21ST CENTURY INSURANCE GROUP
Form 10-K
March 19, 2003

FORM 10-K 21ST CENTURY INSURANCE GROUP

(Exact name of registrant as specified in its charter)

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

For the fiscal year ended December 31, 2002

CALIFORNIA	95-1935264
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification number)
6301 OWENSMOUTH AVENUE WOODLAND HILLS, CALIFORNIA	91367
(Address of principal executive offices)	(Zip Code)

(818) 704-3700
(Registrant's telephone number, including area code)

WEB SITE: WWW.21ST.COM

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

COMMON STOCK, WITHOUT PAR VALUE	NEW YORK STOCK EXCHANGE
(Title of Class)	(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 June 30, 2002, as reported by the New York Stock Exchange, was approximately $466,000,000.

On February 28, 2003, the registrant had 85,431,505 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 stockholders of the registrant, to be held on June 25, 2003, are incorporated herein by reference into Part III hereof.

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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 consolidated subsidiaries, all of which are wholly owned: 21st Century Insurance Company, 21st Century Casualty Company, 21st Century Insurance Company of Arizona(1) ("21st of Arizona"), 20th Century Insurance Services, inc., and i21 Insurance Services. The latter two companies are not property and casualty insurance subsidiaries, and their results are immaterial.

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.

Founded in 1958, 21st Century Insurance Group primarily sells and underwrites personal automobile insurance to customers in California, Arizona, Nevada, Oregon and Washington who prefer excellent service and a high-feature product at a competitive price. Twenty-four hours per day, 365 days a year, customers choose to purchase insurance over the phone from the Company's centralized licensed insurance agents at 1-800-211-SAVE or through its full service Internet site at www.21st.com. The Company has the reputation for excellent customer service and for being among the most efficient and lowest cost providers of personal auto insurance in the markets it serves.

Copies of the Company's filings with the Securities and Exchange Commission on Form 10-K, Form 10-Q, Form 8-K and proxy statements are available along with copies of earnings releases on the Company's web site at www.21st.com. Copies may also be obtained free of charge directly from the Company's Investor Relations Department (6301 Owensmouth Avenue, Woodland Hills, California 91367, phone 818-701-3595).

GEOGRAPHIC CONCENTRATION OF BUSINESS

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. The Company began writing private passenger automobile insurance in Arizona in 1996, followed by Nevada, Oregon and Washington in late 1998.

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1 21st of Arizona was incorporated in Arizona in 1995 as a joint venture owned 49% by the Company and 51% by AIG; the Company acquired AIG's interest on January 1, 2002.

The following table presents a geographical summary of the Company's direct premiums written for the past five years (in millions):

Years Ended December 31,	2002	2001	2000	1999	1998
Personal auto lines(1)					
California	$967.3	$879.4	$861.6	$848.9	$860.8
Arizona(2)	13.0	-	-	-	-
Nevada	8.1	8.9	7.7	2.7	-
Oregon	1.6	2.0	2.2	0.8	-
Washington	5.8	8.5	9.7	3.4	-
Total personal auto lines	995.8	898.8	881.2	855.8	860.8
Lines in runoff					
Homeowner(3) and Earthquake(4)	2.4	30.5	29.5	24.7	24.8
Total consolidated direct premiums written	$998.2	$929.3	$910.7	$880.5	$885.6

The following table summarizes the concentrations of the Company's California direct in-force premiums for the voluntary personal auto lines excluding personal umbrella and motorcycle coverages as of the end of each of the past five years:

December 31,	2002	2001	2000	1999	1998
Southern California excluding San Diego(5)	66.3%	73.5%	76.2%	78.8%	81.8%
San Diego(6)	10.5	10.2	9.4	9.0	8.6
Northern California(7)	23.2	16.3	14.4	12.2	9.6
	100.0%	100.0%	100.0%	100.0%	100.0%

TYPES AND LIMITS OF INSURANCE COVERAGE

The Company's private passenger auto insurance contract generally covers: 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. All of the Company's policies are written for a six-month term except for policies sold to the involuntary market, which are for twelve months.

Minimum levels of 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

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1 Includes motorcycle and personal umbrella coverages, which are immaterial for all periods presented.

2 Excludes amounts not consolidated: $12.8 in 2001; $14.7 million in 2000; $12.9 million in 1999; and $10.0 million in 1998.

3 The Company is running off approximately 5,300 California homeowner policies remaining on its books at December 31, 2002. See further discussion in Item 7 under the caption Underwriting Results - Homeowner and Earthquake Lines in Runoff and All Other.

