	29,460,951	35,278,826	44,606,072
Ratio of Surplus to Assessment Trigger	4.90	4.89	4.71	5.24	4.00

The MIA believes that the small increase in this ratio from 2009 to 2010 is not indicative of an unreasonable, excessive level of surplus.

B. Surplus as measured by RBC

Risk Based Capital (RBC) is a method for establishing the minimum amount of capital an insurance company must have to support its business operations based upon the company's size and risk profile. RBC standards are used to determine when to take regulatory actions relating to an insurer that shows indications of a weak or deteriorating financial condition. It also provides an additional standard for minimum capital requirements that companies must meet to avoid being placed into receivership. As such, RBC is not intended to be a measure of excessive surplus. In fact, Section 4-302 of the

[1] MAIF's surplus is not segregated between its private passenger auto business and its commercial auto business. However, for purposes of determining assessment limits under Section 20-404 a "commercial auto surplus" is determined annually by its Board of Trustees. For the year ended December 31, 2010, the Board of Trustees determined the 'commercial auto surplus" to be $47,223,968. The commercial auto assessment limit was $2,770,775.

Insurance Article provides that it is the public policy of the State that, in order to safeguard the solvency of the insurance business in the State, an insurer should maintain capital in excess of minimum RBC levels to secure the insurer against risks, inherent in the insurance business that are not accounted for in the RBC formula. However, if MAIF's RBC ratio were an outlier when compared to other insurers, it could be indicative of either excessive or insufficient surplus.

Presented below is a listing of the top 15 writers of automobile insurance in Maryland. MAIF'S RBC as expressed as a multiple of authorized control level RBC was 834% as of December 31, 2010.

Surplus as Measured by RBC

Company Name	Direct Premiums Written ($000's)	RBC as % of Authorized Control Level
State Farm Mut Auto Ins Co	657,233	853%
Geico Gen Ins Co	341,068	3,973%
Erie Ins Exch	281,607	1,135%
Government Employees Ins Co	272,378	1,009%
Allstate Ins Co	233,087	624%
Nationwide Mut Ins Co	164,336	574%
Nationwide Gen Ins Co	132,651	51,653%
United Serv Automobile Assn	123,605	1,346%
Allstate Prop & Cas Ins Co	122,260	27,273%
Geico Ind Co	112,792	1,061%
Maryland Automobile Insurance Fund	**111,905**	**834%**
Progressive Advanced Ins Co	104,893	1,084%
Liberty Mut Fire Ins Co	95,623	551%
State Farm Fire & Cas Co	87,523	614%
USAA Cas Ins Co	83,131	25,968%

When compared to the top 15 writers of automobile insurance in Maryland, MAIF's RBC ratio ranked in the mid to lower end of the range. Thus, the RBC ratio comparison does not provide evidence that MAIF's surplus is excessive; rather, it implies that MAIF's current surplus level is reasonable, compared to other insurers writing automobile insurance in the State.

C. The ratio of premium to surplus

The ratio of premium to surplus is a calculation commonly used by the property and casualty insurance industry as a measure of financial strength or to indicate to what degree a particular insurance company is leveraged. The ratio is designed to measure the ability of an insurer to absorb above-average losses, and is computed by dividing direct premiums written by surplus.

Presented below is the five-year historical trend in MAIF's ratio of premiums to surplus:

Ratio of Direct Premiums Written to Surplus

Total	2010	2009	2008	2007	2006
Surplus	124,271,479	128,749,019	138,701,647	184,753,525	178,308,496
Direct Premiums Written	111,904,499	109,168,500	116,636,349	128,672,269	153,127,205
Ratio of Premiums Written to Surplus	90%	85%	84%	70%	86%

The increase in MAIF's premium to surplus ratio from 2009 to 2010 means that there was less surplus in relation to premiums written in 2010 than in the past. The MIA believes that the increase in this ratio is not indicative of excessive surplus.

