BRISTOL WEST HOLDINGS INC
Form 10-K
March 16, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Fiscal Year Ended December 31, 2006

Or

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission file number 001-31984

BRISTOL WEST HOLDINGS, INC.
(Exact name of registrant as specified in its charter)

Delaware	**13-3994449**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

5701 Stirling Road
Davie, Florida 33314
(954) 316-5200
(Address, of principal executive offices; zip code)
(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $0.01 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

YesNo
o x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

YesNo

o x

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.

YesNo

x o

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. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer x Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

YesNo

o x

The aggregate market value of the registrant s voting common stock held by non-affiliates, based on the closing market price, as reported on the New York Stock Exchange, on the last business day of the second quarter of 2006 was $317,522,288. As of February 28, 2007, the total number of shares outstanding of registrant s common stock was 29,478,865.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s definitive proxy statement issued in connection with the 2007 annual meeting of stockholders filed with the Securities and Exchange Commission within 120 days after December 31, 2006 (Part III).

BRISTOL WEST HOLDINGS, INC. 2006 ANNUAL REPORT

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BRISTOL WEST HOLDINGS, INC. 2006 ANNUAL REPORT

PART I

Item 1. Business

Overview

Bristol West Holdings, Inc. (the Company), a Delaware corporation, is a provider of private passenger automobile insurance. When this report uses the words we, us, and our, these words refer to Bristol West Holdings, Inc. and its subsidiaries, unless the context otherwise requires. The Company was organized under the laws of the State of Delaware on February 17, 1998.

Most of the business we write is non-standard automobile insurance. Given the homogeneity of our product, the regulatory environments in which we operate, the type of customer we serve and our method of distribution, we report our operations as one segment. Non-standard automobile insurance provides coverage to drivers who find it difficult to purchase automobile insurance from standard carriers as a result of a number of factors, including their vehicle type, age, claims history, limited financial resources or driving record. Typically, these drivers purchase minimal levels of insurance coverage in order to comply with state-mandated financial responsibility laws. As of December 31, 2006, 82% of our policyholders had purchased minimum limits of liability coverage as required by the states in which they reside, although 71% of our policyholders had clean motor vehicle driving records. For comparable coverage, premiums for non-standard automobile insurance policies generally are higher than for standard or preferred automobile insurance policies.

The operating results of property and casualty insurance companies are subject to fluctuations from quarter-to-quarter and year-to-year due to a number of factors, including, but not limited to, general economic conditions, the regulatory climate in states where an insurer operates, state regulation of premium rates, changes in pricing and underwriting practices of the insurer and its competitors, the frequency and severity of losses, natural disasters and other factors. (See *Item 1A. Risk Factors* below.) Historically, results of property and casualty insurance companies have been cyclical, with periods of high premium rates and strong profitability followed by periods of price competition, falling premium rates and reduced profitability.

We offer insurance coverage exclusively through independent agents and brokers, which totaled 9,141 as of December 31, 2006. Because some of our agents and brokers operate from multiple locations, our products were offered at 12,391 locations. We are licensed to provide insurance in 38 states and the District of Columbia, although we focus our operations in 22 states that we believe provide significant opportunity for profitable growth over time. Our markets include California, Florida and Texas - the three largest non-standard automobile insurance markets in the United States. These states were our first, second, and fourth largest states by premium volume and accounted for approximately 64% of our gross written premium for the year ended December 31, 2006. We charge fees for policy issuance, installment payment processing and other items that, in total, are equivalent to approximately 9% of gross earned premium.

On March 1, 2007, we entered into a merger agreement (the Merger Agreement) with Farmers Group, Inc. (Farmers) pursuant to which BWH Acquisition Company, a wholly-owned subsidiary of Farmers (Merger Sub), will be merged with and into the Company, with the Company continuing as the surviving corporation and becoming a wholly-owned subsidiary of Farmers (the Merger). Pursuant to the Merger Agreement, at the effective time and as a result of the Merger, each then outstanding share (each a Share) of common stock of the Company, par value $0.01 per share (Common Stock), including restricted stock (which vests upon a change in control), will be cancelled and converted into the right to receive $22.50 in cash per Share, without interest (the Merger Consideration). Each share of Common Stock that is subject to a then outstanding option and warrant that is vested or vests upon a change in control will be converted into the right to receive the Merger Consideration less the exercise price per Share for the Option. Each hypothetical share of Common Stock then included in a non-employee director s deferred compensation account (each a Phantom Share) under our Non-Employee Directors Deferred Compensation and Stock Award Plan (the Non-Employee Directors Plan) also will be converted into the right to receive the Merger Consideration. Consummation of the Merger is subject to various customary closing conditions, including, but not limited to, (1) the expiration or termination of applicable waiting periods under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, (2) all insurance antitrust approvals and regulatory approvals from certain insurance departments, (3) absence of certain orders preventing the Merger, and (4) the approval of the Merger Agreement by the Company s stockholders. Further, both the Company and Farmers may terminate the Merger Agreement if the Merger is not consummated by December 1, 2007. We currently expect the Merger to close before the end of 2007.

