

May 22, 2009

Email and Hand Delivery

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Robert G. Mike
President

RE: California Department of Insurance Report on Operational Examination of the Workers' Compensation Insurance Rating Bureau of California

Dear Mr. Citko:

This letter is in response to the April 22, 2009 California Department of Insurance Report (CDI Report) on Operational Examination of the Workers' Compensation Insurance Rating Bureau of California (WCIRB).

The WCIRB appreciates that the CDI Report recognizes the dedication and hard work of WCIRB staff and those who volunteer to serve on WCIRB Committees. As a general observation, we believe the examination was thorough and fair and that the recommendations are constructive and reasonable. The WCIRB has already made progress to address many of the recommendations and we look forward to working with the CDI to address all remaining issues. The WCIRB's response to each of the recommendations contained in Sections IV through VII and comments regarding WCIRB's data collection and compilation activities are provided below. The text of each recommendation appears before the WCIRB response.

WCIRB'S GOVERNING SYSTEM (SECTION IV)**Recommendation 1**

We recommend that procedures be adopted whereby the views of public members of the Governing Committee and the actuary they retain be presented to the CDI on a routine basis. Such views could be presented in any of a number of ways, ranging from a memorandum by the public members' actuary to the CDI following each meeting of the Actuarial Committee (in which the actuary notifies the CDI of any major differences between his views and those adopted by the Committee) to a formal "minority report" of the public members that accompanies any pure premium rate filing with which they disagree. In making this recommendation, we note that CIC Section 11751.35(c) provides not only that the public members of the Governing Committee may retain experts (including an actuary), but also that "[t]he public members may submit information obtained from these experts, as well as any other information they deem appropriate, to the commissioner for his or her consideration in approving a change of any matter specified in

Christopher A. Citko, Esq.
California Department of Insurance
May 22, 2009

subdivision (a)" (which includes changes in pure premium rate filings). We encourage the public members to use this statutory right, when appropriate. By doing so, the Commissioner can be assured of having additional relevant information for his or her consideration.

WCIRB Response: Several current procedures exist that enable the views of the public members and their actuary to be communicated to the CDI on a routine basis. For example, a representative of the Commissioner regularly attends meetings of the Governing Committee, where the public members may express their views. Similarly, the public members' actuary attends and actively participates at the Governing Committee meetings in which the Actuarial Committee's pure premium rate recommendations are considered. Because the Commissioner's representative attends this meeting, the CDI routinely receives the views of the public members and their actuary. Also, the public members of the Governing Committee and their actuary regularly present their findings directly to the Commissioner at the CDI pure premium rate hearings. Further, the CDI actuaries attend and participate in all meetings of the Actuarial Committee and the CDI is provided copies of the minutes of all WCIRB committee meetings.

Recommendation 2

We recommend that the WCIRB staff consider expanding the minutes of Committee meetings so that such minutes better describe the various points of view expressed in the meetings.

WCIRB Response: WCIRB committee meeting minutes are currently intended to document the principal recommendations of the committee and the basis upon which each recommendation is predicated. In particular, when the vote is not unanimous, the meeting minutes also include discussion of alternative viewpoints that were considered by the Committee. In response to this recommendation, the WCIRB will expand the minutes of Committee meetings to ensure that all alternative viewpoints suggested by Committee members or CDI staff and ultimately not reflected in the recommendations adopted by the Committee are clearly presented.

Recommendation 3

We recommend that steps be taken to allow more time for the review of pure premium rate recommendations before "mid-year" rate filings are made with the CDI. We do not have a specific recommendation as to how this should be accomplished, but options that could be considered include not submitting a "mid-year" filing, moving the proposed effective date of the "mid-year" filing to a date other than July 1, and basing the primary analysis pertaining to the "mid-year" filings on data submitted as of an earlier date so that there is sufficient time for data review and analysis. The WCIRB should also consider holding a second meeting of the Actuarial Committee prior to voting on pure premium rate recommendations if Actuarial Committee members propose significant changes to the WCIRB staff recommendation in the initial meeting. We also refer the reader to our comments pertaining to Section V of this Report ("The WCIRB's Data Collection and Compilation Activities"). In that Section, we make recommendations that might streamline the data collection process and thereby free up time that could be used to perform additional analysis and review. Further, our understanding is that the WCIRB and Actuarial Committee prepare and review full rate indications quarterly, even though pure premium rate filings are made only twice a year. Another way to free up time may be to prepare and review full rate indications only twice a year-in conjunction with the rate filings.