4 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 Note 16 of the Notes to Consolidated Financial Statements.

5 Includes all counties not specified in footnotes 6 and 7.

6 Represents San Diego County.

7 Includes these counties: Alameda, Alpine, Amador, Butte, Calaveras, Colusa, Contra Costa, Del Norte, El Dorado, Fresno, Glenn, Humboldt, Inyo, Kings, Lake, Lassen, Madera, Marin, Mariposa, Mendocino, Merced, Modoc, Mono, Monterey, Napa, Nevada, Placer, Plumas, Sacramento, San Benito, San Francisco, San Joaquin, San Mateo, Santa Tehama, Trinity, Tulare, Yolo, Yuba.

Company is required to offer personal injury protection coverage in lieu of the medical payments coverage required in California.

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 standard coverages exclude losses from nuclear sources as well as acts of war.

The Company's personal umbrella policy ("PUP") provides a choice of liability coverage limits of $1.0 million, $2.0 million or $3.0 million in excess of the underlying automobile liability coverage. The $2.0 million and $3.0 million limits were added in May 2002. Minimum underlying automobile limits of $100,000 per person and $300,000 per accident were required for PUP policies sold prior to May 2002, and limits of $250,000 per person and $500,000 per accident are required thereafter. The Company must write the underlying automobile coverage. The Company reinsures 90% of any PUP loss with unrelated reinsurers.

The homeowner program, currently in runoff, utilized 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 provided for a minimum dwelling amount of $65,000 and a maximum dwelling amount of $750,000.

PERSONAL AUTO PRODUCT INNOVATIONS

Starting in May 2002, the Company began offering motorcycle coverage primarily to its auto policyholders in California. In August 2002, the Company introduced a new private passenger auto policy in California that does not have certain standard features found in its primary policy. This limited-feature product is similar in most respects to the product offered by many of the Company's competitors, and is positioned as a lower-cost alternative for customers who believe they need less coverage than provided by the Company's standard product. In October 2002, the Company enhanced its underwriting guidelines allowing it to provide quotes to certain customers who do not meet California's statutory "good driver" definition but who are considered to be insurable risks within the Company's class plan.

All of the foregoing product innovations were designed to achieve an

underwriting profit and, to date, the impact of these new products has been immaterial.

MARKETING

While the Company offers personal auto policies in California, Arizona, Nevada, Oregon and Washington, most of its marketing efforts are focused on the larger urban markets in California. Beginning in late 2002, the Company restarted its active marketing in Arizona.

The Company's marketing and underwriting strategy is to appeal to careful and responsible drivers who desire a feature-rich product at a competitive price. The Company uses direct mail, broadcast and print media, outdoor, community events and the Internet to generate inbound telephone calls, which are served by centralized licensed insurance agents. Because the Company centralizes its sales agents, it can deliver a highly efficient and professional experience for its California and Arizona customers 24 hours per day, 365 days per year through a convenient, toll-free 800-211-SAVE telephone number. California and Arizona customers may also obtain an instant auto rate quotation and purchase a policy on the Company's Internet site at www.21st.com.

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The following table summarizes advertising expenditures (in millions) and total new auto policies written in California, the Company's primary market, for the past five years:

Years Ended December 31,	2002	2001	2000	1999	1998
Total advertising expenditures	$ 43.3	$ 16.9	$ 10.1	$ 22.7	$ 10.1
New auto policies written in California(1)	185,944	51,002	54,642	86,703	104,289

CONSUMER ADVOCACY

The Company has introduced several publications and community events designed to assist customers and potential customers in making choices about their auto insurance and automobile safety. The Insider's Guide to Buying California Auto Insurance, currently available in both English and Spanish, compares coverage and service features of products offered by the Company and its major competitors. The comparisons are explained in understandable language to help "demystify" the choices consumers must make in selecting their personal auto insurance carrier.

The Company also publishes the Child Safety Seat Guide, Crash Test Ratings Guide, and A Driving Need - A Guide for Mature Drivers and Those Who Care about Them. All these publications are available free of charge on the Company's web site at www.21st.com/company/getmore/safety/safety.jsp. The Company has also distributed these publications in California movie theaters, county fairs, direct mail promotions and other venues.

