AUTOONENEWS

Fall 2005

What Drives You? ®

CEO's Message

EXPANDING ON A SOLID FOUNDATION

Whether you are a current AutoOne client or a potential client, meeting your company's Assigned Risk needs has always been the driving force behind both our success and our continuing growth.

We recently announced our 2006 plans to expand our LAD (Limited Assignment Distribution) services to Arizona, Colorado, Idaho, Montana, Nevada, New Mexico, Oregon, South Carolina, Utah, Washington, West Virginia and Wyoming along with the addition of CLAD (Commercial Limited Assignment Distribution) service in South Carolina. As a result, AutoOne now offers an Assigned Risk solution in **22** states covering **28** programs.

AutoOne's services are growing in direct response to the demand from our business partners, who want a stable, financially secure and experienced Assigned Risk servicing carrier for their long-term needs. We now offer carriers an innovative, new choice in service providers for all negotiated LAD/CLAD markets including states where a service monopoly previously existed. In our progressive expansion over the last four years, we have seen a positive competitive impact on each marketplace based on new, financially sound and professional competition. This competition has usually resulted in significant decreases in LAD rates for all carriers utilizing a servicing carrier, even those who have not yet chosen AutoOne.

AutoOne Insurance is a member of the White Mountains Insurance Group, Ltd, a $4 billion insurance services organization. We have both the financial strength and the unique personal auto core competencies necessary to meet the special challenges of managing Assigned Risk programs. And AutoOne recently wrote its 100,000th New York Take-out Policy, helping to significantly reduce the number of drivers in the New York Assigned Risk Automobile Insurance Plan, while at the same time providing

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AutoOne Insurance

P 1.866.252.4669

F 1.631.547.2254

www.AutoOneIns.com
news@AutoOneIns.com

assigned risk services

STABILITY AND GROWTH IN A RAPIDLY CHANGING ENVIRONMENT

As we approach September, we think it will once again be a very interesting LAD / CLAD 'marketing season.' The AutoOne success story continues as we have received regulatory approvals in the latest of our 12 expansion states. With this expansion, we now offer a total of 28 services (i.e. LAD, CLAD, PAP CLAD and Low Cost Auto) in 22 states. This means that we now offer a countrywide solution for managing of your Assigned Risk, ending the prior servicing carrier monopoly that existed in these states.

The big question for 2006 seems to be, "*who else is in the LAD / CLAD business?"* No one seems to be sure. It's likely you have seen or heard of the significant turmoil in the Assigned Risk market. With the announced termination of one LAD carrier's relationship with its former TPA, and another LAD carrier's litigation with one of its former clients (for failure to refund millions of dollars in fees), we think that the AutoOne difference was never as clear as it is today.

We anticipate that our competitors may attempt to be even more aggressive in their 2006 LAD and CLAD pricing in an effort to offset any real or perceived risks of doing business with them. We, however, remain steadfast in the knowledge that our stability, business practices and expertise in this marketplace create real value that can not be simply offset by "a few points of fee" and that AutoOne will continue to win over more and more clients in the end.

Our position on pricing for 2006 is the same as in prior years. No matter how competitive the landscape is, AutoOne will continue to provide the most competitive rates possible. And we will balance our need to be competitive with a pricing discipline that ensures that AutoOne will be here for the long-run. In certain instances this may mean walking away from business that we believe is underpriced. And if that is the case, we will continue to respect each carrier's decision.

The big question for 2006 seems to be, "who else is in the LAD / CLAD business?" No one seems to be sure.

As to the state of our competitors, we can't offer any specific insights. However, in our estimation, this is not the end of the tumultuous times, but may be just the beginning. As you consider your LAD / CLAD relationships for 2006, we think that the rate(s) should be just *one* of the questions. This year, more companies may be asking questions about:

Experience: Who is the underwriting company for this business? Who will actually be processing this business? Who will manage the claims? What is the relationship between these organizations?

Risk: Are there any contractual disputes, court orders or other directives, that could jeopardize their ability to service business for your company in the coming year?

Relationships: How are their relationships with their current and prior clients? Are there any matters in dispute?

Stability: What is their long-term commitment to the Assigned Risk market?

With the market awareness of the present uncertainty associated with the other LAD/CLAD carriers, several companies have asked, "Will AutoOne be able to help my company if my LAD carrier ceases to be able to perform?" Our answer was a resounding, "yes". And that will continue to be our answer throughout 2006 in the event of any market disruptions. We hope as you make your plans for LAD and CLAD services for 2006, the stability and security of your potential servicing carrier will be a significant factor in your initial decision-making process.