WCIRB Response: The WCIRB recognizes that mid-year filings may be burdensome and may not always allow for as extensive an Actuarial Committee review of underlying diagnostic information and alternative methodologies as annual filings. However, such filings can be critical in adjusting pure premium rates upward or downward when there is new legislation, regulation or judicial action, or rapidly changing underlying loss trends that materially affect the cost projections underlying the pure premium rates. The mid-year pure premium rate increases in 2002 and 2003

Christopher A. Citko, Esq.
California Department of Insurance
May 22, 2009

helped restore pure premium rate adequacy following a period when pure premium rates were significantly inadequate due to rapidly escalating medical costs arising out of the Minniear decision. Similarly, the large mid-year pure premium rate decreases in 2004, 2005, 2006 and 2007 lowered pure premium rates quickly once the highly favorable post-reform experience began to emerge.

The WCIRB evaluates the experience emerging for accidents arising during a particular calendar year as soon it becomes available. When that evaluation indicates that projected costs are materially different from those underlying the current pure premium rates, the WCIRB believes the pure premium rates should be amended appropriately as soon as reasonably possible. WCIRB data reporting requirements require insurers to submit aggregate financial data pertaining to all accident years, including the most recent completed year, in February, well before their annual audited statutory statements are due to be submitted to the CDI. The WCIRB has only a few weeks thereafter to validate, compile and analyze the data for presentation to the WCIRB Actuarial and Governing Committees and ultimately to the Insurance Commissioner in a pure premium rate filing with a July 1 effective date.

Notwithstanding the condensed timeframe, mid-year filings routinely include a complete presentation of the methodologies and data upon which the pure premium rate level indication is based. Concerns that the schedule does not (a) permit the inclusion of the same volume of explanatory and alternative loss projection information or (b) provide the Actuarial Committee as much time to review and suggest alternatives as the WCIRB's annual pure premium rate filings are accurate. However, the current mid-year pure premium rate filing process mitigates these concerns inasmuch as (a) the Actuarial Committee agenda material and the mid-year pure premium rate filing include information that will allow actuaries to readily compute alternative projections under a variety of alternative assumptions; (b) the WCIRB publishes a series of alternative loss projections prior to the time of the CDI public hearing; and (c) in the absence of new legislative, regulatory or judicial action or dramatic shifts in underlying experience, the mid-year filing reflects the same underlying actuarial methodologies as those of the most recent annual filing.

While mid-year pure premium rate changes can be significant tools in addressing rapidly changing circumstances affecting pure premium rates, the WCIRB does recognize the need to continually evaluate and improve its efforts in this regard, and looks forward to discussing potential improvements to the mid-year rate filing process so that actuaries have additional time and information to more fully analyze the methodologies and data underlying mid-year filings.

Recommendation 4

We recommend that the WCIRB begin to collect the detailed, transaction-level data needed to perform refined analyses of the potential impact of legislative, regulatory and judicial actions and of why specific components of claim costs are rising or falling.

WCIRB Response: The WCIRB agrees that regular access to detailed transaction-level data is needed to evaluate the impact of new legislation, regulations and judicial actions and to better understand emerging loss trends. Late last year, the WCIRB formed a special committee consisting of representatives with actuarial, claims or data reporting expertise, with the goal of identifying the key diagnostic measures and leading indicators that should be reviewed by the WCIRB Actuarial Committee and Claims Subcommittee on a regular basis. As part of this process, this special

¹ Minniear v. Mount San Antonio Community College District (1996) 61 Cal. Comp. Cases 1055, a WCAB en banc decision, extended the legal presumption of correctness provided to the treating physician to issues related to medical treatment.

Christopher A. Citko, Esq.
California Department of Insurance
May 22, 2009

committee will be reviewing the most cost efficient manner to collect additional data, including transaction level data that is needed by the WCIRB to enhance the ability to identify and respond to emerging trends. The WCIRB will report the findings of the special committee along with specific recommendations related to the collection of transaction level data to the Insurance Commissioner by October 2009.