CUSTOMER RETENTION AND VEHICLES IN FORCE

Customer retention in California, measured based on the number of insured vehicles and the number of vehicles in force, were as follows as of the end of each of the past five years:

December 31,	2002	2001	2000	1999	1998

Average customer retention - California personal auto(2)	93%	92%	96%	97%	96%
California vehicles in force (1)	1,178,459	1,051,982	1,150,643	1,179,928	1,142,303
All other states vehicles in force	27,174	23,489	31,337	18,130	189
Total auto lines exposure (1)	1,205,633	1,075,471	1,181,980	1,198,058	1,142,492
California auto base rate changes	+5.7% MAY	+4.0% July	+6.4% November	-6.9% February	-3.4% January

From March 1996 to October 2000, the Company implemented six rate decreases which resulted in a cumulative reduction in rates of nearly 23%. As a result of this series of rate decreases, retention rates rose to Company record levels through 2000. Growth in vehicles in force during this period was modest as the Company's major competitors also lowered their rates. In response to rising loss costs beginning in 1999 and continuing to date, the Company has implemented three base rate increases as shown above for a cumulative increase of 16%, made changes in its class plan and adopted stricter underwriting measures. Additionally, as the Company upwardly adjusted its rates, it curtailed advertising for new customers throughout 2000. During this same period, competitors held rates steady or continued to take decreases. These actions contributed to the declines in retention and vehicles in force in 2000 and 2001. Beginning in the latter half of 2001, the Company's major California competitors began implementing rate increases and the Company restarted active marketing and advertising, both of which contributed to the increases in

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1 Includes new PUP and motorcycle policies, which are insignificant for all periods presented.

2 Represents an overall measure of customer retention, including new customers as well as long-time customers. Retention rates for new customers are often lower than for long-time customers.

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the Company's retention and vehicles in force in 2002. In January 2003, the Company received approval for a 3.9% rate increase which it expects to implement in March 2003.

UNDERWRITING AND PRICING

The regulatory system in California requires the prior approval of insurance rates, rules 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. These rates are a blend of base rates and class plan filings made with the California Department of Insurance ("CDI"). Base rates are the primary amount projected to generate an adequate underwriting profit for the Company. Class plan changes are filings that serve to modify the factors that impact the base rates. Class plan changes are generally meant to be revenue neutral to the Company but ultimately are done in conjunction with a base rate filing.

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 and include characteristics such as automobile garaging location, make and model of car, policy limits and deductibles, and gender and marital status.

The following table summarizes changes in the Company's base premium rates for each of the past five years. Positive numbers represent increases; negative numbers represent decreases.

Years Ended December 31,	2002	2001	2000	1999	1998
Personal auto lines excluding PUP					
California	5.7%	4.0%	6.4%	(6.9)%	(3.4)%
Arizona	3.7	16.5	20.0	(9.7)	-
Nevada	22.0	12.6	-	-	N/A
Oregon	3.1	14.0	21.0	-	N/A
Washington	10.7	44.9	-	-	N/A
Lines in runoff					
Homeowner	13.2	4.0	-	(7.5)	-
Earthquake	N/A	N/A	N/A	N/A	N/A

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.

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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 the Company's marketing, sales, 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 web site, most customers are now able to receive and accept quotations, bind policies, pay their bills, inquire about the status of their policies and billing information, make most common policy changes, submit first notice of loss on a claim and access a wealth of consumer information. New technology began to be implemented in 2001 that provides the Company's sales and service agents 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 more than 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 perform 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, more than 30% of all damage repairs are handled using the DRP method.

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 12 claims Division Service Offices in areas of major customer concentrations. The five Vehicle Inspection Centers, located in Los Angeles and Orange Counties, handle total losses, thefts and vehicles that are not driveable.

The Claims Services Division is responsible for subrogation and medical payment claims. The Company also maintains a Special Investigations Unit as required by the California State Insurance Code, 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. These attorneys handle approximately 75% of all lawsuits against its policyholders. Suits directly against the Company and those, which may involve a conflict of interest, are assigned to outside counsel.

GROWTH AND PROFITABILITY OBJECTIVES

The Company has stated that its long-term goal is to build an organization that consistently produces a 96% GAAP combined ratio, or better, and at least 15% annual growth in direct written premiums. The Company has only met both of these goals in the same year twice: 1980 and 1981. The Company came closer to meeting both goals in the last half of 2002 for its personal automobile lines. To achieve these goals, the Company has undertaken many steps since 1999 including:

- Restored pricing and underwriting discipline.
- Successfully restarted active advertising for new customers and introduced product innovations to spur growth and profitability.
- Launched numerous initiatives to lower per unit costs throughout the Company's infrastructure while holding the line on fixed expenses.

