

No. 98-0101

**Official Order  
of the  
Commissioner of Insurance  
of the  
State of Texas  
Austin, Texas**

**Date:** JAN 23 1998

**Subject Considered:**

PRIVATE PASSENGER AND COMMERCIAL  
AUTOMOBILE INSURANCE  
PROVIDED THROUGH THE  
TEXAS AUTOMOBILE INSURANCE PLAN ASSOCIATION  
Docket No. 454-96-1640.G

ORDER GRANTING MOTIONS FOR REHEARING IN PART, DENYING MOTIONS  
FOR REHEARING IN PART AND AMENDING  
COMMISSIONER'S ORDER NO. 97-1272

**General remarks and official action taken:**

On this day came on for consideration by the Commissioner of Insurance (Commissioner) the matters of the motions for rehearing filed by the Texas Automobile Insurance Plan (TAIPA) and the Center for Economic Justice (CEJ) of Commissioner's Order No. 97-1272, entitled "PRIVATE PASSENGER AND COMMERCIAL AUTOMOBILE INSURANCE PROVIDED THROUGH THE TEXAS AUTOMOBILE INSURANCE PLAN ASSOCIATION, Docket No. 454-96-1640.G." The Commissioner has jurisdiction over these matters pursuant to TEX. INS. CODE ANN. arts. 1.33B and 21.81 §5, and the GOV'T. CODE ANN. §2001.146.

The Commissioner, after due consideration of the evidence in the record and the arguments of TAIPA and CEJ, finds and determines that the motions for rehearing should be granted in part and denied in part, and that Order No. 97-1272 should be amended.

IT IS THEREFORE, ORDERED by the Commissioner of Insurance that Order No. 97-1272 previously entered herein be amended to read as follows:

The General Counsel and Chief Clerk of the Texas Department of Insurance (Department) issued a Notice of Public Hearing on September 16, 1996. Requirements for the notice of hearing are set forth in 28 TEX. ADMIN. CODE §1.1304. On September 20, 1996, notice of the date, time and place of the January 7, 1997, hearing on the merits

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in this case was published at 21 *Tex. Reg.* 9081 (1996). No person took issue with the notice provided or raised an objection to it. On September 29, 1996, the Commissioner referred the proceeding to the State Office of Administrative Hearings (SOAH) to conduct an evidentiary hearing and issue a proposal for decision.

TAIPA and CEJ filed motions for admission as parties. The Office of Public Insurance Counsel (OPIC) filed a notice of intervention indicating that it would appear in the proceedings as authorized by TEX. INS. CODE ANN. art. 1.35A §(b)(1)(A).

On November 6, 1996, the initial prehearing conference was held as scheduled. Administrative Law Judges (ALJs) Barbara C. Marquardt and Sarah G. Ramos presided at this conference and at all subsequent proceedings. In all proceedings in this docket, TAIPA was represented by Richard S. Geiger and Michael W. Jones. OPIC was represented by Rod Bordelon, Public Insurance Counsel, Janet R. Dewey and Lanetta Cooper. CEJ was represented by D. J. Powers. All motions for admission were granted without objection. On November 7, 1996, following the prehearing conference, a prehearing order was issued. Due to the unavailability of necessary data, the order granted the parties' agreed motion for continuance to February 12, 1997, set a second prehearing conference date, and ordered the parties to file an agreed schedule establishing dates for the filing of prefiled testimony and other procedural matters according to 28 TEX. ADMIN. CODE §§1.1309 and 1.1310.

On January 16, 1997, the parties filed an agreed motion for continuance to avoid a conflict with the automobile insurance benchmark rate case (Docket No. 454-96-1639.G) and agreed scheduling order. By order dated January 21, 1997, a second prehearing conference was scheduled to discuss the new setting date and related topics. On February 4, 1997, following prehearing conferences held on January 27 and January 29, 1997, an order was entered that continued the hearing to April 8, 1997, and revised the filing deadlines accordingly.

On March 20, 1997, the parties appeared for a prehearing conference to argue motions to compel filed by TAIPA and CEJ. By order dated March 21, 1997, the ALJs overruled TAIPA's motion to compel, finding the requested discovery was not relevant to the subject matter in the pending hearing. The order also granted CEJ's request to withdraw its motion to compel TAIPA to answer certain requests for information.

On March 25, 1997, TAIPA appealed the order overruling its motion to compel. On April 3, 1997, the Commissioner entered Order No. 97-0329 affirming the order overruling TAIPA's motion to compel.

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On April 8 and 9, 1997, the hearing on the merits convened in Room 100 (the Commissioner's Hearing Room), 333 Guadalupe, Austin, Texas. At the end of the second day the hearing recessed and reconvened on April 10, 1997, in Committee Room 2 in the William Clements Building, Austin, Texas. All of the parties participated in the hearing. No one spoke at the public comment portion of the hearing. The presentation of evidence concluded on April 10, 1997, and the record was left open for the receipt of written closing arguments and briefs.

The parties filed initial and reply posthearing briefs as permitted by 28 TEX. ADMIN. CODE §1.1317. The record closed May 7, 1997, by agreement of the parties.

TAIPA presented its case through the testimony of Michael J. Miller, an actuary, and Dr. David Appel, an economist. Allan I. Schwartz, an actuary, and Stephen G. Hill, an economist, testified for OPIC. CEJ presented its case through the testimony of Birny Birnbaum, an economist.

The ALJs made and filed a proposal for decision containing findings of fact and conclusions of law. It was properly served on all parties, and all parties were given an opportunity to file exceptions and replies as part of the record herein.