WCIRB'S DATA COLLECTION AND COMPILATION ACTIVITIES (SECTION V)

Recommendation 1

We recommend the WCIRB require all insurers to submit their aggregate financial data call reports via eSCAD and require insurers to resolve all data validation errors prior to submitting the information to the WCIRB.

WCIRB Response: The WCIRB agrees that data submission via eSCAD facilitates the efficient collection of accurate aggregate financial information inasmuch as data reconciliation errors are resolved prior to the insurer submitting the data. The eSCAD software was launched in May 2008. Currently, in excess of 99% of insurers representing more than 99% of the market submit quarterly aggregate financial data via eSCAD. In order to facilitate even greater participation, the WCIRB Governing Committee recently adopted a processing charge of \$250 per call for non-eSCAD data call submissions beginning on October 1, 2009. Following implementation of these charges, the WCIRB will assess if additional incentives and mandates are needed and report the results of this assessment to the Insurance Commissioner by the second quarter of 2010.

Recommendation 2

For those data elements not covered by eSCAD, we recommend that the WCIRB determine the most efficient means for insurers to submit data electronically. We further recommend that the WCIRB prescribe a single, uniform method by which insurers submit such data to the WCIRB.

WCIRB Response: Currently, all WCIRB aggregate data submissions, with the exception of the annual Independent Audit Report, can be submitted through the eSCAD software or through a hard copy submission (with a processing charge for hard copy submissions beginning in October 2009) under a WCIRB-specified format. The annual independent audit review attestation report is submitted to the WCIRB by independent auditing firms in accordance with general WCIRB-specified requirements and therefore is appropriately not incorporated in the eSCAD software, which insurers use to submit aggregate financial data. The WCIRB will review its aggregate financial data reporting requirements with the Actuarial Committee and assess additional procedures to ensure uniformity and compliance and report the results of this assessment to the Insurance Commissioner by the second quarter of 2010.

Recommendation 3

We recommend that the WCIRB alert the CDI if it determines that there is a significant problem with the completeness, accuracy, or timeliness of aggregate financial data filed by insurer groups with significant market share. It is important that the CDI be alerted promptly – within 20 days, for example – after the problem is discovered. By making the CDI aware of such problems, the WCIRB can gain additional support and/or advice regarding the proper course of action with the insurer to remediate current and future reporting problems.

WCIRB Response: Current WCIRB procedures provide that the CDI be advised in writing when the WCIRB determines that an insurer's data is not accurate or cannot be sufficiently validated to be accurate and, as a result, cannot be used in a WCIRB pure premium rate filing. CDI staff is also invited to participate in the remediation process with the insurer. To the extent the CDI believes

Christopher A. Citko, Esq.
California Department of Insurance
May 22, 2009

appropriate, the WCIRB can modify current procedures to advise the CDI at an earlier stage in the process.

Recommendation 4

We recommend the WCIRB take remedial action with respect to any insurer group that is required to obtain an independent auditor's report attesting to the insurer group's annual aggregate data report but is unable to obtain a "clean" opinion regarding such data report. The failure of an insurer to obtain such a report should raise questions regarding the effectiveness of the insurer's internal controls over financial reporting. Accordingly, we further recommend that the WCIRB's existing remedial action procedures be supplemented by having the WCIRB Governing Committee authorize WCIRB staff, or independent persons engaged by the WCIRB, to perform an on-site audit of insurers that are unable to obtain such a "clean" independent audit report.

WCIRB Response: The WCIRB requires, on an annual basis, each of the fifty largest insurance groups in the state to obtain an independent audit review of its December 31 data reported to the WCIRB. Insurers that are unable to provide an opinion in a timely manner are fined for each day the report is late in accordance with the WCIRB's SCAD program, and are subject to substantial additional financial penalties if their data is deemed inappropriate for use in the pure premium rate filing. In several instances, the data of an insurer whose independent auditor's report has not been provided was used in a pure premium rate filing inasmuch as (a) the insurer's data met all other WCIRB data validation tests, (b) a senior executive of the insurer attested to the accuracy of the data and (c) the CDI staff concurred with the use of the data in the pure premium rate filing.

The WCIRB agrees that it may be appropriate in certain circumstances to undertake an on-site audit of insurer records in instances when an independent auditor is unable to provide an adequate attestation report.

