

EFFICIENCY STANDARDS

The data used in the calculations are downloaded from the NAIC Database. Data for California Licensed Insurers are collected from the Annual Statement (AS) & Insurance Expense Exhibit (IEE) information submitted by the insurers.

Components used in the calculations:

AS Statutory Page:	Direct Premiums Earned (Column 2)
California data	Direct Losses Incurred (Column 6)
	Commissions & Brokerage Expenses (Column 11)
	Taxes, Licenses & Fees (Column 12)
IEE Pages - Part III:	Premiums Earned (Column 3)
Countrywide data	Incurred Losses (Column 7)
	Adjusting & Other Expenses Incurred (Column 11)
	Other Acquisitions, Field Supervision, & Collection Exp. (Col. 27)
	General Expenses Incurred (Column 29)

Data Quality Edit: The Department conducts systematic data editing. An insurer's data will be excluded if:

- 1) The insurer is not licensed in California;
- 2) The insurer's California Direct Earned Premium is zero or less (negative premium);
- 3) The insurer's Countrywide Direct Earned Premium is zero or less;
- 4) The insurer's Countrywide Direct Losses Incurred is zero or less (negative losses);
- 5) The insurer's ratio of Underwriting Expenses, including adjusting and other expenses, to Earned Premium is equal to or less than zero (0%) or equal to or more than 65%.

Additionally, the following criteria are applied:

- 1) If an insurer's Commission < \$0, then set Com = 0;
- 2) If an insurer's CA allocated Other Acquisitions, etal. Exp < \$0, then set OAcq = 0;
- 3) If an insurer's CA allocated General Expenses Incurred < \$0, then set GE = 0;
- 4) If an insurer's Taxes, Licenses & Fees < \$0, then set TLF = 0.

Efficiency Standard Calculation (Revised 2006)

Overview:

An Efficiency Standard is calculated for each Line of Business. To compute the Efficiency Standard, it is necessary to assign a Marketing System Code (Direct Writer, Captive Agency or Independent Agency) to each company. The Department uses the "primary" marketing system of each California licensed insurer as provided by the insurers in a 1999 survey. The Efficiency Standard is based on the following five categories of Expenses Incurred in California:

1. Adjusting & Other Expenses Incurred (AOE)
formerly known as Unallocated Loss Adjustment Expenses Incurred (ULAE)
(note: we use AOE and ULAE interchangeably)

2. Other Acquisition Expenses, ... Incurred (OAcq)
3. General Expenses Incurred (GE)
4. Taxes, Licenses & Fees (TLF)
5. Commissions and Brokerage Expenses (Com)

Since the first three items do not have California specific data, we must allocate the Countrywide expenses to California.

California Allocation Ratios:

ULAE (or AOE), OAcq, and GE are allocated to California based on the insurer's Countrywide data from Part III of the IEE.

$$1. \text{ ULAE_Ratio} = \frac{\text{CA_DLI}}{\text{CW_DLI}} \quad (\text{by line})$$

(by Line)

where CA_DLI : California Direct Losses Incurred, CA Statutory Page
CW_DLI : Countrywide Direct Losses Incurred, IEE - Part III

$$2. \text{ OAcq_Ratio} = \frac{\text{Other Acq} \quad (\text{IEE Part III})}{\text{Dir Prem Earned (IEE Part III)}} \quad (\text{by line})$$

$$3. \text{ GE_Ratio} = \frac{\text{Gen Exp} \quad (\text{IEE Part III})}{\text{Dir Prem Earned (IEE Part III)}} \quad (\text{by line})$$

California Expense Allocation Calculation By Line:

$$1. \text{ CA_ULAE} = \text{ULAE_Ratio} * \text{CW_ULAE} \quad (\text{IEE Part III})$$

$$2. \text{ OAcq} = \text{OAcq_Ratio} * \text{CA_DPE} \quad (\text{CA State Page})$$

$$3. \text{ GE} = \text{GE_Ratio} * \text{CA_DPE} \quad (\text{CA State Page})$$

California Direct Premiums Earned is abbreviated as CA_DPE.

Efficiency Standard (Eff Std) Formula

$$\begin{aligned} \text{Eff Std Ratio} &= \text{Total Expenses} / \text{CA Dir Prem Earned} \\ &= \frac{\text{CA_ULAE} + \text{OAcq} + \text{GE} + \text{TLF} + \text{COM}}{\text{CA Direct Premiums Earned}} \end{aligned}$$

Total Calculation of Allocation Items:

1. CA Allctd ULAE Ttl% =
$$\frac{\Sigma (\text{Co's Individual allocated ULAE})}{\Sigma \text{ CA DEP}}$$
2. CA Allctd GenExp Ttl% =
$$\frac{\Sigma (\text{Co's Individual allocated GenExp})}{\Sigma \text{ CA DEP}}$$
3. CA Allctd OAcq Ttl% =
$$\frac{\Sigma (\text{Co's Individual allocated OAcq})}{\Sigma \text{ CA DEP}}$$

We compute the efficiency standards for the latest 3 years and take the simple average by line as the final efficiency standards.