Products and Services

Policies. We offer a wide range of coverage options to meet our policyholders needs. Our liability-only policies generally include:

- bodily injury liability coverage, which protects insureds if they are involved in accidents that cause bodily injuries to others, and also provides insureds with a legal defense if they are sued by others for covered damages; and
- property damage liability coverage, which protects insureds if they are involved in accidents that cause damage to another s property, and also provides insureds with a legal defense if they are sued by others for covered damages.

Our liability-only policies include personal injury protection coverage in certain states, which provides coverage for our insureds injuries without regard to fault.

In addition to the coverages described above, our policies may include, at the option of the policyholder:

- collision coverage, which pays for damages to the insured s vehicle when damaged by a collision with another vehicle or object, regardless of fault;
- comprehensive coverage, which pays for damages to the insured s vehicle when damaged as a result of causes other than collision, such as vandalism, theft, wind, hail or water; and
- medical payments coverage, which pays for an insured s medical or funeral expenses related to an automobile accident.

We offer insurance products and payment plans that we have tailored to the non-standard marketplace. For customers whose selection of an insurance policy is driven by their desire to minimize their initial cash outlay, we offer low down payments and monthly billing plans. Our experience has shown us that total policy cost, although a variable in the purchasing decision, is not as important to this segment of applicants as is an installment plan with a low down payment. Accordingly, we designed our payment plans to be attractive to these customers by minimizing the up-front cash outlay through low down payments and monthly billing. Our billing and collection processes facilitate these payment plans while preventing significant exposure to credit losses.

There is another large segment of drivers who do not qualify for standard products due to a driving record transgression, their age, or recent financial instability, but for whom total policy cost is the most important consideration. We also structured our products to appeal to these potential customers. We offer various discounts for better risks, including in some states where allowed, discounts for having maintained automobile insurance within a prescribed prior time period and/or for maintaining homeowners insurance. Conversely, we add surcharges for traffic violations and accidents.

In addition to the premiums we collect for the insurance coverage we provide, we collect policy origination fees and installment fees. We may also charge additional fees for late payment, policy cancellation, policy rewrite and reinstatement and for other reasons. These fees represented revenues equivalent to approximately 9% of gross earned premium.

Distribution and Marketing

We distributed our products through 9,141 independent producers as of December 31, 2006. Because some producers operate from multiple locations, our products were offered through 12,391 locations. Since we sell our products only through the independent producer channel, building and maintaining strong relationships with our independent agents and brokers is a key element to our long-term success. We strive to maintain these relationships by providing our agents and brokers with high-quality service, a stable presence in their markets and competitive compensation programs. We provide our producers with easy-to-use underwriting and policy administration software. We offer competitively priced products, convenient installment billing plans and superior service to our producers and insureds. We do not provide contingent commissions or incentives to our agents and brokers.

Geographic Distribution. We have licenses to write insurance in 38 states and the District of Columbia, but we focus on 22 states that we believe provide significant opportunity for profitable growth based upon historical results, current market conditions and each state s legal and regulatory environment.