Recommendation 5

We recommend that the WCIRB implement a program applicable to the largest insurers whereby the senior management and the controllers of the insurers attest to the effectiveness of the insurers' statistical and financial reporting systems. Such a program should increase the accuracy of the insurers' reports. The WCIRB may wish to pattern its program after a similar program that has been implemented by the National Council on Compensation Insurance, Inc. ("NCCI"). Similar to the recommendation 4 above, we further recommend that the WCIRB authorize WCIRB staff, or independent persons engaged by the WCIRB, to perform an on-sight audit of insurers that do not file the attestation report.

WCIRB Response: Currently, the WCIRB requires an annual certification by two insurer officers under penalty of perjury of each insurer's report of calendar year premium, losses and expenses. The certified call also requires a reconciliation of premium and loss data reported to the WCIRB to that reported to the CDI in the insurer's annual statutory statements. For the fifty largest insurer groups in the state (these insurers collectively write approximately 99% of the statewide market), this report is also subject to review and attestation by an independent auditor. The WCIRB believes that the combination of insurer certification and independent audit review of the key information underlying the WCIRB's pure premium rate filing, along with the WCIRB's many internal data quality controls, provides for a validation process that is more comprehensive than those in most other jurisdictions and reasonably assures the accuracy and completeness of the underlying data. Nevertheless, the WCIRB is open to further process enhancements in this area to the extent appropriate.

Christopher A. Citko, Esq.
California Department of Insurance
May 22, 2009

Recommendation 6

We recommend that the WCIRB work closely with SCIF to assure that SCIF's data collection and reporting system is functioning effectively. Given SCIF's share of the workers' compensation market in California, it is important that SCIF's data-capturing and reporting systems function effectively.

WCIRB Response: We recognize that changes in experience for State Fund, by far the largest insurer in the state, can have a significant impact on the WCIRB's pure premium rate level indication. As a result, State Fund's aggregate data submissions are carefully scrutinized by WCIRB actuarial staff and, to the extent any potential anomalies in the data are detected, State Fund staff is questioned for an explanation or data correction. Nevertheless, the WCIRB will review its processes with respect to State Fund's reported data to determine the extent to which enhancements may be appropriate.

WCIRB ACTIVITIES OTHER THAN DATA COLLECTION & COMPILATION (SECTION VI)**Recommendation**

We recommend that the WCIRB move toward requiring insurers to file policy information in a standard filing medium, preferably electronically. We note that insurers currently file policy information in both hard copy and electronic format.

WCIRB Response: The WCIRB concurs that the electronic submission of policy documents would facilitate cost efficient processing of required policy information. The WCIRB is in the process of developing a new computer processing system, which will facilitate the electronic submission of policy data.

The new system's functionality will:

- Process all types of policy documents and transactions electronically;
- Improve document tracking;
- Eliminate the need to produce paper output of electronically submitted documents; and
- Improve processing speed.

THE TOWERS REPORT (SECTION VII)**Recommendation 1**

We recommend that the WCIRB consider multiple projection methods when making pure premium rate determinations. No one projection method will be appropriate for all accident years. The WCIRB also should review various diagnostic statistics and retrospective analyses to assist in determining which projection methods are appropriate for each accident year.

WCIRB Response: The WCIRB agrees that no single methodology is appropriate for all circumstances. The WCIRB regularly modifies the methodologies underlying the pure premium rate filing projection as the underlying claims environment changes. The WCIRB also reviews multiple loss and loss adjustment expense projection methodologies and a variety of diagnostic measures as part of its pure premium ratemaking processes. For example, in addition to the methodologies upon which the WCIRB's January 1, 2009 pure premium rate filing projection was based, the filing included ten alternative loss development methodology projections, four

Christopher A. Citko, Esq.
California Department of Insurance
May 22, 2009

alternative loss trending methodology projections, twenty-nine alternative allocated loss adjustment expense methodology projections and twelve alternative unallocated loss adjustment expense methodology projections. These alternative methodologies represent a wide range of varying underlying assumptions.