D. External economic factors, including the overall financial climate

The U.S. economy continues to struggle with the effects of the recent recession, which was caused by unstable financial and real estate markets. The downturn in the economy has had a significant impact on the automobile insurance industry. According to a report dated April 20, 2011 by the Insurance Research Council, despite laws in many states requiring drivers to maintain insurance, about one in seven motorists across the United States remain uninsured. According to the report, "The estimated percentage of uninsured motorists declined in four straight years before rising to 14.3 percent in 2008 and dropping to 13.8 percent in 2009. The economic downturn is thought to be a major factor in the brief increase."

In its 2010 Surplus Analysis Report, MAIF indicated that the continuing sluggish economy and related high unemployment levels have caused consumers to curb spending, resulting in many Maryland drivers choosing to go uninsured. MAIF believes these factors have contributed to its decline in direct premiums written from $153.1 million in 2006 to $111.9 million in 2010. Furthermore, the Report noted that MAIF continued to experience a decline in premiums written in 2011, with a 27.8% decline during the first eight months of the year and a projected 25% overall decline for the year.

MAIF's surplus has historically declined in years when its premium volume significantly increased (i.e., due to increased administrative and claim expenses). As the economy improves, it is likely that MAIF will see an increased premium volume. Although it is impossible to predict the magnitude of MAIF's surplus decline should this happen, we believe MAIF should retain surplus to protect against this uncertainty.

E. Trends in the automobile insurance market nationally and in Maryland

The United States' property and casualty industry is in the midst of a prolonged soft market as ongoing economic issues, including high unemployment, have resulted in lower demand for insurance. A soft market is characterized by: intense competition for new business; insurers being willing to insure risks that are considered less desirable than usual; and an inability of insurers to increase premium rates to desired levels. According to data obtained from the National Association of Insurance Commissioners, the property and casualty industry's "combined ratio"[2] has trended upward from 93% in 2006 to 103% in 2010.

With regard to the Maryland automobile insurance market, we noted an increase in total premiums written over the past three years, and a slight improvement in the "pure direct loss ratio"[3] from 2009 to 2010. With regard to MAIF's business we noted a general downward trend in premiums along with an increase in the pure direct loss ratio, as depicted in the following chart:

Maryland Automobile Insurance Market	2010	2009	2008	2007	2006
Total Maryland Direct Premiums Written	4,214,776,000	4,032,360,000	4,020,112,000	4,174,663,000	4,121,866,000
Pure Direct Loss Ratio	63%	65%	63%	61%	57%
MAIF Direct Premuims Written	111,904,499	109,168,500	116,636,349	128,672,269	153,127,206
MAIF Pure Direct Loss Ratio	79%	78%	72%	64%	59%

In its 2010 Surplus Analysis Report, MAIF cited several adverse trends in the Maryland automobile insurance market. Specifically, MAIF noted a significant increase in the average cost of medical expenses submitted to MAIF for bodily injury claims. Also, MAIF noted increases in the motor vehicle parts and equipment consumer price index and the motor vehicle maintenance and repair consumer price index, which will result in increased repair costs. Furthermore, MAIF cited the increasing number of Maryland motorists electing to forego buying insurance.

It is likely that the increased competition for business among automobile insurers in the current soft market has helped contribute to the decline in MAIF's premium volume. As the market hardens, these insurers may choose to tighten underwriting standards, resulting in drivers needing to turn to MAIF for insurance. As discussed above, an increased premium volume could result in MAIF experiencing a decline in surplus. (Note that these additional policyholders would be in addition to the new policyholders MAIF anticipates as the economy improves and drivers that are currently uninsured once again purchase insurance, as discussed in Section D above.) In addition, the increasing claim costs associated with increasing medical and repair costs could result in operating losses if premium rates prove to be insufficient. We believe MAIF should retain adequate surplus to protect against these uncertainties.

F. Financial projections including projected premium and surplus levels for the next twenty-four months

MAIF projected a continued decline in earned premium in 2011 and 2012, despite a rate increase in 2011, due to continued decreases in the number of policies written as

[2] The "combined ratio" depicts the ratio of underwriting expenses (claim costs, claim handling, claim adjustment and administrative expenses) to premiums earned.