AutoOne is sound and strong. We continue to grow, and to manage our business for the long-run. This discipline means we are a safe and stable alternative that you can trust as a business partner. If these are values that your organization shares, we hope that we can do business together in the coming years.

~ Phillip D.Gibson
Senior Vice President

underwriting

READY TO GROW AGAIN

AutoOne's Underwriting Department has been busy addressing Assigned Risk processing requirements for our latest expansion of LAD services to Arizona, Colorado, Idaho, Montana, Nevada, New Mexico, Oregon, South Carolina, Utah, Washington, West Virginia and Wyoming and CLAD services to South Carolina. AutoOne has built a solid infrastructure to manage Assigned Risk business. Our present expertise and knowledge base regarding multi-state LAD/CLAD business operations provides our managers and staff with the core competencies that allow us to easily adapt our skills to process business in these additional states.

With this solid infrastructure already in place, we are examining our processes to ensure that any additional staffing and system resources will effectively execute all functions related to our expanded program offerings. Our preparations included researching the regulations and AIPSO Plan rules for each service in each state. We also focused on the residual market environments in each of the new markets.

Our customer service focused staff already possesses an abundance of Assigned Risk experience and we are looking forward to delivering more of the same service levels which have built our stellar reputation. We have high standards and we are confident that Underwriting's proactive and well-established internal processing methods and performance standards will continue to provide high quality results across all the programs we service.

Our expansion of services to these new states will open up AutoOne as a new carrier for many more LAD and CLAD clients and allow us to expand our business relationships with our existing clients. AutoOne is a company that has already proven to be a leader within the residual market Assigned Risk services area. We are ready and we look forward to another great year of service excellence.

~Myra Rakosky
VP, Underwriting

actuarial

WHERE ARE LAD RATES HEADED?

Since AutoOne entered the New York LAD market in late 2001, rates have declined each year and by over 85 percent from their peak in 2002. Will LAD rates continue to fall in 2006? Unfortunately, our indications say, “no.” We have cited some of the most significant factors that are driving the upward pressure on LAD rates in major markets.

Smaller Plan Sizes and Shifting Mix — As companies have acted to take risks out of the NYAIP to realize the quota benefit of Take-out Credits and as the voluntary market has become a more competitive market for AIP renewals (i.e. through prior insurance discounts), the renewal policy portion of the NYAIP has continued to decline. This means that the business remaining in the Plan is now comprised of a higher proportion of new business. Since new business typically runs at a significantly higher loss ratio than renewal business, the underlying loss ratios in the Plan will increase as a result.

In addition, significant declines in new NYAIP applications (35% so far in 2005) mean that what remains in the Plan are the lowest-quality risks that carriers are not willing to write through voluntary programs, even in this soft market (at least not at rates competitive with the Plan). This combination of fewer renewals and the movement of some of the higher quality new business into the voluntary market will push the AIP Plan loss ratio higher in 2006.

This same phenomenon is happening in many of the other large LAD markets such as New Jersey, Texas and California. As rate levels have increased and/or the voluntary markets have become more competitive, better risks are being removed from the Assigned Risk plans. This is expected to increase combined ratios in the AIP Plans and will require higher LAD rates to subsidize the underwriting losses. In many of the larger markets, 2006 will be a transitional period as AIP Plans return to being truly the "residual markets," and where underlying AIP costs increase.

NYAIP Rate Decrease Uncertainty — The most recent rate filing indication for the NYAIP is for a -16.8% rate decrease, based on data through 2003 — and after the impact of the Stewart Formula. This does not mean that the NYAIP rates are adequate. The 'pure' rate indications for the NYAIP (without the Stewart Formula) actually indicate a +14% rate increase, without consideration of the loss ratio impact of expected changes in the mix of business in the NYAIP in 2006.

Since the New York State Insurance Department reviews the rate indications after the effect of the Stewart Formula, it is likely that they will approve a rate decrease to the Plan, which would increase the inadequacy of Plan rates, requiring higher LAD rates. Unfortunately, the uncertainty regarding both the timing and the magnitude of a NYAIP rate decrease (in late 2005 or early 2006) leaves the impact to LAD rates in question.

Non-Standard PPA Rate Levels — If NYAIP rates decrease before 2006, it is likely that the Plan would start to repopulate in areas where AIP rates are the most inadequate. This would exacerbate the mix problem and would accelerate deterioration in the loss ratio. Non-standard PPA carriers may no longer be able to write AIP risks profitably at a rate level lower than the AIP and the AIP volume in these segments will increase at a higher loss ratio.