On August 28, 1997, the Commissioner considered the proposal for decision and the exceptions, briefs and arguments of the parties in open meeting. On December 18, 1997, the Commissioner issued Order No. 97-1272 setting the rates for private passenger and commercial automobile insurance provided through TAIPA, to be effective at 12:01 a.m. March 1, 1998. On January 6, 1998 and January 8, 1998, TAIPA and CEJ, respectively, filed their motions for rehearing. On January 15, 1998 TAIPA filed its reply to CEJ's motion for rehearing.

The Commissioner grants TAIPA's motion for rehearing in part insofar as TAIPA correctly pointed out that the tort reform bodily injury (BI) factor was erroneously applied to Unallocated Loss Adjustment Expenses (ULAE) in the rate calculations in Appendix A, Sheet 2. A revised Appendix A, Sheet 2 recalculating the BI indication without applying the tort reform TAIPA BI factor to ULAE is contained in this order. Correcting this error has the effect of changing the TAIPA private passenger BI rate indication from +4.0 percent to +5.3 percent, an increase in BI rate levels of 1.3 percent (1.053/1.040). Upon reviewing the similar calculations for TAIPA Uninsured/Underinsured Motorists (UM/UIM) in Appendix A, Sheet 5, the Department staff determined that the ULAE load was calculated incorrectly when it was removed from the total loss and Loss Adjustment

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Expenses (LAE). Correcting this error has the effect of reducing the TAIPA private passenger UM/UIM rate indications by 0.2 percent. Changes in Appendix A, Sheet 1 and Appendix B, Sheets 1 and 2 are also required to correct the errors described herein. Finding No. 107 is amended to correctly reflect the calculations made in the revised Appendix A, Sheet 2; the calculations made in the revised Appendix A, Sheets 2 and 5; and a typographical error changing the approved rate change after tort reform for TAIPA private passenger property damage liability (PD) from -12.2 percent to -12.8 percent as indicated in Appendix A, Sheet 3. All other points of error raised by TAIPA are hereby denied.

The Commissioner grants CEJ's motion for rehearing in part insofar as CEJ correctly contended that the combined private passenger BI/PD rate change was not -3.9 percent as was indicated in Appendix A, sheet 1. Upon reviewing these calculations, the Department staff determined that an incorrect change in the voluntary BI rates due to the change in the tort reform BI factor was used in its calculations in determining the TAIPA rate relativity to the voluntary benchmark rates in Appendix B, Sheet 1. This correction has the effect of reducing the calculated TAIPA private passenger BI rates by 0.7 percent. All other points of error raised by CEJ are hereby denied.

Based on the changes in the calculations above, the effective date of the rates applicable to private passenger automobile insurance policies written through TAIPA will be amended from 12:01 a.m. March 1, 1998 to 12:01 a.m. April 1, 1998.

The Commissioner has the responsibility under TEX. INS. CODE ANN. art. 21.81 to set appropriate rates to be charged for insurance provided through TAIPA. The prescribed rates are to be just, reasonable, adequate, not excessive, not confiscatory, and not unfairly discriminatory for the risks to which they apply. The rates are to be set in an amount sufficient to carry all claims to maturity and to meet expenses incurred in the writing and servicing of the business. Upon consideration, the Commissioner has amended the proposed findings of fact and conclusions of law as more fully described below. The Commissioner adopts the following findings of fact and conclusions of law and denies all proposed findings of fact submitted by any party hereto not specifically made.

**REVISIONS TO FINDINGS OF FACT AND CONCLUSIONS OF LAW**

References in the justifications for amended, renumbered findings are shown by their new number followed by their original number in parenthesis.

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The Commissioner adopts the following findings based on prior precedent in administrative decisions: 7, 9, 14, 19-30, 34-37, 44, 45, 51-56, 60-61, 83, 84, 86, 88-91, 92, 94, 95, 97-99, and 102-108. The Commissioner adopts or amends the following findings due to technical errors in the findings that should be changed: 7, 8, 10, 11, 13, 17, 18, 31, 32, 38, 41, 43, 46-50, 58, 59, 62-72, 74, 76, 78, 80-81, 84b-d, 85a-c, and 93. Of the above findings, the following were adopted to include necessary findings omitted by the ALJs: 19-30, 45, 51-56, 92 and 102-108.

### **FINDINGS OF FACT**

#### **Private Passenger Rates** **Fast Track Data**

Findings Nos. 7-9 are amended.

Finding No. 7 is amended to eliminate medical payments as a type of coverage excluded from the Fast Track data since TAIPA does not offer medical payments coverage. Finding No. 7 - 9 are amended to make references to terms consistent throughout the order. Finding No. 9 is also amended because although the Commissioner accepts that it is reasonable to consider Fast Track data in reviewing the reasonability of such things as trends, it is inappropriate to include Fast Track data in actual numerical rate calculations.

#### **Actuarial Methodology**

Finding No. 10 is deleted; Findings Nos. 10(28), 11(29), 13(12) and 15(13) are amended; Findings Nos. 28, 29, 11, 12, 13 and 14 are renumbered to 10, 11, 12, 13, 15 and 16; and Findings Nos. 14, 17 and 18 are adopted. Findings Nos. 11(29), 12, 17 and 18 are amended to make references to the coverage consistent throughout the order.

Findings Nos. 28 and 29 are renumbered to Findings Nos. 10 and 11 in this section because they more appropriately belong in this section. Finding No. 10(28) is amended to show that the data described is used to calculate rates, rather than trends as indicated by the ALJs.