[3] The "pure direct loss ratio" is the ratio of claim costs to premiums earned. The ratio does not include costs other than claim costs, such as claim handling, claim adjustment and administrative expenses.

economic issues continue. MAIF projected net incomes of $333,000 and $1.3 million[4] for 2011 and 2012, respectively. However, it projected a decline in surplus of $13.5 million for the year ended December 31, 2011 due to anticipated significant investment market declines.

MAIF's financial projections support MAIF's view that its surplus is not excessive.

III. Conclusion:

The continued economic uncertainty, coupled with the impact from the current soft insurance market, leads the MIA to conclude that MAIF's current surplus is not excessive.

[4] As can be seen on Exhibit 2 to MAIF's 2010 Surplus Analysis Report, the projected increase in net income from 2011 to 2012 is attributable to a decrease in projected premiums, and a resulting decrease in its net underwriting loss.

**MEMORANDUM OF UNDERSTANDING
BETWEEN THE
MARYLAND AUTOMOBILE INSURANCE FUND
AND THE
MARYLAND INSURANCE ADMINISTRATION**

THIS MEMORANDUM OF UNDERSTANDING ("MOU") dated this 14th day of November, 2008 is made by and between the Maryland Automobile Insurance Fund ("MAIF") and the Maryland Insurance Administration ("MIA").

Whereas, on October 3, 2008, the MIA and MAIF jointly submitted to the Senate Budget and Taxation Committee and the House Appropriations Committee ("the Committees") a report regarding the surplus in MAIF's Insured Division; and

Whereas, MAIF and the MIA are committed to keeping the Committees informed on an annual basis regarding MAIF's surplus; and

Whereas, one of the purposes of the October joint report was to make recommendations on the options for determining whether the MAIF surplus is excessive; and

Whereas, in the report, the MIA and MAIF committed to enter into a MOU by December 15, 2008, to formalize an annual review of MAIF's surplus.

NOW, THEREFORE, MAIF and the MIA have agreed to execute and implement this MOU for the purpose of formalizing a process to review MAIF's surplus annually, and inform the Committees of the results.

A. REPORT FILING REQUIREMENTS

1. Section 20-506(b) of Maryland's Insurance Law requires MAIF's Board of Trustees to review the reasonableness and adequacy of reserves on an annual basis. Prior to May 1, 2009 and prior to May 1 of each year thereafter, MAIF agrees to file with the Insurance Commissioner ("Commissioner") a detailed report on a variety of economic and market factors including those enumerated in Section C, as well as its conclusion as to whether its surplus is excessive.

2. By June 30 of each year, the Commissioner shall review MAIF's analysis and conclusion and determine whether MAIF's surplus is excessive in light of its statutory purpose, market conditions and economic climate. Prior to the June 30 deadline, the Commissioner may request additional information from MAIF.

B. REQUIRED FACTORS FOR ANNUAL REPORT

1. The MIA will evaluate the MAIF surplus based upon the reporting on the following factors:

Exhibit A

a. the ratio of the surplus to the assessment trigger;
b. the surplus as measured by Risk Based Capital ("RBC");
c. the ratio of premium to surplus;
d. external economic factors, including the overall financial climate;
e. trends in the automobile insurance market nationally and in Maryland;
f. financial projection including projected premium and surplus levels for the next twenty-four (24) months.

2. The MIA may request any other document that it reasonably believes is necessary to the evaluation of the MAIF surplus. MAIF agrees to respond in a timely manner to the MIA's request for additional information.

3. In making its determination, the MIA must also consider factors including:

a. type of insurance provided by the insurer;
b. quality of the risk assumed by the insurer;
c. geographic scope of the insurer's market;
d. insurers' relative market share and competitive position in the marketplace;
e. overall best interest of the insurance consumer.

C. Commissioner's Determination

1. If the Commissioner determines that MAIF's surplus is excessive, the Commissioner will order MAIF to develop a plan, within a timeframe set by the Commissioner, to accomplish any necessary reduction of MAIF's surplus.

2. The plan would include the recommended method for reduction, which could include reduction of rates or rebates to current and/or former policyholders and a proposed timeline for the reduction.

3. If MAIF's recommended plan is found insufficient, the Commissioner could direct policyholder relief in the form of reduced insurance premiums or direct rebates to current and/or former insureds.