Although new customers generally have higher aggregate loss ratios, their loss experience tends to improve over time. The Company believes it can significantly increase premium volume without incurring significantly higher fixed costs while continuing to lower per unit costs in its variable expense

operations. Thus, assuming a responsible regulatory climate, the goal of a 96% combined ratio should be achievable consistently despite the higher loss ratio often associated with new customers. However, it must be noted that the personal lines insurance business is, as a regulated industry, exposed to legislative, judicial, political and regulatory action in addition to the normal business forces of competition between companies and the choices of consumers.

AGGREGATE EXPENSE RATIO - PERSONAL AUTO LINES

The Company believes a competitive advantage can be achieved by operating more efficiently than its competition. One measure of relative efficiency is the "aggregate expense ratio" - defined as the sum of incurred loss adjustment expenses and underwriting expenses, divided by gross premiums written. This aggregate expense ratio removes many of the inconsistencies in how different companies classify their expenses.

The following table presents aggregate expense ratio information extracted from statutory filings by A.M. Best for the top ten California personal automobile insurance companies for 1997 through 2001, the most recent data available.

	Statutory Aggregate Expense Ratio				
Years Ended December 31,	2001	2000	1999	1998	1997
21ST CENTURY INSURANCE GROUP	33.5%	31.3%	30.1%	27.1%	22.8%
California State Auto Association	39.8	43.6	28.9	35.7	32.1
State Farm	38.4	41.3	40.3	38.1	34.1
Mercury	38.0	38.8	38.6	37.9	37.6
Progressive	37.1	35.4	33.4	35.0	33.7
Allstate	36.9	39.8	39.2	39.2	39.0
Farmers	35.8	35.2	33.6	35.2	34.4
Auto Club of Southern California	32.0	32.6	34.0	35.4	32.6
USAA	28.0	30.7	34.1	29.5	26.2
GEICO	24.4	27.0	29.0	27.6	24.2

The Company's aggregate expense ratio for the auto lines in 2002 was 33.2%. In 2002, the capacity of the Company's new business call center was doubled, enabling the Company to handle a record volume of new business throughout the year. Several productivity enhancement

initiatives are underway aimed at reducing per unit process costs and lowering fixed costs in corporate support areas. The increases in the Company's ratio from 1997 through 2001 were primarily due to the cumulative 23% decrease in rate level in California from 1996 to 1999, and increases in data processing, depreciation and advertising expenditures.

LOSS AND LOSS ADJUSTMENT EXPENSE RESERVES

The cost to settle a customer's claim is comprised of two major components: losses and loss adjustment expenses.

Losses in connection with third party coverages represent damages as a result of an insured's acts that result in property damage or bodily injury. First party losses involve damage or injury to the insured's property or person. In either case, the ultimate cost of the loss is not always immediately known and may develop higher or lower than initial estimates over time. When establishing initial and subsequent estimates, the amount of loss is reduced for salvage (e.g., proceeds from the disposal of the wrecked automobile) and subrogation (e.g., proceeds from another party who is fully or partially liable, such as the insurer of the driver who caused the accident involving one of the Company's customers).

Loss adjustment expenses ("LAE") represent the costs of adjusting, investigating and settling the loss, most of which comprise the cost of the Company's claim department, external inspection services, and internal and external legal counsel. Because staff areas such as human resources, finance, and information technology support the Company's overall operations, a portion of their operational costs are also allocated to LAE.

Accounting for losses and LAE is highly subjective because these costs must be estimated, often weeks, months or even years in advance of when the payments actually are made to claimants, attorneys, claims personnel and others involved in the claims settlement process. At the time of sale of an auto policy, for example, the number of claims that will happen is unknown, and so is the ultimate amount it will take to settle them.

Accounting principles require insurers to record estimates for loss and LAE in the periods in which the insured events, such as automobile accidents, occur. This estimation process requires the Company to estimate both the number of accidents that may have occurred (called "frequency") and the ultimate amount of loss and LAE (called "severity") related to each accident. The Company employs experts called "actuaries" who are professionally trained and certified in the process of establishing estimates for frequency and severity. From time to time, actuarial experts from outside firms are engaged to review the work of the Company's actuaries.