Finding No. 10 is deleted because October 1, 1997 is not the effective date and rates should not be set using that date. Instead, Findings Nos. 51 - 56 are adopted to show



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the adjustments that are necessary because the actual effective date of the rates is different from the date the parties assumed as an effective date in their loss trending calculations.

Finding No. 13(12) is amended to eliminate the references to \$356.4 million since the record does not support this exact amount.

Finding No. 14 is adopted to clarify what TEX. INS. CODE ANN, art. 21.81 requires of the Commissioner in setting the TAIPA rates.

Finding No. 15(13) is amended to clarify that the preferable loss ratio method is actuarially based, rather than based on public policy as suggested by the method recommended by CEJ.

Findings Nos. 67 and 68 are renumbered to Findings Nos. 17 and 18, respectively because they logically belong in this section.

**Loss Development Factors**

The heading of this section is amended to properly describe the contents of the section. Finding No. 15 is deleted; Findings Nos. 27(16) and 29(17) are amended; Findings Nos. 16 and 17 are renumbered to 27 and 29, and Findings Nos. 19-26 and 28 are adopted.

Finding No. 19 is adopted to explain the purpose of establishing loss development factors. Finding No. 15 is deleted to eliminate the implication that the alternatives mentioned in that finding are the only alternatives available.

Findings Nos. 20 and 21 are adopted to reflect the loss development factors to be used for Bodily Injury Liability (BI), Property Damage Liability (PD), and Personal Injury Protection (PIP). These findings are necessary but were not included in the ALJs' proposed findings. Findings Nos. 22-24 are adopted to describe the Uninsured/Underinsured Motorist Bodily Injury (UMBI/UIMBI) loss development factor recommendations of the parties. Findings Nos. 25 and 26 are adopted to explain the Commissioner's selection of UMBI/UIMBI development factors. Finding No. 27(16) is amended to describe the Uninsured/Underinsured Motorist Property Damage (UMPD/UIMPD) development factors recommended by the parties. Finding No. 28 is adopted to show the Commissioner's selection of UMPD/UIMPD development factors. The selection of these development factors were not included in the ALJs' findings but

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are necessary in making the rate calculations. Finding No. 29(17) is amended to show the Commissioner's selection of Uninsured/Underinsured Motorist (UM/UIM) loss development factors. Findings Nos. 27(16) and 29(17) are also amended to make references to certain terms consistent throughout the order.

**Unallocated Loss Adjustment Expense (ULAE)**

A new section heading is adopted to properly identify the subject matter contained in the section. Findings Nos. 18 and 20 are deleted; Finding No. 31(19) is amended; Finding No. 19 is renumbered to Finding No. 31; and Finding No. 30 is adopted.

Findings Nos. 18 and 20 are deleted because they are unnecessary findings. Finding No. 30 is adopted to show the Commissioner's selection of OPIC's ULAE factor indications. The selection of the ULAE factor indications is necessary and was not included in the ALJs' findings. Finding No. 31(19) is amended to clarify that the indications, rather than the data should be averaged.

**Tort Reform**

Findings Nos. 22, 23 and 25 are deleted; Finding No. 32(21) is amended; Finding No. 24 is renumbered to Finding No. 33; and Findings Nos. 34-37 are adopted.

Finding No. 32(21) is amended to more accurately describe the legislation related to tort reform as it regards the present rate case.

Findings Nos. 22 and 23 are deleted because they are unnecessary. Finding No. 25 is deleted and 34 is adopted to indicate what should be done to adjust BI for the effects of tort reform. Finding No. 35 is adopted to describe the similarities among the UMBI/UIMBI and the BI coverages, and the effects of tort reform on the coverages. Finding No. 36 is adopted to reflect the Commissioner's determination that the tort reform legislation would have an impact on UMBI/UIMBI claims and to specify that the primary impact would be felt in the BI portion of UM/UIM coverage. Finding No. 37 is adopted because the Commissioner is persuaded by the record that the effects of tort reform on UMBI/UIMBI coverage should appropriately be accounted for by applying the same tort reform loss and Allocated Loss Adjustment Expense (ALAE) reduction percentage to UMBI/UIMBI expected losses and ALAE as is applied to voluntary private passenger BI.

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### **Take Out Program**

Findings Nos. 26 and 27 are renumbered to Findings Nos. 38 and 39.

Finding No. 38(26) is amended to include a qualification for the take out program that was not included by the ALJs.

### **Selected Trend Factors**

Findings Nos. 32, 40, and 41 are deleted; Findings Nos. 10(28), 11(29), 41(31), 44(34), 46(35), and 47(36)-50(39) are amended; Findings Nos. 28, 29, 30, 31, 33, 34, 35, and 36-39 are renumbered to Findings Nos. 10, 11, 40, 41, 42, 44, 46 and 47-50; Findings Nos. 43, 45, and 51-56 are adopted. Findings Nos. 47-50(36-39) are amended to make references to percentages and other terms consistent throughout the order. Findings Nos. 28 and 29 are amended and renumbered to 10 and 11, respectively to place the findings in a more appropriate section of this order.

Finding No. 41(31) is amended to better describe the indications displayed and to correctly name the curve.

Finding No. 32 is deleted and Findings Nos. 51 - 56 are adopted to clarify how far into the future losses should be trended. These calculations were not included in the ALJs' proposed findings and are necessary to determine the trend period.