4. The Commissioner has the authority and discretion to, if necessary, hold a hearing and/or employ the services of an outside actuary as an aid to arrive at a determination.

D. Distribution of the Report

In addition to posting the MIA report on the MIA's website, the MIA will submit its report to:

1. the presiding officers of both chambers of the General Assembly;
2. the Chair and Vice-Chair of the Senate Finance;
3. the Chair and Vice-Chair of the House Economic Matters Committees.

E. TERM OF AGREEMENT

This MOU shall begin on the date it is signed by both parties and continue for a term of five (5) years or until terminated by agreement of the parties.

F. NOTICE

Any notice given pursuant to this MOU shall be in writing and shall be considered to have been fully given when actually received by the following persons (or their successors).

M. Kent Krabbe, Executive Director
Maryland Automobile Insurance Fund
1750 Forest Drive
Annapolis, Maryland 21401-4294

Ralph S. Tyler, Insurance Commissioner
Maryland Insurance Administration
525 St. Paul Place
Baltimore, Maryland 21202-2272

Individuals and addresses for such notices may be changed by notice given as provided herein.

G. AMENDMENT

This MOU may be amended or modified only as MAIF and the MIA mutually agree in writing.

IN WITNESS WHEREOF, the parties have caused these presents to be executed, by and through their undersigned authorized representatives, as of the date first above written.

Witness:

Trish Winkler

Maryland Insurance Administration
Ralph S. Tyler, Insurance Commissioner

Ralph S. Tyler

Witness:

Maryland Automobile Insurance Fund
M. Kent Krabbe, Executive Director

Kent Krabbe

Approved for Form and Legal Sufficiency

Assistant Attorney General
Principal Counsel for MIA

Date: NOV. 14, 2008

maif

M. Kent Krabbe, Executive Director

Maryland Automobile Insurance Fund

October 25, 2011

The Honorable Therese M. Goldsmith
Commissioner
Maryland Insurance Administration
200 St. Paul Place, Suite 2700
Baltimore, Maryland 21202

RE: Maryland Automobile Insurance Fund's 2011 Analysis of Surplus Report

Dear Commissioner Goldsmith:

Pursuant to the November 14, 2008 Memorandum of Understanding entered into with Commissioner Tyler, herewith is the Maryland Automobile Insurance Fund's 2011 Analysis of Surplus Report.

MAIF's surplus continues to remain reasonable and not excessive. Despite the sluggish national economic recovery, MAIF's 2010 financial results slowed the surplus decline from the prior year. MAIF's healthy surplus will continue to allow us to provide automobile insurance to those eligible Maryland residents without assessing the Maryland driving public.

Very truly yours,

Kent Krabbe

M. Kent Krabbe

MKK/sel
Enclosure
cc: Neil Miller
Lynn Beckner

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kkrabbe@emaif.com ◆ www.emaif.com

Maryland Automobile Insurance Fund's 2011 Surplus Analysis

In 2010, the Maryland Automobile Insurance Fund's surplus declined for the third consecutive year. MAIF sustained a $13.9 million operating loss, but a recovering investment portfolio again contributed positively, and as a result, surplus diminished by slightly under $4.5 million. At the end of 2010, surplus stood at $124,271,479 down from a 2009 year-end figure of $128,749,019.

As in 2009, the slowing in the magnitude of the decline in the surplus as compared to 2008 was a welcome development. Surplus stability, however, given MAIF's role in the market, will remain an elusive goal. Twice in this decade, the MAIF surplus has declined by almost $50 million in a single year.[1] In contrast, in the two year period between 2004 and 2005, surplus grew over $50 million.[2] Volatility is the only constant, and these results conclusively establish the importance of MAIF maintaining a healthy gap between its surplus and its statutorily mandated assessment trigger.

The purpose of the analysis that follows is to review a variety of factors that compel the conclusion that the $124.2 million year-end 2010 surplus is not excessive within the meaning of a Memorandum of Understanding ("MOU") entered into between MAIF and the Maryland Insurance Administration ("MIA") on November 14, 2008. *See* Section II, infra., for further details on this Memorandum of Understanding. The Memorandum procedures supplement an October 3, 2008 study that determined MAIF's August 31, 2008 surplus of $171 million was reasonable. That study also cautioned that "In light of the nation's financial crisis, the full implications of which remain unknown, prudence councils strongly against reducing MAIF's surplus." *See* October Study at 1.