Smaller NYAIP Take-out Credit Margins — Many companies have reduced their exposure to new AIP assignments by writing Take-out policies and leveraging the 2-for-1

Take-out Credit multiple. However, the shrinking pool of AIP renewals (from which to take business out) means that the risks now available for Take-out have significantly worse characteristics and generally run at higher loss ratios. Higher loss ratios translate into a smaller available subsidy from the Take-out programs, which in turn, means that a higher LAD rate is warranted.

It should also be noted that any AIP rate decrease would have to be followed by a corresponding Take-out program rate decrease in order to keep the Take-out program rates competitively below AIP rate levels. Such an action would further reduce the effect of the 2-for-1 subsidy and decrease the incentive to write Take-out policies on any scale.

NY PIP Litigation Cost Drag — The time lag for resolution of thousands of litigated PIP cases in New York will continue to cause uncertainty in pricing for future years. Since the statute of limitations on PIP cases extends for six years, it is likely that the data (both on the indemnity side and the LAE side) reflecting the resolution of these cases will not filter into industry data for some time. Actuarially speaking, the incurred loss development "tail factor" for PIP is significantly extended compared to historical industry experience. AutoOne has certainly seen this PIP litigation lag and loss development in our own NYAIP book. We think this adds a significant component of uncertainty that will be magnified in 2006 as the size of the Plan declines and the mix in the AIP continues to deteriorate.

NJ Considerations — In New Jersey, the second largest Plan in the country, LAD rates are facing upward pressure due to two recent developments. The first is the 8% NJ PAIP rate decrease that became effective 12/1/2004. This rate decrease was generally not factored in to LAD pricing for the 2005 policy year. The second is uncertainty regarding the impact of the DiProspero vs. Penn ruling on BI and UM loss costs. The ruling removes the requirement that injured parties prove that an injury has a serious life impact in order to qualify for benefits under the verbal tort threshold. A recent study published in the Journal of Insurance Regulation indicates that this ruling could have a significant impact on combined ratios in New Jersey, which will put further upward pressure on the 2006 LAD rate relative to 2005.

There is some good news! The primary dynamic in many markets that is putting upward pressure on LAD rates is shrinking Plan size. Therefore, while LAD rates may be higher in some of these markets, the overall dollar amount of LAD fees paid in those markets will be at least partially offset by smaller Plan volume. Lower quota premium obligations (the product of a company's quota share and Plan volume) should help to mitigate any increases in LAD rates in these markets.

Pricing discipline is one of AutoOne's core disciplines. While we work in every way to provide the lowest possible LAD rates, we balance that drive with pricing discipline. By maintaining that balance, we ensure that we provide a competitive alternative for your company year after year. Disciplined pricing allows AutoOne to provide our clients with a full-service LAD solution for many years to come and minimizes the risk of market disruption that has been seen in the past.

In this part of the market cycle most AIP mechanisms are returning to a true residual market position and rising AIP loss cost trends are being seen in many states. Those carriers that practice pricing discipline will be much more likely to provide a financial stable choice through all stages of the assigned risk and voluntary auto market cycles. We hope that AutoOne will be your choice for LAD and CLAD service through the entire market cycle.

~ Ben Walden
VP, Chief Actuary

claims management

THE IMPORTANCE OF TEAMWORK

As we enter the fourth quarter of 2005, we are preparing for another exciting year of growth, challenges and new opportunities across our organization.

It was recently announced that AutoOne would be expanding our business into 12 new states with 12 new programs. Given our broad capabilities and experience, the Claims team will be well prepared to manage our activities relating to claims compliance laws and regulations in each of the new states, and will be well positioned for continued success.

A key factor in the ability to drive effective results across the current and expanding AutoOne landscape, are the integrated working relationships that exist with the partners in our Special Investigations Unit (SIU) and the Legal Department.

The AutoOne SIU Department has developed a strong reputation within the insurance industry for combating insurance fraud. We plan on taking this same assertive approach as we enter our new markets. We have the ability to utilize our numerous industry affiliations including the National Insurance Crime Bureau (NICB) and the International Association of Special Investigation Units (IASIU). We also have the ability to leverage the resources of our parent company, White Mountains, and their affiliated companies.

We have instituted many successful anti-fraud initiatives at AutoOne. SIU provides regularly scheduled fraud awareness training to our claims and underwriting staff in order to allow for the early identification of potential fraud. Topics include provider fraud, staged accidents, enhanced damages, owner give-up thefts and rate evasion. Our approach does not just entail the identification and investigation of suspicious losses, but also includes the vigorous defense of these matters through our Legal Department.