For the year ended December 31, 2006, our top three states represented 70.2% of our gross written premium. The following table sets forth the distribution of our gross written premium by state, excluding the change in the provision for expected cancellations, as a percent of total gross written premium for the years ended December 31, 2006, 2005 and 2004:

	Years Ended December 31,		
	2006	**2005**	**2004**
California	40.4%	46.3%	56.1%
Florida	17.9	15.2	14.3
Michigan	11.9	13.9	10.2
Texas	5.2	3.8	2.4
South Carolina	4.9	3.4	2.5
Pennsylvania	4.0	3.0	2.2
New Hampshire	2.3	2.6	1.8
Colorado	2.0	1.2	0.7
Maine	2.0	2.4	1.9
Virginia	1.8	1.5	1.6
All other states	7.7	6.7	6.3
	100.0%	100.0%	100.0%

Major Producers. Our top 10 producers, as measured by premium volume, accounted for 20.1%, 22.4%, and 25.5% of our gross written premium for the years ended December 31, 2006, 2005 and 2004, respectively. In 2006, no single producer accounted for 10% or more of our gross written premium. The concentration of our business with our top producers has declined as we have increased our producer base, entered new markets, and encountered increased competition in California, resulting in a decline in production from both large and small producers. We do not have any long-term producer contracts. Eight of our 10 largest producers produce the majority of their business in California.

Relationships with Agents and Brokers. We offer our policies through 9,141 agents and brokers with 12,391 locations as of December 31, 2006. We devote considerable time and resources to developing and maintaining relationships with these producers, and we endeavor to provide them with responsive service, a stable presence, and competitive compensation programs.

Our marketing department regularly visits and works closely with our agents and brokers in order to keep them up to date on our products and to gather information on industry trends.

We provide proprietary software to agents and brokers that permits them to access centralized information about their customers. In addition, we have deployed point-of-sale underwriting and policy issuance software at most of our producers locations. Point-of-sale underwriting technology uses Internet connectivity to obtain and verify an applicant s underwriting and rating information as part of the application process. The producer enters the applicant s underwriting data into a Company-provided software application, OneStep® or OneStep Raptor®. Concurrently, these software applications automatically and electronically obtain key underwriting and rating information, such as driving record and claim history, and reconcile it to the application information. In this manner, the producer can provide a final price quote to the applicant at the point of sale. If the applicant chooses to purchase the policy, producers can complete the transaction immediately. The producer can collect the payment and provide the insured with their policy and insurance identification card, and in some cases, with their policy declaration page and a copy of their first invoice.

We employ daily, weekly, monthly and quarterly data analysis to monitor various aspects of a producer s business conduct including adherence to our underwriting policies and procedures and the profitability of the producer s business with us. We evaluate each producer on numerous key factors, including the following:

loss experience;

violations of our underwriting guidelines;

claim timing: we terminate relationships with producers we find backdating policies to make them effective prior to the occurrence of a loss; and

business activity: we measure our producers business activity to identify and actively manage our relationship with producers that are not consistently selling our products.

Producer Compensation. We have designed our producer compensation programs to be competitive in each market in which we operate. At policy inception or renewal, we pay commissions at a percentage of the full term policy premium. Our producers highly value receiving the full term commission up front. If a policy cancels before its expiration date, the producer is bound contractually to return the unearned commission to us.

For 2006 and 2005, the only forms of compensation we paid to our producers were new and renewal commissions. In previous years and on a case-by-case basis, we had negotiated profit sharing agreements with some of our larger producers. Such agreements awarded additional compensation to producers which maintained or outperformed specified loss ratio targets and maintained an agreed amount of in-force business. Effective January 1, 2005, we discontinued these profit sharing arrangements and implemented various fixed commission tiers into which producers are placed depending upon our assessment of economies of scale, the producer s level of expertise in placing automobile insurance and the geographic scope of the producer s operations. Within each state, we revised the commission structure to produce a commission ratio consistent with the previous structure.

The ratio of commission expense to gross earned premium, including all profit sharing compensation, of which there was none in 2006 and 2005, was 14.8%, 14.7%, and 15.3% for the years ended December 31, 2006, 2005 and 2004, respectively. The ratio of profit sharing commission expense to gross earned premium was 0.0%, 0.0%, and 0.6% for the years ended December 31, 2006, 2005 and 2004, respectively.

Point-of-Sale Underwriting and Policy Issuance. We have made significant strides in point-of-sale underwriting. In the aggregate, we utilized point-of-sale underwriting to process over 99% of our new business applications in 2006. We have fully deployed OneStep, our browser-based point-of-sale underwriting system, in 12 states.

By utilizing point-of-sale underwriting, policy issuance is now immediate in the states in which we have deployed it compared to an average of five days prior to our implementation of point-of-sale underwriting. In addition to reducing uprates (increases in premiums after issuance), the efficiency gains have helped us to improve policyholder service.

