

Dryden review

April 2005

This newsletter is intended to discuss issues of general interest to Dryden Mutual agents. This letter is written as the rough equivalent of what would be covered in a current marketing visit from our professional staff. Please try to share this letter with all the people in your agency that work with Dryden Mutual.

SUMMARY of KEY FINANCIAL STATISTICS REPORTED by DRYDEN

The following financial numbers are identical to those submitted to the National Association of Insurance Commissioners (NAIC) and the New York State Insurance Department on our Annual Statements filed for the past 5 consecutive years. It should be obvious that 2004 was an outstanding year even when compared to a long string of great years for Dryden Mutual. A key issue to note below is that Dryden Mutual much more than doubled its premium volume in only a few years during the most recent hard market cycle.

	<u>12-31-00</u>	<u>12-31-01</u>	<u>12-31-02</u>	<u>12-31-03</u>	<u>12-31-04</u>
Direct Written Premium	\$16,482,014	\$19,639,666	\$25,401,823	\$31,862,668	\$35,186,899
YTD DWP Growth Rate	+ 9.19%	+ 19.16%	+29.34%	+25.43%	+10.43%
Net Written Premium	\$14,670,660	\$17,666,765	\$23,424,804	\$29,550,144	\$33,067,106
Net Admitted Assets	\$29,904,843	\$33,918,196	\$41,936,224	\$48,898,453	\$63,928,504
Policyholder Surplus	\$12,477,337	\$13,110,970	\$15,316,575	\$17,046,465	\$28,211,180
Net Leverage (NWP/PHS)	1.18 to 1	1.35 to 1	1.53 to 1	1.73 to 1	1.17 to 1
Combined (Trade) Ratio	98.86	96.76	91.72	88.45	79.30
A.M. Best Rating	A-	A-	A-	A-	A-

FINANCIAL MANEUVERING has WORKED VERY WELL for DRYDEN

The rapid growth of Dryden Mutual in the hard market years 2000 through 2004 produced great results for the company, but it also put a lot of stress on our financial leverage as can be seen in the above chart. We started the hard market with a very respectable financial leverage ratio of 1.18 to 1.00 (net written premiums versus policyholder surplus), but by the end of 2003 our growth forced the leverage up to 1.73 to 1.00. No matter what rating agencies like A.M. Best say about their sophisticated financial analysis, they basically “love” companies whose financial leverage ratio falls around or below 1.00 to 1.00 and generally give such low-leveraged companies superior ratings. As can be seen above, Dryden Mutual used several financial maneuvers to get back into relatively safe leverage territory by the end of 2004.

During 2004, Dryden Mutual used several tactics to avoid potential future problems. First of all, as we kept growing fast and hit a high leverage ratio of 1.73 to 1.00 in 2003, we managed to at least keep reporting improving combined ratios. So when we hit 1.73 to 1.00 in 2003, it was not a major problem because at the same time we also concurrently produced an 88.45 combined ratio in 2003. In mid-2004, we also obtained a surplus note to finance the growth that had caused the company to double in such a short period and we also made a conscious attempt to slow down our rate of growth. This attempt to slow our rate of growth was necessary even though we knew we were at the tail-end of hard market conditions. The benefit in slowing down in 2004 was that, even by excluding the value of the surplus note, our internal rate of surplus growth was boosted to three times the rate of our premium growth in that year! Finally, we were able to use the surplus note as an alternative risk transfer device to substitute for the purchase of two layers of conventional per risk treaty reinsurance starting in 2005 and potentially save the company literally millions of dollars in the coming years.

Study the chart above. It all worked! Thank you for the role you and your agency have played in helping us to produce such a great track record over all these years.