That advice proved prescient throughout 2008 and 2009, and remains true today. During the remainder of 2008 and into 2009, the nationwide economic crisis saw continued contraction of the MAIF surplus. Surplus fell from the $171 million figure in August of 2008 to $139 million at the end of 2008. It dropped further to $129 million at the end of 2009, and declined further to $124.3 million at the end of 2010.

To some degree, then, this report has outlived its usefulness. Conceived during a period of surplus growth, it is written after three consecutive years of surplus decline. Overall, since the original study, MAIF's surplus has dropped from $171 million to $124.3 million. If $171 million was not excessive, and the intervening years demonstrated conclusively that it was not, then a $124 million surplus is not likely to be excessive either. For this, and the other reasons outlined in this report, MAIF again believes that "prudence councils strongly against reducing MAIF's surplus."

I. Overview

MAIF serves Maryland automobile insurance consumers and the state's compulsory insurance system by insuring those eligible applicants who have been turned

[1] $51.8 million in 2002, $46 million in 2008.
[2] $51.4 million

down by two other carriers or cancelled by one carrier. In this role it reacts to Maryland's insurance market needs. Application volume has fluctuated from 250,000 applicants in one year to 65,000 applicants in another year, as the private industry expands or contracts in capacity. MAIF manages through these business cycles successfully, growing surplus when it can, seeing surplus drawn down when it must, while avoiding an assessment on the Maryland driving public since 1989.

This report is not a study of MAIF's solvency. Such a study of carriers is a well defined process at the Maryland Insurance Administration. This study is a unique endeavor trying to determine what is too much, whether MAIF is too healthy, and whether MAIF should risk a future assessment by artificially, and intentionally, lowering surplus. To decide that, pursuant to the Memorandum of Understanding with the MIA, MAIF has reviewed a number of specified factors to determine whether its surplus is excessive in light of its statutory purpose, including three financial ratios, market conditions, and the nation's economic climate. With only one of the specified ratios improving slightly from 2009, the overall result again compels the conclusion that MAIF's year-end 2010 surplus level of $124.3 million is not excessive.[3]

Moving forward, MAIF does not project a quick improvement in the nation's financial sector or unemployment rates generally, and as explained more fully below, expects continued pressure on its surplus throughout 2011. Importantly, MAIF believes that its 2011 year-end surplus will be adequate to avoid a 2012 assessment.

II. Report Background

This report traces its lineage directly to a November 14, 2008 Memorandum of Understanding between the Maryland Automobile Insurance Fund and the Maryland Insurance Administration. That MOU itself was an outgrowth of a mandate contained in the 2008 Joint Chairman's Report on the State Operating Budget. In the Joint Chairman's Report, MAIF and the MIA were asked to study and provide recommendations on three topics, including a determination of the reasonableness of the MAIF surplus.

The study requested in the Joint Chairman's Report was completed and submitted on October 3, 2008 ("the October Study"). It reviewed the MAIF surplus as of the end of August 2008. While concluding that the MAIF surplus was not excessive, given its 2008 size, MAIF and the MIA also recommended a yearly formal review of the MAIF surplus.

MAIF submitted a report to the MIA on April 30, 2009 with 2008 year-end data. In light of near catastrophic nationwide economic disruption, and highlighting a large drop in MAIF's surplus, the review concluded MAIF's remaining surplus was not excessive. MAIF submitted a second report in May of 2010, with an analysis of year end 2009 data. After a rigorous review, the Administration again concluded that the surplus was not

[3] For convenience, various figures relating to MAIF's 2009 operating results are attached as Exhibit 1. The full figures, and the source for the year-end numbers reproduced in Exhibit 1 are MAIF's year-end Annual Statements, on file with the MIA.

excessive. This report includes year-end 2010 data attached in Exhibit 1, notes the further erosion of surplus, and again supports the conclusion that MAIF's surplus is not excessive.

