21ST CENTURY INSURANCE GROUP
Form 10-K
March 04, 2002

FORM 10-K 21ST CENTURY INSURANCE GROUP

(Exact name of registrant as specified in its charter)

CALIFORNIA (State or other jurisdiction of incorporation or organization)	95-1935264 (I.R.S. Employer Identification number)
6301 OWENSMOUTH AVENUE WOODLAND HILLS, CALIFORNIA (Address of principal executive offices)	91367 (Zip Code)
(818) 704-3700 (Registrant's telephone number, including area code)	Web site: www.i21.com

SECURITIES REGISTERED PURSUANT TO SECTION 12 (B) OF THE ACT:

COMMON STOCK, WITHOUT PAR VALUE (Title of Class)	NEW YORK STOCK EXCHANGE (Name of each exchange on which registered)

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements, incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

The aggregate market value of the voting stock held by non-affiliates of the registrant, based on the average high and low prices for shares of the Company's Common Stock on January 31, 2002, as reported by the New York Stock Exchange, was approximately $422,000,000.

On January 31, 2002, the registrant had 85,362,484 shares of common stock outstanding, without par value, which is the Company's only class of common stock.

DOCUMENT INCORPORATED BY REFERENCE:
Portions of the definitive proxy statement used in connection with the annual meeting of shareholders of the registrant, to be held on June 26, 2002, are incorporated herein by reference into Part III hereof.

PART I

ITEM 1. BUSINESS

GENERAL

21st Century Insurance Group is an insurance holding company founded in 1958 and incorporated in California. The term "Company," unless the context requires otherwise, refers to 21st Century Insurance Group and its wholly owned subsidiaries, 21st Century Insurance Company and 21st Century Casualty Company, both of which are incorporated in California as property and casualty companies. The common stock of the Company is traded on the New York Stock Exchange under the trading symbol "TW." Through several of its subsidiaries, American International Group, Inc. ("AIG"), currently owns approximately 63% of the Company's outstanding common stock.

The Company is a direct-response underwriter, which sells and services mainly private passenger automobile insurance directly to the public without commissioned agents. The Company has gained a reputation for excellent customer service and for being among the most efficient and low cost providers of personal auto insurance in the markets it serves.

The Company's business began in Los Angeles and historically has been concentrated in Southern California, principally the greater Los Angeles metropolitan area. In the mid-1980's, the Company expanded into the San Diego area and, in the early 1990's, the Northern California area. In August 1996, 21st Century Insurance Company of Arizona ("21st of Arizona") began writing private passenger automobile insurance in that state. 21st of Arizona began as a joint venture between the Company, which owned a 49% interest, and AIG, which owned 51% until the Company acquired that interest on January 1, 2002. In late 1998, the Company began writing private passenger automobile insurance in Nevada, Oregon and Washington.

The Company is running off approximately 73,000 homeowner policies remaining on its books at December 31, 2001. Under a January 1, 2002, agreement with Balboa Insurance Company ("Balboa"), a subsidiary of Countrywide Credit Industries, Inc. ("Countrywide"), 100% of homeowner unearned premium reserves and future related losses are reinsured by Balboa. The Company began non-renewing homeowner policies expiring on February 21, 2002, and thereafter. Substantially all of these customers are expected to be offered homeowner coverage through an affiliate of Countrywide.

The Company ceased writing earthquake coverage in 1994 but remains exposed to possible upward development in certain loss estimates relating to the 1994 Northridge Earthquake (see further discussion in Item 7 under the captions Underwriting Results - Homeowner and Earthquake Lines in Runoff and All Other, Critical Accounting Policies, and in Note 16 of the Notes to Consolidated Financial Statements).

TYPES AND LIMITS OF INSURANCE COVERAGE

The Company offers the following types of insurance coverage for private passenger automobiles in California: bodily injury liability; property damage; medical payments; uninsured and underinsured motorist; rental reimbursement; uninsured motorist property damage and collision deductible waiver; towing; comprehensive and collision. Bodily injury and property damage are required by state law and typically cover the other party's costs when the Company's policyholder causes an accident. Uninsured and underinsured motorist are optional coverages and cover the Company's policyholder when the other party is at fault and has no or insufficient liability insurance to cover the insured's injuries and loss of income. Comprehensive and Collision coverages are also optional and cover damage to the policyholder's automobile whether or not the insured is at fault. In some states, the Company is required to offer personal injury protection coverage in lieu of the medical payments coverage required in California. Policies are written for a six-month term.