Finding No. 43 is adopted to clarify the BI and PD trends adopted by the Commissioner. This finding incorporates part of Finding No. 46(35) concerning the ALJs' acceptance of TAIPA trends for BI and PD as reasonable. Finding No. 44(34) is amended to eliminate the implication that improper reporting is the likely reason for the discrepancy between the frequency trends. Finding No. 45 is adopted to describe additional evidence from the record that supports the selection of a lower PIP claim frequency trend. Findings Nos. 46(35) and 47(36) are amended to clarify the selection of a lower PIP frequency trend.

Findings Nos. 40 and 41 are deleted because the use of the concept of "best fit" is inappropriate in this case because all of the trends are selected values and not based on a particular curve of best fit.



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**Fixed and Variable Expenses**

Findings Nos. 45-50 and 58 are deleted. Findings Nos. 58(43), 59(44), 68-72(51-55), 74(57), 76(60)-78(62), 80(64), and 81(65) are amended. Findings Nos. 42-44, 51-57 and 59-66 are renumbered to Findings Nos. 57-59, 68-74 and 75-82. Findings Nos. 60-67 are adopted. Findings Nos. 58(43), 59(44), 68-71(51-54), 78(62), 80(64), and 81(65) are amended to make references to findings and other terms consistent throughout the order. Finding No. 59(44) and 72(55) are amended for grammatical clarity.

Finding No. 45 - 47 are deleted because the Commissioner disagrees and Finding No. 60 is adopted to explain why the Commissioner did not accept TAIPA's recommendation. Finding No. 61 is adopted because the Commissioner is persuaded by the record that an adjustment is appropriate. This finding is also consistent with the previous year's decision.

Findings Nos. 48 and 49 are deleted and 62-67 are adopted to explain more completely the reasons for the Commissioner's decision concerning Farmers' management fee.

Finding No. 50 is deleted because it is duplicative of Findings Nos. 68-71(51-54). Finding No. 68(51) is also amended to clarify the two markets which are combined in this finding. Finding No. 71(54) is also amended to describe the expense categories affected by this finding.

Finding No. 74(57) is amended to remove the reference to the time value of money, because it is unnecessary and to eliminate the implication that an adjustment from SAP and GAAP should be made.

Finding No. 58 is deleted because it is unnecessary and also to eliminate any implication that CEJ's suggested method of basing expense ratios on written premium is not relevant or in need of empirical supporting evidence in order to be relevant.

Findings Nos. 76(60) and 77(61) are amended to reflect that the figures in these findings are estimates. Finding No. 80(64) is amended because there was no evidence presented that the average lag in the remittance of premium is actually 40 days.

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### **Uninsured Motorist Coverage**

The heading of this section is deleted and the two Findings Nos. 67 and 68 are renumbered to Findings Nos. 17 and 18, respectively.

### **Rate of Return**

Findings Nos. 73-75 are deleted; Findings Nos. 83-85(69-71), 93a(76a) and 93b(76b) are amended; Findings Nos. 69-71, 72 and 76 are renumbered to Findings Nos. 83-85, 87 and 93; and Findings Nos. 86 and 88-92 are adopted. Findings Nos. 84b-d(70b-d), 85a-c(71a-c), and 93(76) are amended to make references to terms more consistent throughout the order. Findings Nos. 85(71) and 93(76) are amended to correct references to other findings.

Finding No. 83(69) is amended because the Commissioner disagrees that the DCF is the primary method to be used to estimate the rate of return or cost of capital. The Commissioner does, however, agree that the DCF model is an important model to be considered. Finding No. 84(70) is amended to eliminate the implication that some DCF models are necessarily less reliable than others. Finding No. 86 is adopted to clarify that the average DCF result reflected in Finding No. 85c(71c) is not the only reasonable result obtainable through use of the DCF model.

Finding No. 73 is deleted and Findings Nos. 88-91 are adopted to reflect the Commissioner's determinations regarding the CAPM cost of capital. Finding No. 74 is deleted because the Commissioner prefers to consider the other cost of capital estimates rather than completely dismiss them as recommended by the ALJs. Finding No. 75 is deleted because the Commissioner disagrees with the ALJs' recommendation concerning the weighting scheme of the various cost of capital estimates and with the supporting arguments. The Commissioner adopts Finding No. 92 to state the Commissioner's determinations regarding a reasonable cost of capital for the sample companies.

Findings Nos. 93a(76a) and 93b(76b) are amended for purposes of clarification. Finding No. 93a(76a) is also amended to more accurately reflect the Commissioner's perspective.

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### **Profit Calculations**

Findings Nos. 77, 79a, 79b, 80 and 81 are deleted, Finding No. 97(79) is amended, Finding No. 79 is renumbered to Finding No. 97, and Findings Nos. 94, 95, 98 and 99 are adopted. Finding No. 93(76) and 97(79) are amended to make references to terms and findings consistent throughout the order.

Finding No. 93b(76b) is amended to eliminate the implication that the estimate of cost of capital is based on past decisions rather than based on the evidence in the record of this case.

Finding No. 77 is deleted and Finding No. 94 is adopted reflecting the Commissioner's determinations regarding OPIC's estimated post-tax investment return. Finding No. 95 is adopted to reflect the Commissioner's determinations regarding leverage factors.

Finding No. 97(79) is amended to indicate the Commissioner's usage of both models to develop a range of reasonable profit factors, and to eliminate references to deleted Findings Nos. 80 and 81. Finding No. 79a is deleted as unnecessary and Finding No. 79b is deleted because it is inconsistent with other adopted findings. Findings Nos. 80 and 81 are deleted and Findings Nos. 98 and 99 are adopted to reflect the Commissioner's derivation of a range of reasonable underwriting profit provisions, and his determination of a specific underwriting profit provision to be used in this proceeding.