III. Required Factors Review

Six factors are to be reviewed in this analysis. The first three of these measure a variety of ratios to surplus, and provide tools for determining whether MAIF's surplus is growing or shrinking in comparison to its business volumes. The next two call for a review of insurance and financial trends, and the final one calls upon MAIF to project premium and surplus levels for year-end 2011 and 2012.

Reflecting the decline in MAIF's overall surplus, all but one of the required ratios of surplus to other factors discussed below has weakened since the last report. Further, MAIF's review of the external operating environment and its financial projections strongly caution against any artificial lowering of the MAIF surplus, as MAIF projects that surplus will not grow as the economy has yet to yield sufficient job recovery and the economic recovery remains tenuous.

A. The Analysis of the Requested Ratios

1. The Ratio of the Surplus to the Assessment Trigger

The strength of the ratio of MAIF's surplus to its assessment trigger is perhaps the best measure of the adequacy of its surplus. As the October Study noted, MAIF's 2000 to 2003 financial history shows that a surplus to assessment ratio "as high as 6-to-1" is not excessive. *See* October Study at page 9. At the end of 2009, this critical ratio stood at 4.36. This figure was obtained by dividing the 2009 year-end surplus of $128,749,019 by the assessment trigger of $29,539,760.

In 2010 MAIF's ratio of surplus to assessment trigger strengthened slightly from 4.36 to 4.42. This ratio, while healthy, still stands below the 6-to-1 ratio that proved vital in the 2000 to 2003 time frame. It therefore strongly suggests surplus is not excessive.

2. The Surplus as Measured by Risk Based Capital

The October 2008 Study recognized that in addition to comparing MAIF's surplus to MAIF's assessment trigger, it could be a useful measuring tool to compare MAIF's surplus to what would be its authorized control level if MAIF were acting under risk based capital standards. While the report was quick to caution that "minimum risk based capital cannot be viewed as a measure of a company's health", it was thought that the ratio could provide a tool to compare MAIF to other insurers in Maryland. Under this comparison, MAIF's ratio of 2009 surplus to risk based capital authorized control level was 8.38.

During 2010, this ratio weakened. It fell from 8.38 in 2009 to 8.34 in 2010. This erosion, while modest, further indicates that surplus is not excessive.

3. The Ratio of Premium to Surplus

In calendar 2010, MAIF's direct written premium increased $2.7 million, but earned premium continued to decline. Overall, direct written premium rose from $109 million to $112 million. Earned premium fell from $113 million to $112 million. These figures reflect a further decline during 2010 of MAIF's overall book of business.

Indicating a continued weakening of the MAIF surplus, the earned premium to surplus ratio for 2010 went from 0.88 to 0.90 and the ratio of direct written premium to surplus went from 0.85 to 0.90. This slight deterioration of the surplus to premium ratio is further evidence that MAIF's surplus is not excessive.

Overall, these ratios indicate the MAIF year-end 2010 surplus is not excessive. The slight improvement in one, the surplus to assessment trigger ratio, is welcome, but even that ratio still strongly suggests that the 2010 MAIF surplus is not excessive. The year-end 2010 ratio still trails badly the October 2008 ratio. Taken together, the three ratios covered in this portion of the analysis illustrates the fact that in addition to a momentary decline in absolute surplus, there was also a relative decline in surplus to the majority of the measuring standards.

B. External Economic Factors, Including the Overall Financial Climate

While the ratios detailed above provide an important snapshot of the MAIF surplus, that picture always needs to be placed into the context of an expanding or contracting economy. This economic picture is an element of predicting MAIF's future surplus needs. Therefore, the Memorandum of Understanding requires MAIF to analyze the external economic factors, including the overall financial climate.

A careful review of the most recent economic data indicates that this recession is proving to be much more persistent and problematic than was previously thought. While there has been some slight economic improvement, the continuation of that improvement is suspect given the ongoing employment climate in the state of Maryland.