GROWTH CAPACITY FULLY RESTORED for 2005

Now that the books on 2004 are closed, we have to start planning for conditions unfolding in 2005. Dryden Mutual's published plan is to try to continue growth in 2005 at around the +10% level. From a review of the chart on the first page of this newsletter, it should be quite obvious that Dryden Mutual has been able to fully restore our capacity to handle almost any reasonable level of growth in 2005, but the big question is whether or not the +10% will really turn out be a "stretch" goal in a rapidly softening 2005 market. After 3 straight years of 20% compounded annual growth in levels of new business for Dryden Mutual in 2001-2002-2003, new business counts dropped 7% in 2004. So far in 2005, it appears that the market still seems to be turning competitive "with a vengeance" and our new business counts are dropping even faster than they did in 2004. Our underwriters and marketing staff are being given the message in 2005 that Dryden Mutual is open to help our agents do what they always do best – write quality new business!

COMMERCIAL LINES RENEWAL BUILDING and CONTENTS VALUES

Almost all easy-to-use replacement cost valuation guides readily available to us are now badly outdated and getting worse as we go into 2005. Rebuilding any kind of office, mercantile or habitational structure at under \$100 a square foot in Upstate New York is virtually impossible in 2005, especially when debris removal costs have to be included. Building materials and labor costs have been increasing at a pace that far exceeds the published federal inflation indexes for many years now. This rapid inflation has been fueled by vast overseas (mainly Chinese) demand for plywood, lumber and all other building materials. Building material pricing has also been severely impacted by major wild fires in California and hurricanes in Florida that have driven building material costs ever higher as Americans start rebuilding entire communities.

A 2005 survey of builders in rural Central New York reveals that most commercial and residential frame building construction costs start in the \$120 to \$130 range with reputable builders who carry workers compensation and general liability. Some modular builders can put a decent residence up for costs in the \$100 range per square foot range at the very low end of what is realistic in 2005. However, our typical inforce replacement cost insurance policy on a frame residence, apartment, or office is being insured for values only around \$45 to \$50 per square foot (an average 1800 square foot building is typically insured for around \$80,000 to \$90,000). Our underwriters keep hearing arguments that minimal quality new construction in certain areas can be done with non-union labor at \$85 to \$90 a square foot, but we also know that these low per square foot estimates do not take into account the additional insurable reconstruction costs of debris clean-up and removal, and we also know that we can not force insureds to always choose non-union contractors when they actually have to re-build. Severe underinsurance has

never been in anyone's best interest. The company benefits from proper insurance to value before a loss by collecting correct premiums, and insureds benefit from proper insurance to value after a loss occurs because they can collect full replacement cost payment after their buildings have been damaged. Our goal in 2005 is to write most replacement cost new business property values at a replacement cost at a minimum in the \$100 to \$130 per square foot range, and write lesser values only on ACV or flat-rated policies.

Since we can not offer a perfect replacement cost guide for all commercial structures, we are going to start automatically adding a +4% increase in insured values on all commercial renewals to parallel what we have been doing to Personal Lines policies for years. We believe that virtually our entire book of business is desperately underinsured at this point, so a +4% compounding on every renewal is a very conservative approach towards addressing this serious problem. This approach will be taken on structures and contents whether rated on replacement cost, actual cash value (ACV) or on a flat basis, but of course every insured is still free to object (in writing) and to roll-back these annual suggested increases.

E-MAIL to DRYDEN MUTUAL

E-mail is obviously a very useful communication tool when working with both Dryden Mutual's underwriting and claims departments. E-mail is a very quick way to collect answers to claims and underwriting questions and it is a great way to transmit photographs. However, we are also continually running into problems when agency staff use e-mail to a specific individual on our staff. The downside of e-mail to a specific individual is that it only gets routed to that person, who may or may not be at work on the day the message is received.

SOLUTION: If someone in your agency needs to e-mail Dryden Mutual, please use e-mail to our new general e-mail boxes at:

claims@drydenmutual.com
underwriting@drydenmutual.com

We request that this new general e-mail address be used rather than those of individual Dryden Mutual staff because important inquiries need to be addressed expeditiously. Our digital scanning department is instructed to open these mailboxes several times a day and route messages to appropriate staff. New items sent to these general claims and underwriting e-mail address are now automatically routed into our Imaging System and then distributed to the appropriate departments several times daily. However, if a specific person on our staff has already corresponded with your office via an e-mail regarding a certain claim or policy, we still encourage your direct reply to that person at their individual e-mail address.