In response to the recommendations of the 2008 Towers Perrin report as well as those contained in recent CDI pure premium rate decisions, the WCIRB has formed a special committee consisting of representatives with actuarial, claims or data reporting expertise. The objective of this special committee is to identify the key diagnostic measures and leading indicators that should be reviewed by the WCIRB Actuarial Committee and Claims Subcommittee on a regular basis in order to identify the environmental conditions impacting loss and loss adjustment expense emergence. In addition, the WCIRB has contracted with Towers Perrin to develop recommendations as to specific loss development methodologies that will be most appropriate given the environmental conditions existing at the time the projections are made. The WCIRB will report the findings of the special committee and the Towers Perrin report along with specific ratemaking process enhancements based on those findings and recommendations to the Insurance Commissioner by October 2009.

Recommendation 2

We recommend that retrospective projected ultimate loss ratios (“LRs”) be selected judgmentally by accident year and that the original projected ultimate LR be compared to the updated projected ultimate LR by accident year. Further, we recommend that retrospective analyses be prepared annually so that changes in projected ultimate pure premium LR by accident year can be observed and explained.

WCIRB Response: Currently, the WCIRB publishes retrospectively projected ultimate loss ratios on a quarterly basis. The retrospective loss ratios are projected each quarter based on the actuarial methodology recommended by the WCIRB Actuarial Committee for the most recent pure premium rate filing. In response to this recommendation, the WCIRB will include a summary of changes in projected ultimate loss ratios by accident year over time in its annual pure premium rate filings.

Recommendation 3

After considering the results of multiple methods, we recommend that the WCIRB provide a range of reasonable pure premium rate level indications to the Actuarial Committee and the Governing Committee.

WCIRB Response: Currently, on a quarterly basis, the Actuarial Committee reviews (a) a summary of the most current quarter-ending accident year premium and loss information, (b) a series of relevant diagnostic measures (e.g., paid-to-incurred ratios, quarterly changes in claim frequency, and claims closing rates), (c) a pure premium rate level indication based on the methodologies previously recommended by the Actuarial Committee for the most recent pure premium rate filing as well as those reflected in the most recent CDI pure premium rate decision, and (d) the underlying data for which multiple alternative projections can be readily derived (e.g., incurred loss development factors). Following this review, the Actuarial Committee either agrees upon the methodologies determined to be most appropriate for purposes of the upcoming pure premium rate filing or requests additional data or analysis to be provided for the Committee’s review at subsequent meetings.

The resulting indication produced by a number of alternative projection methodologies are also discussed by the Actuarial Committee in preparation for the annual pure premium rate filing and a full presentation of those methodologies is included in the annual pure premium rate filing. In

Christopher A. Citko, Esq.
California Department of Insurance
May 22, 2009

response to this recommendation, the WCIRB will include presentation of a wide range of alternative loss projection methodologies in the Actuarial Committee and Governing Committee agenda materials so that these alternative approaches can be reviewed by the Committees prior to their meetings and fully considered in their deliberations of annual pure premium rate changes.

Recommendation 4

Rather than presenting the CDI with the results of only one method, we recommend that the WCIRB prepare and provide to the CDI a chart or side-by-side comparison showing projected on-level pure premium LRs by accident year using each method considered by the WCIRB. Providing this information will allow the CDI to better understand the variability surrounding the projections and the extent to which projections are sensitive to alternate assumptions. We also believe it would be helpful for the WCIRB to explain why it believes certain methods are more reasonable than others for particular accident years. We recommend that the WCIRB describe the key assumptions underlying each method, the extent to which the WCIRB believes those assumptions are valid, and alternate scenario projections for key assumptions. We also recommend that the WCIRB explain its rationale behind the selected LRs by accident year.

WCIRB Response: Currently, the WCIRB's annual pure premium rate filing fully documents the WCIRB indicated pure premium rate level change. In addition, the WCIRB filing includes a review and discussion of a variety of diagnostic measures presented in the filing as well as a comprehensive discussion as to why, in light of the review of the diagnostics, the WCIRB believes the recommended methodologies are the most appropriate. The filing also currently includes a wide range of side-by-side alternative loss and loss adjustment expense projections with discussion as to the key assumptions underlying each methodology and why the WCIRB believes the alternative projection is not as appropriate as that reflected in the WCIRB's recommended methodology. Further, the WCIRB regularly provides any additional information related to the WCIRB's projection or any alternative projection upon request by the CDI actuaries.