Various limits of liability are underwritten with maximum limits of $500,000 per person and $500,000 per accident. The most frequent bodily injury liability limits purchased are $100,000 per person and $300,000 per accident.

The Company's personal umbrella policy ("PUP") provides liability coverage with a limit of $1,000,000 in excess of the underlying automobile liability coverage. Minimum underlying automobile limits of $100,000 per person and $300,000 per accident are required. The underlying automobile coverage must be written by the Company. The Company reinsures 90% of any PUP loss with unrelated reinsurers.

The homeowner program utilizes an extended replacement cost policy, thereby limiting the insured's recovery to 150% of the amount specified in the contract for Coverage A - Dwelling and Other Building Structures. Underwriting guidelines provide for a minimum dwelling amount of $65,000 and a maximum dwelling amount of $750,000.

MARKETING

The Company, through its subsidiaries, markets personal auto policies in California, Arizona, Nevada, Oregon and Washington. As a direct writer, the Company does not incur agent commissions. Marketing efforts currently are focused primarily on the larger urban markets in California.

The Company offers a feature-rich product, high quality service and low cost. This combination appeals to customers in the growing segment of the market who are comfortable assessing their own insurance needs and distinguishing genuine value from illusion in the marketplace.

The Company's marketing and underwriting strategy is to appeal to careful and responsible drivers, who can obtain low cost insurance by dealing directly with the Company and thereby avoid broker and agent commissions. In addition to referrals, the Company uses direct mail, print, radio, television, outdoor and Internet advertising to generate sales. Because a policy is purchased directly by the customer, the Company focuses on making the purchasing process simple and convenient. In California and Arizona, quotes may be requested 24 hours a day, 7 days a week through a convenient, toll-free 800 number. California prospects may also obtain an instant auto rate quotation and purchase a policy on the Company's Internet site (http://www. i21.com).

UNDERWRITING AND PRICING

The following table indicates the concentrations of the Company's underwriting risks for the past five years:

	Percent of Direct Premiums Written				
	2001	2000	1999	1998	1997
Personal auto lines					
California	94.6%	94.6%	96.4%	97.2%	97.0%
Other states	2.1	2.2	0.8	-	-
Total auto lines	96.7	96.8	97.2	97.2	97.0
Homeowner lines in runoff	3.3	3.2	2.8	2.8	3.0
	100.0%	100.0%	100.0%	100.0%	100.0%

The regulatory system in California requires the prior approval of insurance rates and forms. Within the regulatory framework, the Company establishes its premium rates based primarily on actuarial analyses of its own historical loss and expense data. This data is compiled and analyzed to establish overall rate levels as well as classification differentials. The Company's rates are established at levels intended to generate underwriting profits and vary for individual policies based on a number of rating characteristics. California law requires that the primary rating characteristics that must be used for automobile policies are driving record, annual mileage and number of years the driver has been licensed. A number of other "optional" rating factors are also permitted and used in California.

The Company is required to offer insurance to any California prospect that meets the statutory definition of a "Good Driver." This definition includes all drivers who have been licensed more than three years and have had no more than one violation point count under criteria contained in the California Vehicle Code. These criteria include a variety of moving violations and certain at-fault accidents.

The Company reviews many of its policies prior to the time of renewal and as changes occur during the policy period. Some mid-term changes may result in premium adjustments, cancellations or non-renewals because of a substantial increase in risk.

SERVICING OF BUSINESS

Computerized systems provide the information resources, telecommunications and data processing capabilities necessary to manage the Company's business. These systems support the activities of employees in the Company's call centers and marketing, policy service and claims areas that are dedicated to serving the needs of customers. New technology investments have been focused on making it faster and easier for customers to transact business while ultimately lowering the cost per transaction. Using the Company's Internet site, California consumers are now able to receive a quotation, accept the quote and bind a policy, pay their bill, inquire about the status of their policy and billing information, make most common policy changes, submit a first notice of loss on a claim and access a wealth of consumer information.

New Customer Relationship Management technology began to be implemented in 2001 that provides the Company's call center representatives with integrated knowledge about customer contacts and enables speedier and even more convenient customer service.