### **Class and Territorial Relativities**

Findings Nos. 82 and 83 are renumbered to Findings Nos. 100 and 101.

### **TAIPA Rate Selection**

This new section comprised of Findings Nos. 102-108 is adopted to explain how the final rates are to be determined.

### **Commercial Rates**

Finding Nos. 84 is renumbered to Finding No. 109.

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### **CONCLUSIONS OF LAW**

Conclusions Nos. 1 and 2 are amended to make statutory references consistent throughout the order.

This order is also amended to reflect the actual effective date and time of the TAIPA rates.

### **FINDINGS OF FACT**

#### **Procedural Matters**

1. On September 16, 1996, the Texas Department of Insurance (the Department) issued its Notice of Public Hearing in this matter, and it was published at 21 *Tex. Reg.* 9081 (1996).
2.
  - a. On March 25, 1997, the Administrative Law Judges (ALJs) entered an agreed protective order (designated Prehearing Order No. 6) as to the computer spreadsheets of the internal rate of return model (IRR) contained on the diskettes of Dr. Appel, one of the expert witnesses for Texas Automobile Insurance Plan Association (TAIPA).
  - b. In its Post Hearing Brief filed April 30, 1997, TAIPA requested that the ALJs recommend making the agreed order permanent, so that the diskettes (admitted as Exhibit Nos. 19, 20 and 21) would remain confidential.
  - c. None of the parties to this proceeding has objected to the request referenced in Finding 2b.
3. The hearing was continued and convened on April 8, 1997. It was adjourned on April 10, 1997.
4. The following entities appeared and participated as parties in the hearing: the Office of Public Insurance Counsel (OPIC), TAIPA, and the Center for Economic Justice (CEJ).
5. The hearing was held before Sarah G. Ramos and Barbara C. Marquardt, ALJs.
6. The record in the case was closed with the filing of reply briefs on May 7, 1997.

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**Private Passenger Rates**  
**Fast Track Data**

7. Fast track data, the combined reports from the National Association of Independent Insurers and the Insurance Services Office, include total limits data and do not include uninsured/underinsured motorist (UM/UIM) data.
8. Not all insurers are included in the Fast Track data base.
9. Even though checking Fast Track data is a common actuarial procedure, particularly because of the data's recentness, the data should not be used directly in rate calculations for this proceeding.

**Actuarial Methodology**

10. Accident-year data for the years ending December 31, 1993, 1994, and 1995 should be used to calculate rates.
11. Credibility weights of 15 percent, 30 percent and 55 percent should be applied for each respective year from 1993 to 1995.
12. Premiums at present rates should be calculated using actual rate changes previously implemented by the Department.
13. Setting TAIPA bodily injury liability (BI), property damage liability (PD) and personal injury protection (PIP) rates at 145 percent of benchmark rates and setting TAIPA UM/UIM rates at 130 percent of benchmark would create a projected shortfall in premium.
14. TEX. INS. CODE ANN. art. 21.81 requires that the Commissioner of Insurance (the Commissioner) set TAIPA rates in an amount sufficient to carry all claims to maturity and to meet expenses incurred in the writing and servicing of the business.
15. Compared to setting TAIPA rates as an arbitrarily or judgmentally selected percentage of benchmark rates, the actuarially based loss ratio method is preferable because the method considers reports of aggregated premiums earned and losses and expenses incurred in the writing of motor vehicle insurance through TAIPA.



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16. While continued TAIPA depopulation may result in higher risk drivers remaining in the plan, it is possible to set assigned risk rates at adequate levels using the loss ratio method.
17. Although the reasons are unclear, the data indicate a wide variance between voluntary market and TAIPA insureds' UM/UIM experience.
18. Because of the variance, TAIPA UM/UIM rates should be based on TAIPA experience.

**Loss Development Factors**

19. Losses must be developed actuarially because the losses shown by industry data at any particular time may not be those that will ultimately be paid out by the insurers.
20. OPIC and TAIPA recommended virtually the same loss development factors for BI, PD, and PIP.
21. The loss development factors for BI, PD, and PIP recommended by TAIPA are reasonable and should be used because they are based strictly on the indications.
22. No basic limits loss development experience data for uninsured/underinsured bodily injury (UMBI/UIMBI) was available to the parties.
23. OPIC recommended that loss development factors for UMBI/UIMBI be based on basic limits BI experience.
24. TAIPA recommended that loss development factors for UMBI/UIMBI be based on total limits UMBI/UIMBI experience.
25. It is preferable to base UMBI/UIMBI development factors on UMBI/UIMBI experience because the development indications for UMBI/UIMBI are markedly different than those for BI.
26. It is reasonable to use TAIPA's recommended UMBI/UIMBI development factors.

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27. There was no loss development experience available for Uninsured/Underinsured Motorists Property Damage (UMPD/UIMPD) so both OPIC and TAIPA recommended using the basic limits PD development factors.
28. It is reasonable to use the PD development factors recommended by TAIPA to develop UMPD/UIMPD losses.
29. The weighted average UM/UIM loss development factors recommended by TAIPA are reasonable and should be used.

**Unallocated Loss Adjustment Expense (ULAE)**

30. The ULAE factor indications for each of the years 1993 - 1995 calculated by OPIC are reasonable.
31. In calculating the ULAE factor, indications for each of the years 1993 - 1995 should be averaged.