Estimating the Frequency of Auto Accidents. By studying the historical lag between the actual date of loss and the date the accident is reported by the customer to the claims department, the Company's actuaries can make a reasonable, yet never perfect, estimate for the number of claims that ultimately will be reported for a given period. This measurement is often referred to as frequency. The difference between the estimated ultimate number of claims that will be made and the number that have actually been reported in any given period is often referred to as "IBNR (incurred but not reported) claims".

For example, when estimating the frequency of accidents, history has shown that approximately 95% of property damage claims and 81% of liability claims are reported by year-end. Accordingly, in this illustration, the Company's actuaries add an estimated 5% to the number of property damage claims and 19% to the number of liability claims to provide for incurred but not reported ("IBNR") claims.

When making estimates of frequency, the Company's actuaries reviewed historical trends, noticing that there has been a slight decrease since 1999. For example, the Company's actuaries noted that about 11.9% of California vehicles had a collision-related accident in 2000, which declined to approximately 11.8% in 2001 and they are estimating 11.7% will have an accident in 2002. For bodily injury claims, the actuaries saw 3.328% in 2000, 3.168% in 2001 and are

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estimating 3.175% in 2002. These slight declines in frequency are believed to be attributable mainly to relatively dry weather in California beginning in 2001 and throughout 2002.

In making these estimates, a fundamental assumption is that past events are representative indicators of future outcomes. These estimates are also highly sensitive. For example, in the above illustration, if the actuaries had picked 11.9% for 2002 collision frequency, the Company would have reported additional pre-tax loss expense of $3.3 million.

Homeowner and Earthquake Frequency. The Company's remaining homeowner exposures

are mainly fully reinsured although the Company has exposure on claims that might develop from 2000 and 2001 as well as from before July of 1996. However, the homeowner line is considered to be a relatively short-tailed line and few IBNR claims are expected.

By contrast, general liability commercial lines claims counts may take seven, ten or more years to fully develop, and coverages such as asbestos and environmental liability may involve discovery periods of twenty or thirty years. The Company does not have any such long-tailed exposures.

However, California Senate Bill 1899(1) ("SB 1899") allowed insureds in 2001 to report 1994 Northridge Earthquake claims the Company believes were previously barred by the statute of limitations. SB 1899 is an egregious example of an event that no reasonable actuary or other insurance professional would have forecast or have even considered as possible seven years earlier in 1994. However, when the law took effect and the number of claims became reasonably estimable, the Company recorded an estimate for these claims as if they were a 1994 event (when the earthquake occurred) rather than as a 2001 event (when the new law was effective)(2). While the number of true "SB 1899" claims should be a fixed number, the Company continues to receive new Northridge Earthquake claims based on alternative legal theories. These claims are included in the Company's reserve estimates and are handled similarly to true SB 1899 claims.

Estimating the Severity of Auto Claims. Adjusters in the Company's claim department establish loss estimates for individual claims based upon various factors such as the extent of the injuries, property damage sustained, and the age of the claim. The Company's actuaries review these estimates, giving consideration to the adjusters' historical ability to accurately estimate the ultimate claim and length of time it will take to settle the claim. Generally, the longer it takes to settle a claim, the higher the ultimate claim cost. The ultimate amount of the loss is considered the "severity" of the claim. In addition, the actuaries estimate the severity of the IBNR claims.

The severities are estimated by the Company's actuaries each quarter based on historical studies of average claim payments and the patterns of how the claims were paid.

Returning to the above collision example, the Company's actuaries estimate that the average incurred claim severity for collision coverage in the 2002 accident year was $2,467, versus $2,394 in 2001 and $2,295 in 2000. This suggests that average collision claim costs rose about 3.0% in 2002 and 4.1% in 2001. With actual price inflation for repairs and parts running somewhat higher than either of those figures, the better performance by the Company reflects the care and attention it pays to claims handling and in particular to its Direct Repair Program (DRP) which offers superior quality to customers at a lower overall cost, and its salvage and subrogation methods.

Average severity for the BI coverage in California was $4,416 in 2002, $4,417 in 2001 and $4,374 in 2000. While medical inflation is inherently increasing BI severities, there is a trend

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1 See further discussion in Item 7 under the caption Underwriting Results - Homeowner and Earthquake Lines in Runoff and all Other.

2 After discussion with legal counsel, the Company has concluded that providing certain details, such as the total number of SB 1899 claims and average claim amounts, would likely prejudice the claims settlement process to the Company's detriment.

where the level of loss is decreasing in California. Actuaries generally believe the improvements in automobile safety, more rational jury awards, and drought-like conditions are moderating the increase in BI severities.