CLAIMS

Claims operations include the receipt and analysis of initial loss reports, assignment of legal counsel when necessary, and management of the settlement process. Whenever possible, physical damage claims are handled through the use of Company drive-in claims facilities, vehicle inspection centers and Direct Repair Program ("DRP") providers. The claims management staff administers the claims settlement process and oversees the work of the legal and adjuster personnel involved in that process. Each claim is carefully analyzed to provide for fair loss payments, compliance with the Company's contractual and regulatory obligations and management of loss adjustment expenses. Liability and property damage claims are handled by specialists in each area.

The Company makes extensive use of its DRP to expedite the repair process. The program involves agreements between the Company and over 130 independent repair facilities. The Company agrees to accept the repair facility's damage estimate without requiring each vehicle to be reinspected by Company adjusters. All DRP facilities undergo a screening process before being accepted, and the Company

maintains an aggressive inspection audit program to assure quality results. The Company's inspection teams visit all repair facilities each month and performs a quality control inspection on approximately 40% of all repairable vehicles in this program. The customer benefits by getting the repair process started faster, and by having the repairs guaranteed for as long as the customer owns the vehicle. The Company benefits by not incurring the overhead expense of a larger staff of adjusters and by negotiating repair prices it believes are beneficial. Currently, over 30% of all damage repairs are handled using the DRP method.

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The Company's policy with respect to vehicle repairs is not to use after market "crash" parts. As a result, the Company believes it does not face exposure to the types of class action suits some competitors have drawn over their use of such parts.

The Company has established 14 claims Division Service Offices in areas of major customer concentrations. The three Vehicle Inspection Centers, located in Los Angeles and Orange Counties, handle total losses, thefts and vehicles which are not driveable.

The Claims Services Division is responsible for subrogation and medical payment claims. The Company also maintains a Special Investigations Unit, which investigates suspected fraudulent claims. The Company believes its efforts in this area have been responsible for saving several million dollars annually.

The Company utilizes internal legal staff to handle most aspects of claims litigation. In-house attorneys handle approximately 70% of all lawsuits. Suits directly against the Company and those which may involve a conflict of interest are assigned to outside counsel.

LOSS AND LOSS ADJUSTMENT EXPENSE RESERVES

The Company establishes a liability at each accounting date for losses and loss adjustment expenses arising from claims, both reported and unreported, which have been incurred but which remain to be paid. Such reserves are estimates, as of a particular date, of the amount the Company will ultimately pay, net of any recoverable salvage and subrogation, for claims incurred as of the accounting date.

The Company establishes case basis reserves based upon various factors such as the severity of the injuries and property damage sustained, and the age of the claim.

The Company supplements the case basis reserve estimates with bulk loss reserves, which are estimated using actuarial methodologies. These reserves are designed to provide for claims incurred but not reported ("IBNR") as of the accounting date, changes over time in case reserve estimates and loss adjustment expenses which include estimates of the legal and other costs of settling claims. The Company's reserving methodology uses aggregate trends regarding loss frequency and severity that implicitly consider the effects of inflation, which management believes is appropriate given the relatively short-term nature of the Company's personal lines exposures. Management believes the use of explicit inflation assumptions would unnecessarily complicate its methodology without appreciably improving its accuracy or reliability. The Company does not discount its reserves to present value for financial reporting purposes.

Reserve estimates are necessarily subject to the outcome of future events, such as changes in medical and repair costs as well as economic and social conditions that impact the settlement of claims. Management believes that, given the inherent variability in any such estimates, the aggregate reserves are within a

reasonable and acceptable range of adequacy. The methods of making such estimates and for establishing the resulting reserves are reviewed and updated quarterly with any resulting adjustments reflected in earnings currently.

The Company believes that the earthquake loss and loss adjustment reserves resulting from California Senate Bill 1899 ("SB 1899") cannot be estimated by conventional reserving techniques. See further discussion in Item 7 under the captions Underwriting Results - Homeowner and Earthquake Lines in Runoff and All Other, Critical Accounting Policies, and Note 16 of the Notes to Consolidated Financial Statements.

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In the Consolidated Balance Sheets, the reserves for losses and loss adjustment expenses are shown "gross," that is before reduction for reinsurance. A rollforward of loss and loss adjustment expense reserves, including the effects of changes in estimates recorded in the current year that pertain to loss events of prior years, loss payments and reinsurance for each of the three years in the period ended December 31, 2001, is presented in the Notes to Consolidated Financial Statements.