**Tort Reform**

32. TEX. INS. CODE ANN. art. 5.131 §3(g) requires the Commissioner to consider the effect of the tort reform legislation described in TEX. INS. CODE ANN. art. 5.131 §1 in determining rates for TAIPA.
33. There was insufficient evidence demonstrating tort reform may have different impacts upon total limits and basic limits policies.
34. The BI losses and ALAE should be adjusted for the anticipated effects of tort reform by applying the same tort reform loss and ALAE reduction percentage as is applied to voluntary private passenger BI.
35. UMBI/UIMBI and BI cover losses from similar events: bodily injury caused by a negligent third party.
36. The tort reform legislation will have an impact on UMBI/UIMBI claims experience similar to that on BI losses and ALAE.
37. UMBI/UIMBI losses and ALAE should be adjusted for the anticipated effects of tort reform by applying the same tort reform loss and ALAE reduction percentage as is applied to voluntary private passenger BI.

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**Take Out Program**

38. The TAIPA plan of operation provides for mandatory take out of drivers only if they have been in TAIPA, licensed, without accidents, and free of surchargeable traffic violations for three years.
39. No party presented quantitative evidence supporting an impact adjustment for TAIPA take out programs.

**Selected Trend Factors**

40. Even though TAIPA trends are higher than voluntary market trends, the BI and PD coverages show similar patterns to the voluntary market trends.
41. As calculated by TAIPA, the indicated three year linear assigned risk trends, as compared to the voluntary market trends, are:

**BI Claim Frequency**

TAIPA	18.7%
Voluntary Market (basic limits)	4.7%
Selected	4.0%

**BI Claim Severity**

TAIPA	3.9%
Voluntary (basic limits)	-1.6%
Selected	3.0%

Selected Pure Prem. Trend	7.1%
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**PD Frequency**

TAIPA	2.8%
Voluntary (total limits)	3.3%
Selected	0.0%

**PD Severity**

TAIPA	7.2%
Voluntary	

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(total limits)	5.2%
Selected	7.0%

Selected Pure Prem. Trend	7.0%
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**PIP Frequency**

TAIPA	25.8%
Voluntary	
(total limits)	1.4%
Selected	7.5%

**PIP Severity**

TAIPA	9.4%
Voluntary	
(total limits)	2.0%
Selected	5.0%

Selected Pure Prem. Trend	12.9 %
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42. Because some data points show signs of moderating, it is appropriate to select lower trends than those indicated.
43. The BI and PD pure premium trends selected by TAIPA are reasonable and should be used.
44. There was no evidence explaining why such a large discrepancy exists between the TAIPA PIP frequency trend and the voluntary market frequency trend.
45. Fast Track data through September, 1996, which is nine months more recent than the voluntary and TAIPA ratemaking trend data, shows a decreasing trend in PIP frequencies since late 1995.
46. It is reasonable to select an even lower PIP frequency trend than that recommended by TAIPA.
47. A 4.4 percent PIP frequency trend and a 9.4 percent PIP pure premium trend are reasonable and should be used.
48. Although trend data were available for UM/UIM coverage, it was not available separately for the UMBI/UIMBI and UMPD/UIMPD coverages.

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49. A 7.1 percent trend should be applied to UMBI/UIMBI and a 7.0 percent trend to UMPD/UIMPD.
50. The weights of 0.836 for BI and 0.164 for PD should be used to derive a UM/UIM pure premium trend of 7.1 percent.
51. A reasonable and common assumption made in trending losses is to use the midpoint of the experience period as the average experience date.
52. In making calculations, the parties assumed that the rates would become effective on October 1, 1997, and remain in effect for one year.
53. Losses should be trended based on the actual effective date of March 1, 1998.
54. Assuming policies are written for terms of one year, losses could occur as late as February 29, 2000 based on the actual effective date for the revised rates.
55. Assuming losses are distributed symmetrically over the entire experience period, the average date of loss is March 1, 1999.
56. Based on Findings Nos. 51 - 55, it is necessary to trend the cost of claims (losses) over time to that date.

**Fixed and Variable Expenses**

57. Expenses show some cyclicity; thus, data for three years should be averaged when calculating fixed and variable expenses.
58. With the exceptions addressed in Findings 72-74 and 79-81, it is reasonable to adopt OPIC's expense calculations in this proceeding (including using the average fixed dollar expense per automobile as the basis for calculating fixed expenses) because:
  - a. OPIC's expense calculations closely follow methodology previously adopted; and
  - b. no party seriously challenged the basic methodology.

**Policy Completion Factor**



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59. Data presented at the hearing indicated 95.6 percent of the policy premium is earned on voluntary business, but only 82.9 percent is earned on assigned risk business, based on data for three months.
60. There is insufficient evidence to support the application of the 1.25 factor recommended by TAIPA to reflect possible cost differentials between the voluntary and assigned risk markets.
61. It is reasonable to apply a factor of 1.153 (95.6 divided by 82.9 - see Finding No. 59) to reflect possible cost differentials between the voluntary and assigned risk markets.

Farmers Management Fee

62. Farmers Exchange pays a management fee to its management company and attorney-in-fact, Farmers Group, Inc.
63. The management fee paid by Farmers Exchange is higher than the actual administrative expenses of Farmers Exchange.
64. The Commissioner removed a portion of the Farmers management fee in the automobile insurance benchmark rate case, Order No. 96-0592 (Findings of Fact Nos. 111-113).
65. The 353rd District Court affirmed Order No. 96-0592, finding it supported by substantial evidence.
66. The excess amounts paid to Farmers Group, Inc. amounted to 5.5 percent of premium, which given the companies' approximately 16 percent market share in Texas, corresponds to 0.9 percentage points of the average fixed expense ratio.
67. It is reasonable to deduct 0.9 percentage points from the fixed expense ratio in determining the average fixed expense ratio, as recommended by OPIC.