Last year at this time, there were some signs that the economy may be improving. That improvement appeared to be short-lived. Retail sales, housing starts, service sector employment and manufacturing are all languishing. The first quarter 2010 GDP figures show growth at a very modest 2%, compared with a 5.6% gain in the fourth quarter of the prior year. This decrease in GDP is considered by many to be an indication of very poor growth prospects. Consumers continue to hold back on their spending and businesses are responding by not increasing production and employment.

Unemployment remains one of MAIF's greatest concerns. In the past, MAIF's volume (PIF) fell as unemployment increased. MAIF's surplus rose during periods of good employment and contracted during times of high unemployment. The Bureau of Labor reports Maryland unemployment continues to climb, reaching 7.4%. Nationwide, the unemployment rate is reported to be approximately 9.1%, which is the highest it has been in many years. These statistics have stubbornly resisted the federal and state governments' best efforts to spur employment opportunities.

Further, according to Federal Reserve reports, the economy is hobbled by a continued soft housing market. Certainly Maryland's housing market is indicative of the national trend in general.

With the economy still sluggish and the jobless rate stuck at 7.1%, MAIF feels it is prudent to maintain its time tested conservative approach and maintain a reasonable level of surplus. Current predictions for the end of the recession range from 2012 well into 2014. Much depends on the continued softness of the housing market, the construction industry, as well as the ever developing European financial crisis.

Finally, it is worth re-emphasizing language from MAIF's prior report. As noted last year, a 2008 report by the Insurance Research Council "uninsured motorist" concluded that:

> "As the economic downturn persists, consumers will seek additional ways to curb spending. Some consumers may choose to forego auto insurance, despite mandatory coverage requirements and financial responsibility laws in many states and the significant risk associated with driving uninsured.
>
> As more people lose their jobs, more tend to drive without insurance."

The report further states an increase in the unemployment rate of 1 percentage point is associated with an increase in the uninsured motorist rate of more than 3/4 of a percentage point. Maryland's unemployment has risen from an overall average of 4.4% in 2008 to 7.1% as of October 20, 2011. The significant increase in unemployment strongly suggests vehicle owners are going uninsured. As the economy strengthens and the unemployment rate decreases, these uninsured drivers may return to the insurance market, but find themselves unable to obtain coverage from private carriers. These individuals will more than likely be insured by MAIF since many carriers will not insure an individual with a gap in insurance coverage. If this proves correct, MAIF's surplus could erode quickly and dramatically.

This analysis indicates that MAIF needs to retain its surplus cushion against the economic difficulties throughout the 2011 – 2012 periods, as the national and state economies hopefully will continue their slow recovery.

C. Trends in the Automobile Insurance Market Nationally and in Maryland

At the beginning of 2011, the insurance industry found itself under significant negative pressures. Overall the forecasts are that the insurance industry will continue to face rising claims costs. If these claims costs are coupled with an increase in business volume at MAIF, pressures on the MAIF surplus will be severe.

The insurance industry faced greater price pressures in 2010 than did the overall U.S. economy. The Bureau of Labor Statistics has reported that the Washington – Baltimore Consumer Price Index for medical care increased 3.6% from September 2010 to September 2011.

The average cost of medical expenses submitted to MAIF for bodily injury claims has increased 86% from the first quarter of 2006 to the first quarter of 2011 (from $3,670 to $6,826). The change from first quarter 2010 to first quarter 2011 alone was 28%. Second quarter 2011 average submitted medical expenses were lower at $5,976, but still the second highest average ever. We believe that the increases in medical costs will continue, because of the mandatory increase in bodily injury limits enacted by statute on January 1, 2011.

For the six month period ending September, 2011, the Bureau of Labor Statistics reports that the motor vehicle parts and equipment consumer price index increased 7.3%, and the motor vehicle maintenance and repair consumer price index increased 3.7%. These increased costs flow directly to collision repairs. These rising claims costs will further draw down the MAIF surplus.

If, instead of prior trends where people leave private carriers and seek the MAIF alternative, people are now leaving private carriers and going uninsured, a time bomb in effect could be hidden within the system. As the economy recovers, uninsured drivers will attempt to reenter the market. Private carriers will refuse to write them due to the gap in coverage, and MAIF would be confronted with an exploding increase in volume. This "perfect storm" of circumstances has happened before and would put tremendous stress on MAIF's surplus. New business issuance cost and increasing claim settlement cost could add further stress to surplus levels.