The tables on the following two pages present the development of loss and loss adjustment expense reserves, net of reinsurance (Table 1) and direct (Table 2), for the years 1991 through 2001.

The top line of each table shows the reserves at the balance sheet date for each of the years indicated. The upper portion of the table indicates the cumulative amounts paid as of subsequent year-ends with respect to that reserve liability. The lower portion of the table indicates the re-estimated amount of the previously recorded reserves based on experience as of the end of each succeeding year, including cumulative payments made since the end of the respective year. The estimates change as more information becomes known about the frequency and severity of claims for individual years. A redundancy (deficiency) exists when the original reserve estimate is greater (less) than the re-estimated reserves.

Each amount in the tables includes the effects of all changes in amounts for prior periods. The tables do not present accident year or policy year development data. Conditions and trends that have affected the development of liabilities in the past may not necessarily occur in the future. Therefore, it would not be appropriate to extrapolate future deficiencies or redundancies based on the table.

Excluding the effects of the homeowner and earthquake lines shown in the tables, which are discussed under the caption Underwriting Results - Homeowner and Earthquake Lines In Runoff and All Other and in Note 16 of the Notes to Financial Statements, the deficiency that emerged in the 1999 column is primarily due to the Company's initial over-estimate of the beneficial effect on loss costs of laws passed in prior years which limited the rights of uninsured motorists and drunk drivers to collect non-economic damages. The deficiency in the 2000 column, excluding the effects of the homeowner and earthquake lines, is mainly due to the Company's under-estimate of the changes in loss severity trends that became apparent in 2001.

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TABLE 1 - As of December 31, (Amounts in thousands)	1991	1992	1993	1994	1995

RESERVES FOR LOSSES AND LOSS ADJUSTMENT EXPENSES, NET OF REINSURANCE	$547,098	$554,034	$574,619	$ 755,101	$ 552,320	$
PAID (CUMULATIVE) AS OF:						
One year later	320,264	327,634	344,876	519,969	351,985	
Two years later	401,019	403,434	423,713	635,861	485,462	
Three years later	426,412	425,671	443,055	721,445	527,908	
Four years later	433,642	432,086	457,430	745,912	574,260	
Five years later	436,522	434,949	460,857	787,262	583,397	
Six years later	437,365	436,876	461,901	795,331	610,472	
Seven years later	437,758	436,982	462,647	818,078		
Eight years later	437,713	437,125	462,609			
Nine years later	437,876	437,115				
Ten years later	437,839					
RESERVES RE-ESTIMATED AS OF:						
One year later	473,209	491,048	490,166	715,637	526,730	
Two years later	461,343	447,880	465,036	725,098	537,635	
Three years later	440,198	438,726	453,431	751,302	579,093	
Four years later	437,350	435,128	460,947	790,479	582,013	
Five years later	436,929	435,942	462,372	791,377	583,536	
Six years later	437,600	437,034	461,347	795,037	658,288	
Seven years later	437,706	436,476	462,075	865,785		
Eight years later	437,383	436,738	462,341			
Nine years later	437,603	436,905				
Ten years later	437,696					
Redundancy (deficiency)	109,402	117,129	112,278	(110,684)	(105,968)	
Less effect of Homeowner and Earthquake lines in runoff *	2,959	2,978	10,524	(228,232)	(181,961)	
Redundancy (deficiency) excluding Homeowner and Earthquake lines	$106,443	$114,151	$101,754	$ 117,548	$ 75,993	$

TABLE 1 - As of December 31, (Amounts in thousands)	1999	2000	2001
RESERVES FOR LOSSES AND LOSS ADJUSTMENT EXPENSES, NET OF REINSURANCE	$ 243,398	$ 266,953	$325,778
PAID (CUMULATIVE) AS OF:			
One year later	227,230	271,116	
Two years later	310,570		
Three years later			
Four years later			
Five years later			
Six years later			
Seven years later			
Eight years later			
Nine years later			
Ten years later			
RESERVES RE-ESTIMATED AS OF:			
One year later	288,421	384,960	
Two years later	371,946		
Three years later			
Four years later			
Five years later			
Six years later			
Seven years later			

Eight years later		
Nine years later		
Ten years later		
Redundancy (deficiency)	(128,548)	(118,007)
Less effect of Homeowner and Earthquake lines in runoff *	(73,128)	(72,201)
Redundancy (deficiency) excluding Homeowner and Earthquake lines	$ (55,420)	$ (45,806)