Agents--Adjustment in General and Other Acquisition Expenses

68. The average commission ratio in 1995 was 5.7 percent for both voluntary and assigned risk markets combined.
69. Since the TAIPA commission ratio is 10.0 percent, the voluntary market commission ratio must be lower than 5.7 percent.

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70. Based upon the proportion of the business in each market, the voluntary market commission rate is approximately 5.2 percent.
71. Using a 1.5 percentage point reduction, which is less than 1/3 of the difference between 10 percent and 5.2 percent to adjust general and other acquisition expenses is reasonable.

SAP to GAAP

72. There was insufficient evidence offered to prove that OPIC's recommended reduction in expenses on a GAAP basis, which was based on OPIC's analysis of the SAP and GAAP reports of one insurer (Allstate), was reasonable.
73. There was no proof the Allstate data were representative of the industry as a whole.
74. Over time, rates of return based on SAP versus GAAP essentially are the same.

Installment Fee Revenue

75. Because installment fee charges are a revenue source not included as part of premium income, they may be reflected as a deduction from fixed expenses.
76. The assumption that eighty percent of TAIPA policies are financed through the installment payment plan is reasonable.
77. It is a reasonable estimate that each policy paid in installments will have total installment fee revenue of approximately \$32.00.
78. The average installment revenue as a percentage of premium is 2.6 percent.

Prepaid Expenses

79. The TAIPA plan of operation provides payment to an agent must be made in no more than 40 days from when the premium has been remitted or the policy has been bound and issued.
80. Because 40 days is roughly 1/9 of a year, 11 percent of commissions may not be prepaid.

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81. In determining prepaid expenses, it should be assumed that 89 percent of commissions are prepaid.

Limited Assignment Distribution Revenue

82. Because the limited assignment distribution revenue to one insurer will be an expenditure for another, no adjustment should be made for those fees.

Rate of Return

83. The discounted cash flow (DCF) model can provide a valuable estimate of the cost of capital.
84. OPIC's alternate DCF model, which is a modified version of the TAIPA DCF model, will yield a reliable result.
- a. It reviews data over a longer time period than the preferred OPIC model, and its growth rates are not based on subjective judgments by the economist as are those in OPIC's preferred model.
  - b. Instead of using the forecast growth rates TAIPA calculated with its witness' algorithm, which are unreasonably higher than the published ones, OPIC's alternate DCF model uses the actual forecast growth rates published in Value Line. This results in a calculation more likely to match investor expectations.
  - c. Instead of weighting forecast growth data very heavily as TAIPA recommends, OPIC's alternate DCF model gives equal weight to forecast and historical growth. This results in a calculation more likely to match investor expectations.
  - d. OPIC's alternate DCF model uses TAIPA's witness' dividend yield adjustment methodology, which is used by the Federal Energy Regulatory Commission in setting benchrates.
85. The DCF model referenced in Finding 84 should be calculated as follows.
- a. Value Line's published ten-year, five-year and projected values for earnings, dividends and fundamental growth should be averaged equally for the 16 companies named in Exhibit 11, Sched. 7, to determine an average growth rate of 10.12 percent.

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- b. Dividend yield for each company is calculated by multiplying the current quarterly dividend by one plus one-half the growth rate, multiplied by four and divided by the current market price, deriving an average, adjusted dividend yield of 2.19 percent.
  - c. The average DCF result is 12.31 percent.
- 86. Reasonable variations in the approach used to estimate dividend yields and/or growth rates, or in the sample of companies selected, would cause the DCF result to be somewhat above or below 12.31 percent.
  - 87. The capital asset pricing model (CAPM) is another, independent method by which the rate of return or cost of capital should be estimated, because sole reliance on the DCF for calculating the cost of capital is inappropriate.
  - 88. OPIC's estimated risk-free rate of 5.25 percent, based on 13-week U.S. Treasury bills, is reasonable.
  - 89. A market risk premium of 7.75 percent, based on the average of the geometric mean and the arithmetic mean, is reasonable.
  - 90. A Beta of .89 is reasonable.
  - 91. The CAPM cost of capital derived based upon Findings Nos. 88, 89, and 90  $\{5.25 + (.89 \times 7.75) = 12.15\}$  is reasonable.
  - 92. Based upon the DCF results, the CAPM results, and the other indications of the cost of capital, a reasonable cost of capital for the sample companies is 12 to 12.5 percent.
  - 93. The cost of capital estimate referenced in Finding No. 92 should be adjusted downward to compensate for the fact that the stock companies studied by the economists have more debt in their capital structures than their operating subsidiaries.
    - a. Adjusting the cost of capital through the use of the weighting scheme proposed by OPIC is not sufficiently supported by the record.

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- b. A reasonable estimate of the cost of capital for this proceeding is 11.5 to 12 percent or 50 basis points lower than the cost of capital determined to be reasonable for the sample companies.