In the end then the analysis remains the same. MAIF's claims costs will continue to rise, putting pressure on its surplus. If business volumes dramatically increase either now or as the economy recovers, that will further enhance the need for sufficient surplus. Under both scenarios, the existing surplus is not excessive.

D. Financial Projections

By far the most difficult exercise required by the Memorandum of Understanding is a prediction by MAIF of 2011 and 2012 premium and surplus levels. While the first eight months of 2011 provides some data upon which to make a year-end projection, 2012 results depend upon economic predictions, made in the midst of the hills and valleys in the recovery of the national economy.

MAIF projects a steep decline in policy writings in 2011 as the economic recovery continues to falter. MAIF experienced a 27.8% decline in policy writings during the first eight months of the year, and projects an overall decline of 25% by year end. MAIF implemented two rate changes in 2011, and these rate changes should yield a written premium of slightly over $90 million by the end of 2011, with an earned premium of almost $100 million. If these projections prove accurate, MAIF's surplus would remain flat. In 2011 however, based upon the first eight months of 2011, MAIF expects that significant investment market declines could reduce surplus by as much as $14 million.

In 2012, MAIF projects a 0 – 10% decline in policy writings, as the loss of applications begins to moderate. These projections do not anticipate any rate changes at this time for 2012. With the decline in policies, MAIF expects written premium of $85.5 million at the end of 2012, with an earned premium of $88.2 million. Under these projections, MAIF's surplus should remain fairly stable, absent significant swings in the investment market. (See attachment 2).

MAIF's financial projections then support the view that the current MAIF surplus will stabilize and cannot be viewed as excessive. A healthy surplus will allow MAIF to navigate the current economic uncertainty of 2011 and avoid assessments on the driving public in 2012.

IV. Conclusion

The dramatic decline in the MAIF surplus that began in calendar year 2008 continued through 2011, but at a slower pace. While operational results will improve significantly in 2011, MAIF expects further erosion of surplus due to investment market changes. Under these circumstances, the existing surplus cannot be viewed as excessive.

Despite this predicted decline in surplus, MAIF continues to be well poised to survive the economic downturn and thrive in the emerging recovery. Retaining sufficient surplus over several years with the support of the General Assembly has left MAIF, and the Maryland driving public, in a protected position moving forward.

Surplus Reporting Factors

	12/31/2010	12/31/2009
Surplus	$124,271,479	$128,749,019
Assessment Trigger	$28,142,446	$29,539,760
Risk Based Capital (RBC)		
Authorized Control Level (ACL)	$14,894,049	$15,366,583
Premium		
Direct Written Premium	$111,904,499	$109,168,500
Earned Premium	$111,931,923	$113,138,082
	2010	**2009**
Ratio of Surplus to Assessment Trigger	4.42	4.36
Ratio of Surplus to RBC Authorized Control Level	8.34	8.38
Ratio of Premium to Surplus		
Direct Written Premium	0.90	0.85
Earned Premium	0.90	0.88

Exhibit 1

Financial Projections

	Projected 2011		Projected 2012	
Written Premium	$90,822,388		$85,500,000	
Earned Premium	99,834,890		88,200,000	
Losses Incurred	63,894,329	**64.0%**	54,259,135	**61.5%**
Loss Expense Incurred	27,691,959	**27.7%**	25,578,000	**29.0%**
Other U/W Deductions	24,915,357	**25.0%**	24,074,440	**27.3%**
Total U/W Deductions	116,501,646	**116.7%**	103,911,575	**117.8%**
Net U/W Gain (Loss)	**(16,666,756)**	**-16.7%**	**(15,711,575)**	**-17.8%**
Investment Income	17,000,000		17,000,000	
Net Income (Loss)	$333,244		$1,288,425	
Beginning Surplus	$124,271,479		$110,736,209	
Net Income or (Loss)	333,244		1,288,425	
Change in Unrealized Gains/(Losses)	(14,225,001)		0	
Change in Non-Admitted	356,487		0	
Ending Surplus	$110,736,209		$112,024,634	

Exhibit 2