The WCIRB believes its pure premium rate filings reflect a comprehensive state-of-the-art actuarial analysis and provide for a wide range of alternative analyses. The 2008 Towers Perrin actuarial review of the WCIRB methodologies found that "the procedures, processes and methodologies in place and in use at the WCIRB are reasonable and consistent with current actuarial practice, and that they are documented in a filing that is straightforward and easy to understand. The WCIRB is in many aspects ahead of other organizations in its ratemaking processes, in that its filings make extensive use of external data and research, its methodologies are thoroughly documented, and its findings are accompanied by extensive commentary."

Nevertheless, the WCIRB recognizes the need to continually enhance its ratemaking methodologies and processes to be more flexible to changing conditions and looks forward to discussing potential enhancements with the CDI.

WCIRB DATA COLLECTION AND COMPILATION COMMENTS

In order to put the recommendations and the WCIRB's responses in a more complete contextual framework, a brief description of WCIRB data collection and compilation activities is provided below.

Christopher A. Citko, Esq.
California Department of Insurance
May 22, 2009

WCIRB staff and its committees fully appreciate the significance of the WCIRB's need to utilize accurate, timely and complete data in order to retain public confidence in the information it provides, and are committed to expending the resources necessary to achieve this goal. The data compiled and produced by the WCIRB forms the basis upon which advisory pure premium rates are developed by the WCIRB, reviewed and established by the Commissioner, and relied upon by insurers. As such, data quality is of paramount importance. Recognizing the critical role of data quality, the WCIRB expends considerable resources and utilizes numerous enforcement mechanisms to (a) collect accurate, timely and complete data and (b) ensure that the data utilized for ratemaking is accurate, timely and complete. In fact, the WCIRB is widely recognized as a leader in this regard and has implemented a wide range of innovative programs, many of which are unique to California, to help ensure that the data is accurate, timely and complete.

The purpose of the WCIRB's data collection enforcement mechanisms is to encourage the submission of accurate, timely and complete data, which is essential to fulfilling its statutory ratemaking responsibilities. Toward this end, in addition to maintaining a classification inspection regimen that is one of the most vigorous in the country, the WCIRB has developed and implemented multiple programs to promote, monitor and enforce standards to enhance the integrity of the data reported to the WCIRB. These programs include the Test Audit Program, the Data Quality Enhancement Program, the Submission of California Aggregate Data (SCAD) Program, the Large Risk Data Validation Program, the Unit Statistical Report fine system, and the independent audit attestation requirements, some of which are unique to California or are significantly more robust than similar programs in place in other jurisdictions.

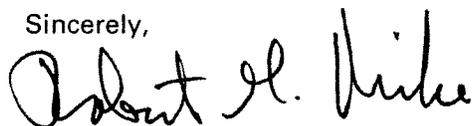
These programs were adopted to facilitate compliance with WCIRB data reporting requirements and to enhance the submission of accurate, timely and complete data. An insurer that fails to meet program standards is required to promptly remediate the deficiency and is subject to a series of escalating actions, including referral to WCIRB committees, the imposition of substantial fines (as much as \$50,000 per month) and citation to the CDI for regulatory action – all of which have been taken in the recent past. With rare minor exceptions, the actions specified, including the imposition of fines, are consistently applied and have proven to be effective in remediating data reporting problems. The WCIRB notes that with the exception of the exclusion of the data of American International Group from the January 1, 2007 and July 1, 2007 pure premium rate filings during a period when several significant data quality issues were being remediated by the insurer, WCIRB pure premium rate filings since 2003 have, on average, reflected 98% of the total statewide market. The latest two pure premium rate filings, which followed implementation of new WCIRB data submission software and changes to the SCAD program, have reflected 100% of the statewide market.

In summary, the WCIRB believes that the extensive nature of the monitoring and enforcement activities it undertakes to promote the quality and integrity of insurer-reported data is second to none; however, the WCIRB recognizes the need to continually evaluate and improve its efforts in this regard and looks forward to discussing potential process improvements with the CDI.

Christopher A. Citko, Esq.
California Department of Insurance
May 22, 2009

The WCIRB is committed to working collaboratively with the CDI to effect the recommendations and will contact the CDI within 30 days after the recommendations are adopted to discuss a plan of action. Please let me know if you have any questions or if there is any additional information we can provide.

Sincerely,

A handwritten signature in black ink that reads "Robert G. Mike". The signature is written in a cursive style with a large initial "R" and "M".

Robert G. Mike
President

RGM:smd