This close working relationship allows for a comprehensive defense and utilizes the vast experience of our investigative, legal and claims staff in court proceedings. Our partnership is not limited to the defense of claims. It also includes a proactive strategy to address global issues, specifically in the area of actively identifying provider fraud on many fronts and avoiding unwarranted payments for such services.

AutoOne's Legal Department has developed a reputation within the legal community of providing outstanding legal services along with appropriately active defense work. As the various jurisdictions and judges wrestle with the many nuances of automobile litigation, the attorneys and staff within our Staff Counsel Offices forge ahead, representing the interests of the Company and its insureds with resolve and integrity. It has been our experience and practice to stand firm, remain calm and steadfast, because that is how cases are won, especially in less agreeable court environments such as those hearing first party cases against the Company.

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Our aim is to be as prepared as possible from the referral of a case, all the way to trial, with all of the tools necessary to assist us. This includes access to the most recent case law, statutes, regulations, and most importantly, the collaboration with our Claims and SIU partners to develop creative and effective legal strategies to achieve desired results. This teamwork is most prominent in the joint effort between the three departments in the development of cases where provider fraud and improperly formed medical corporations are suspect.

Our claim professionals, staff attorneys and SIU investigative teams work together as we identify behaviors and trends which can adversely affect results. Legal and SIU bring unique perspective to the claims adjustment dynamic given their knowledge of current case law and trends of the courts. SIU's ability to access both our own and national database information, adds tremendous perspective to investigative and adjusting activities, allowing us to make more informed decisions which in turn allows AutoOne to affect the best possible claim outcome. It's a team effort, and we have the right players to win!

~Ralph Marinello
VP, Claims

~ Dave Tetlak, Esq.
AVP, Legal

~ Harvey Aloni
AVP, SIU

We are pleased to announce the appointment of **Paul DiFrancesco** to the newly added position of **Chief Operating Officer**. This position was created as of a result of our rapid growth and continued expansion.

Paul brings 26 years of experience in the insurance industry, most recently as the Vice President of the Specialty Automobile division at St. Paul Travelers and as the President of Mendota Insurance Company, a St. Paul Travelers' Non-Standard auto operation. Prior to Travelers, Paul served as the Executive VP of product and business development at ACE-INA Holdings, Inc., a multi-line international insurance and reinsurance firm.

Paul brings an especially appropriate range of experience in personal lines and extensive experience in building and managing organizations in specialized automobile insurance businesses. Paul will be actively involved in the planning and execution of organizational strategies and programs in support of critical business objectives.

Welcome Paul!

AutoOne in the News

Our own AVP of Claims, Adam Karol, was featured in a special supplement of the National Underwriter's TechDecisions magazine. The article discussed how insurers are improving their claim's systems through cost-cutting and enhanced customer service, investing in new management systems and workflow-focused tools.

The full article, *"Claims Technology, Double Play"* is available online at:

http://www.technologydecisions.com/
August 2005

Also in the news was our SVP, Phil Gibson. He was interviewed by *Best Services*, A.M. Best's daily newsletter, discussing AutoOne's expansion plans and the state of the Assigned Risk market.

The full article, *"AutoOne Expanding Assigned Risk Business to New Markets"* is available online at:

http://www.ambest.com
August 2, 2005

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a method of reducing the Assigned Risk quotas and costs for our New York clients.

Each phase of our Company's growth in Assigned Risk offerings has been accomplished on the foundation we've built: strong organizational capabilities, experienced management team and associates, and an adherence to best practices and fair dealings. Our goal is to be a long-term trusted business partner for our clients.

With the continuing soft personal auto market and given the number of rate reductions implemented or expected in several AIP programs, 2006 looks to be an interesting year for all of us in the personal auto insurance business. We have observed that many Assigned Risk plans are shrinking, with new application counts for the largest Plans down over 30% compared to 2004. Generally this means that AIP plans will be composed of the core, or "worst of the worst" risks. This means that Plan loss ratios will likely deteriorate from current levels, as the "better" business finds a home in the voluntary market. However, even with this anticipated deterioration in results, we will work to maintain the most competitive fee structures possible.

You will hear more about our expansion of services and our expectations for the Assigned Risk markets in this newsletter and through our personal communications with you over the next few months. I hope your find this information useful in your business. We look forward to continuing our business relationship with your firm, as well as continuing to reach out to new clients.

~ Carey D. Benson
President & CEO

Questions? Contact Us.

Peter Treutlein
Director, Assigned Risk Services
631.547.2010
PTreutlein@AutoOneIns.com

Ben Walden
VP, Chief Actuary
631.547.2310
BWalden@AutoOneIns.com

Phil Gibson
Senior Vice President
631.547.2350
PGibson@AutoOneIns.com