Underwriting and Pricing

We establish policy rates utilizing a variety of factors, including, but not limited to, vehicle type, driver age, driving record, type of coverage, miles driven, financial responsibility, prior insurance coverage and policy limits. We continuously evaluate and modify our rates in order to maintain an acceptable level of underwriting profitability.

We have product managers for each state in which we operate or that we are considering entering. Each product manager is responsible for monitoring our competitive position and profitability. They work closely with our pricing actuaries, marketing department and senior staff to develop or alter our product and pricing strategies.

Claims Handling

Our Claims Department currently has over 500 claims employees and managers located in 14 offices around the country. Each claims office has an assigned geographic service area, but has the flexibility to handle claims from other areas as necessitated by workloads and available staff.

We respond quickly to reported claims. A toll-free access number allows policyholders to report claims 24 hours a day, seven days a week. Claims representatives endeavor to contact all parties involved in an accident within 24 hours of receipt of loss notification and inspect any damaged property within 72 hours of contact with the owner. Claims managers review all new claims within 24 hours of receipt of notification to provide input and direction, and maintain involvement throughout the life of the claim.

We focus on prompt, accurate claims handling. Our claims staff investigates all claims and handles most vehicle damage appraisals, with a small percentage of inspection appraisals completed by independent appraisers when warranted by the location or when our appraisers are not available. Twenty-two in-house attorneys in seven offices defend most of the lawsuits brought against our insureds. We maintain a Special Investigation Unit with 37 employees deployed nationwide who control costs through fraud mitigation, form effective relationships with law enforcement agencies and ensure our compliance with applicable anti-fraud regulations. The Special Investigation Unit uses anti-fraud databases and real time intelligence from law enforcement agencies to identify suspicious losses. We have a Claim Quality and Employee Development (QED) group responsible for auditing and training. The Audit Department conducts comprehensive internal audits of claim handling, focusing on procedures, financial controls, data integrity and regulatory compliance. The Training Department provides both new hire training and advanced training to experienced claims representatives.

Technology

We have substantially upgraded our information technology capabilities in recent years, including the following:

Data Warehouse. We maintain an extensive proprietary database, which contains statistical records with respect to our insureds, including, among other data, the insured s rating classification, motor vehicle records, years licensed, and loss experience by each rating variable. Analysis of this data enables us to identify trends emerging in our business and to respond with changes to prices, product or underwriting guidelines.

Claims Administration. Our in-house claims administration system maintains all notes, diaries and related party information on each claim and provides automated on-line management reports on the number of outstanding claims and service levels. It provides a financial control and automatically generates and maintains loss and loss adjustment expense reserves. The system interfaces with a standardized estimating service and retains pictures of each appraised vehicle.

Point-of-Sale Underwriting. We have online point-of-sale application systems, OneStep and OneStep Raptor; and as of December 31, 2006, we were producing more than 99% of our business through these systems. We have an exclusive license to use OneStep in the non-standard automobile insurance industry through December 2009. OneStep and OneStep Raptor use technology to provide fast and accurate quotes by accessing third-party information at the point of sale, including an applicant s driving record, accident history and, where permitted by law, credit reports. This process reduces the frequency of uprates, which may occur when an application is incomplete or inaccurate. Our point-of-sale application systems permit the producer to print the policy, the identification cards and the policy declaration page as soon as the verifications are complete, usually within minutes.

BWProducers.com. This website provides our producers with complete access to all information about their Bristol West policyholders, including billing information, policy status, cancellations and installments. This access to timely and centralized information gives our producers the ability to better manage their business and increase their retention rates. The system allows online payments from our producers.

Policyholder Tools. We provide automated phone and web payment functionality for our policyholders that is available 24 hours per day, seven days per week.

Loss and Loss Adjustment Expense Reserve Development

Automobile accidents generally result in insurance companies paying settlements resulting from physical damage to one or more automobiles or other property and injuries to one or more persons. Because our insureds typically notify us immediately after an accident has occurred, our ultimate liability on our policies generally becomes fairly apparent in a relatively short period of time. However, months and sometimes years may elapse between the occurrence of an accident, reporting of the accident to us and payment of the claim. We record a liability for estimates of losses and loss adjustment expenses (LAE) that we expect to pay on accidents reported to us and we estimate and record a liability for accidents that have occurred but have not been reported to us, which we refer to as incurred but not reported loss and LAE reserves. For a discussion of our methodologies for establishing loss and LAE reserves as well as our estimates of loss and LAE reserves as of December 31, 2006, 2005 and 2004, see *Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies - Estimation of Unpaid Losses and Loss Adjustment Expenses*.