#### **Profit Calculations**

- 94. OPIC's estimated post-tax investment return of 5.20 percent is conservative, i.e., is likely to understate the actual investment return of insurers.
- 95. None of the witnesses have made compelling cases regarding appropriate premium-to-surplus, premium-to-GAAP net worth, or reserve-to-surplus ratios. Viewed as a ratio of premium-to-GAAP net worth, the 1.75-to-1 ratio proposed by OPIC is unreasonably high.
- 96. The adoption of OPIC's recommended zero operating profit would be inappropriate.
  - a. It would deny insurers a return on the capital they have invested in support of TAIPA business.
  - b. It would be an unreasonable reflection of the cost of capital supporting TAIPA business, which has risk associated with writing it.
- 97. OPIC's calendar year accounting model and TAIPA's (IRR) should both be used to determine a range of reasonable underwriting profit factors.
- 98. Assuming an investment return somewhat higher than OPIC's 5.20 percent, and, in the model offered by OPIC, a premium-to-GAAP net worth ratio somewhat lower than 1.75-to-1 and a prepaid expense assumption consistent with 89 percent of commissions being prepaid, the profit models indicate that a 11.5 to 12.0 percent return on equity equates to an underwriting profit provision ranging somewhat above or below zero percent.
- 99. A reasonable underwriting profit provision is zero percent.

#### **Class and Territorial Relativities**

- 100. There was insufficient evidence indicating a change in the classes and territories presently used for TAIPA insureds, i.e., the same as those used in the voluntary market, are necessary.



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101. Although setting a PIP base rate and driver class rating factor independent of BI rates seems reasonable, the evidence was insufficient to determine whether such a change would be advantageous.

**TAIPA Rate Selection**

102. It is customary and convenient for the TAIPA rates to be expressed as a multiple of the voluntary private passenger automobile benchmark rates.
103. It has also been customary for BI and PD coverages to be the same multiple of their respective voluntary private passenger automobile benchmark rates.
104. The ratio of the current TAIPA PD base rate to the current TAIPA BI base rate differs substantially by territory.
105. The separate indicated BI and PD multiples of benchmark rates differ substantially, and applying a single common multiplier to the voluntary BI and PD rates would result, given Finding No. 104, in some TAIPA insureds paying too much and others too little.
106. It is preferable to have separate multiples of BI and PD benchmark rates to avoid this inequity.
107. The rate changes for TAIPA by statewide coverage and their relationship to the January 20, 1998 benchmark rates (Appendix A and B) are :

Approved Rate Change After Tort Reform		TAIPA Rates Relative to January 20, 1998 Benchmark
BI	+ 5.3%	+158.5%
PD	-12.8%	+ 45.8%
PIP	+44.2%	+382.6%
UMBI	+19.1%	+507.7%
UMPD	+19.1%	+425.2%

108. TAIPA rates will be determined by applying the percentages in Finding No. 107 "TAIPA Rates Relative to January 20, 1998 Benchmark" to the individual voluntary private passenger automobile benchmark rates by coverage, class and territory.

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**Commercial Rates**

109. Based on the lack of assigned risk commercial auto experience available for analysis, TAIPA commercial auto insurance rates should be set equal to the voluntary commercial auto benchmark rates.

**CONCLUSIONS OF LAW**

1. The Commissioner of Insurance has jurisdiction over this matter pursuant to TEX. INS. CODE ANN. arts. 1.33B and 21.81 §5.
2. The State Office of Administrative Hearings has jurisdiction over matters related to the hearing in this proceeding, including the authority to issue a proposal for decision with proposed findings of fact and conclusions of law, pursuant to TEX. INS. CODE ANN. art. 1.33B and TEX. GOV'T CODE ANN. §§2003.021(b) and 2003.042(5).
3. As referenced in Finding 1, proper and timely notice of the hearing was given pursuant to 28 TEX. ADMIN. CODE §1.1304 and TEX. GOV'T CODE ANN. §§2001.051 and 2001.052.
4. Pursuant to TEX. R. CIV. P. 166b (which is made applicable to rate proceedings by 28 TEX. ADMIN. CODE §1.1310 (a)), Prehearing Order No. 6 (referenced in Finding 2), granting TAIPA's motion for protective order as to Exhibits 19, 20 and 21, will remain permanently in effect, so that the diskettes, which contain proprietary information entitled to protection, will remain sealed and confidential.
5. Adoption of OPIC's recommended zero operating profit would violate the requirements in TEX. INS. CODE ANN. art. 21.81 §5(a) that the rates be adequate for the risks to which they apply and not confiscatory.
6. The setting of rates in accordance with these findings and conclusions is in compliance with the provisions of TEX. INS. CODE ANN. arts. 21.81 §5(a) and 5.131§3(g).

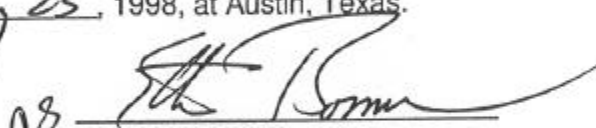
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IT IS, THEREFORE, THE ORDER OF the Commissioner of Insurance that, effective 12:01 a.m., April 1, 1998, rates applicable to private passenger automobile insurance policies written through the Texas Automobile Insurance Plan Association will be calculated based on these Findings of Fact and Conclusions of Law.

IT IS FURTHER ORDERED by the Commissioner of Insurance that the rates applicable to commercial automobile insurance policies assigned through the TAIPA are the commercial automobile benchmark rates established in Docket No. 454-96-1639.G, with such rates to be effective 12:01 a.m., March 1, 1998.

SIGNED and ENTERED January 23, 1998, at Austin, Texas.

  
09 ELTON BOMER  
COMMISSIONER OF INSURANCE