RECORD CONTINGENCIES

Dryden Mutual's management staff has been delivering record contingency commission checks to our agents during the past several weeks. Dryden Mutual is a relatively small company in a vast market, but we seem to hold the record in New York State for returning the highest percentage of our direct premiums written to our agents as profit sharing at **5.38%** of our total 2004 direct premiums (an national industry survey for 2003 reported an average of only 1.04% of direct written premiums returned as contingency commissions by the top 60 companies). On the first page of this newsletter, we point out that our premium volume has more than doubled in 4 short years from 2000 to 2004, but the total values being delivered by Dryden Mutual as contingency commissions has much more than **tripled** since 2000! We delivered \$588,039 in early 2001 for 2000 results, but in early 2005 when we are delivering checks totaling \$1,882,335 based on 2004 results.

But, it is also clear that there are considerable political pressures now to redesign contingency contracts to move away from any appearance of even perceived impropriety. Dryden Mutual's current contingency commission

contract rewards both profit and growth as well as a safeguard for larger books of business with some minimum level commission as a “stop-loss” feature. Some redesign may be necessary for 2006 or 2007, but it is still our clear intent to provide ongoing incentives for creating, growing and protecting profitable books of business in each agency.

Despite the nature of many press releases from gubernatorial candidate New York State Attorney General Elliott Spitzer, we still believe that the type of profit-driven contingency arrangements such as that used by Dryden Mutual has ultimately been in the best interests of the insuring public. By giving our independent agents special financial incentives to produce growing, profitable books of business, the company has been able to keep the rates we charge the public for our products much lower than they would have been otherwise. So, Dryden Mutual and the insuring public both owe a debt of gratitude to you, our independent agents!

CREDIT SCORING and NYS INSURANCE DEPARTMENT REGULATION 182

Dryden Mutual has to comply with NYS Insurance Department Regulation 182 (11 NYCRR 221) entitled “Limitations upon and Requirements for the Use of Credit Information for Personal Lines Insurance.” Effective with applications received on or after Saturday, April 23, 2005, Dryden Mutual will notify each customer in a mailing if the company has ordered a credit report on a specific application for Personal Lines Insurance (Homeowners, Mobilehomes, Renters, Landlords Packages, and Residential Fire) in accordance with the Fair Credit Reporting Act statement that the insured(s) signed on their new application for insurance. This is yet another reason to be absolutely sure that you get original signatures on each and every new application. Dryden Mutual will not ask our agents to give this notification in their offices since we do not order credit reports on every applicant, but every applicant should be advised that this is a potential procedure we reserve the right to utilize.

As per Regulation 182, “the disclosure notice must be provided to the consumer in a separate written document, on company letterhead that clearly identifies the insurer, and shall include the address and toll-free telephone number of the insurer.” Dryden Mutual will take on the responsibility for sending this notice via standard mail in order to prove that this notification was made properly, and we will maintain such documentation in our digital imaging files.

Consistent with our past practices, Dryden Mutual reserves the right to review available credit histories on new applications, but we will not rely solely on a credit score to accept, rate or reject an applicant for insurance. Any refusal to continue coverage bound by an agent will be done so only for reasons other than just a weak general credit history. Dryden Mutual actually uses credit scoring models primarily to assess an individual’s likelihood to actually make the scheduled insurance premium installments on a timely basis after we issue our new policy. In our experience we have found that people who let policies lapse for non-pay usually continue to do so for a wide variety of reasons and that this financial behavior doesn’t change much even when they switch carriers. It has made a deep impression on us that our company is routinely forced to send out an average of between 50 to 75 non-payment cancellation notices every single working day of the year. This means that close to half our current policyholders are not likely to make their installment payments on time or even at all, year-in, year-out!

Robert B. Baxter, CPCU, CIC
CEO & General Manager