Quarterly, for each financial reporting date, we record our best estimate, which is a point estimate, of our overall loss and LAE reserves for both current and prior accident years. As our experience develops and we learn new information, our quarterly reserving process may produce revisions to our previously reported loss and LAE reserves. We refer to such revisions as development and such development may be material. We recognize favorable development when we decrease our previously reported loss and LAE reserves, which results in an increase to net income in the period recognized. We recognize adverse development when we increase our previously reported loss and LAE reserves, which results in a decrease to net income in the period recognized.

The following table presents the development of our loss and LAE reserves, net of reinsurance, for the calendar years 1996 through 2006 (in thousands of dollars).

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
As Originally Estimated:	21,013	26,593	59,472	44,174	51,349	39,089	82,280	89,010	105,420	197,403	204,654
As Re-estimated as of December 31, 2006:	25,946	39,237	57,656	54,484	84,810	79,942	107,492	105,695	113,121	202,696	
Liability Re-estimated as of:											
One Year Later	24,630	44,295	55,640	50,502	68,002	67,274	91,594	91,523	105,429	202,696	
Two Years Later	28,169	38,239	55,977	51,667	80,655	75,203	102,382	101,373	113,121		
Three Years Later	25,520	38,368	56,602	52,928	83,277	78,113	106,627	105,695			
Four Years Later	25,662	38,943	56,950	53,805	84,260	79,863	107,492				
Five Years Later	26,089	39,029	57,161	54,438	84,934	79,942					
Six Years Later	26,005	39,051	57,634	54,622	84,810						
Seven Years Later	25,923	39,183	57,753	54,484							
Eight Years Later	25,971	39,290	57,656								
Nine Years Later	25,983	39,237									
Ten Years Later	25,946										
Cumulative Deficiency (Redundancy)	4,933	12,644	(1,816)	10,310	33,461	40,853	25,212	16,685	7,701	5,293	
Cumulative Amounts Paid as of :											
One Year Later	18,069	27,371	51,201	43,231	61,891	50,870	75,489	67,411	42,736	139,079	
Two Years Later	23,520	36,674	56,448	50,016	75,642	71,619	94,793	85,226	93,293		
Three Years Later	25,189	38,320	57,101	51,839	81,953	75,777	103,431	100,625			
Four Years Later	25,653	38,808	57,046	52,693	83,591	78,725	106,468				
Five Years Later	25,850	38,945	57,185	54,344	84,369	79,119					
Six Years Later	25,872	38,969	57,610	54,556	84,492						
Seven Years Later	25,866	39,190	57,719	54,520							
Eight Years Later	25,970	39,290	57,652								
Nine Years Later	25,983	39,239									
Ten Years Later	25,946										

Net Loss and Loss Adjustment Expense Liability as a Percentage of Initially Estimated Liability

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006

Liability Re-estimated as of:										
One Year Later	117%	167%	94%	114%	132%	172%	111%	103%	100%	103%
Two Years Later	134%	144%	94%	117%	157%	192%	124%	114%	107%	
Three Years Later	121%	144%	95%	120%	162%	200%	130%	119%		
Four Years Later	122%	146%	96%	122%	164%	204%	131%			
Five Years Later	124%	147%	96%	123%	165%	205%				
Six Years Later	124%	147%	97%	124%	165%					
Seven Years Later	123%	147%	97%	123%						
Eight Years Later	124%	148%	97%							
Nine Years Later	124%	148%								
Ten Years Later	123%									
Cumulative Deficiency (Redundancy)	23%	48%	-3%	23%	65%	105%	31%	19%	7%	3%
Net Loss and Loss Adjustment Cumulative Paid as a Percentage of Initially Estimated Liability										
Cumulative Amounts Paid as of:										
One Year Later	86%	103%	86%	98%	121%	130%	92%	76%	41%	70%
Two Years Later	112%	138%	95%	113%	147%	183%	115%	96%	88%	
Three Years Later	120%	144%	96%	117%	160%	194%	126%	113		