Again, the fundamental assumption used in making these estimates is that past events are reliable indicators of future outcomes. History, unfortunately, has a way of thwarting even the most strongly held expectations. For example, in the above illustration, if the actuaries would have selected a BI severity that increased the same from 2001 to 2002 as it did from 2000 to 2001, the Company would have reported additional pre-tax loss expense of $1.8 million in 2002.

Earthquake Severity. A necessarily more subjective process is used to estimate earthquake losses arising out of SB 1899 due to the fact that they cannot be determined with traditional actuarial methods that rely on credible historical or industry data, neither of which are available in regard to this event. Because a large number of these claims are being asserted through litigation, the ultimate amounts will depend on many factors including whether the claim is settled before entering the pre-trial stage, during pre-trial proceedings, or requires a full trial to resolve. Future judicial decisions, jury verdicts and settlements may affect the cost of resolution of remaining cases, both positively and negatively. These and many other earthquake claim litigation factors (see below and Note 16 of the Notes to Consolidated Financial Statements) are difficult to predict based on past events and thus assumptions and estimates are more likely to be subject to modification in the future.

More than two-thirds of the Company's remaining earthquake claims are in litigation. Many suits seek extracontractual and punitive damages as well as contractual damages far in excess of the Company's estimates. The Company cannot estimate and, therefore, has not established a reserve for potential extracontractual or punitive damages, or for damages in excess of estimates the Company believes are correct and reasonable. It denies liability for any such alleged damages. Nevertheless, extracontractual and punitive damages, if assessed against the Company, could be material in an individual case or in the aggregate, and damages in excess of the Company's reasonable estimates could be material in the aggregate. The Company may choose to settle litigated cases for amounts in excess of its own estimate of contractual damages to avoid the expense and/or risk of litigation.

The average costs and ranges for Earthquake settlements and verdicts vary widely. For example, the Company recently had one claim with a plaintiff's estimate of $200,000 settle for $500 on the courthouse steps; however, before SB 1899, the Company had one earthquake trial that required more than $1 million in defense costs. Many lawsuits contain multiple claimants that courts may or may not sever for trial. Thus, the Company faces the prospects of mass trials as well as numerous individual trials, each with different potential costs and litigation risks. The Company may also seek to settle groups of litigated claims represented by a single attorney or law firm as a means of efficiently resolving cases without incurring substantial attorneys' fees defending multiple lawsuits. The discovery process is not yet underway for the majority of these cases, and it is difficult to estimate litigation costs at this stage of the process since the level (and hence cost) of discovery is not entirely within the Company's control and it depends on the litigation strategy plaintiffs' counsel may employ as well as other factors (see discussion in Note 16 to the Notes to Consolidated Financial Statements). These strategies are expected to vary by plaintiff attorney and firm. The Company's reserve estimate for legal defense costs assumes that the Company will be successful in settlement of the vast majority of its earthquake litigation before trial.

Meanwhile, events such as the Company's recent fraud suit brought against a public adjuster, Unlimited Adjusting Company (1) ("Unlimited Adjusting"), could have a favorable impact on future settlements with claimants represented by

Unlimited Adjusting. Approximately 20% of the pending claims are or have been represented by Unlimited Adjusting.

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1 For more information on this suit, please see the Company's press release dated December 17, 2002, available on the Company's web site, www.21st.com.

Loss and Reserve Development. Management believes that, given the inherent variability in the estimates, the Company's reserves are within a reasonable and acceptable range of adequacy(1). However, because reserve estimates are necessarily subject to the outcome of future events, changes in estimates are unavoidable in the property and casualty insurance business. These changes sometimes are referred to as "loss development" or "reserve development."

Quarterly, the Company's actuaries prepare a new evaluation of loss and LAE indications by accident year, and the Company assesses whether there is a need to adjust reserve estimates pertaining to previous accounting periods. As claims are reported and settled and as other new information becomes available, changes in estimates are made and are included in earnings of the period of the change.

The changes in prior accident year estimates recorded in each of the past five years, net of applicable reinsurance, are summarized below (in thousands)(2):

For the years ended December 31,	2002	2001	2000	1999	1998
Personal auto	$16,200	$ 45,742	$42,178	$(14,239)	$(39,476)
Homeowner and Earthquake	56,158	72,265	2,845	5,543	43,099
	$72,358	$118,007	$45,023	$ (8,696)	$ 3,623

To understand these changes, it is useful to put them in the context of the cumulative reserve development experienced by the Company over a longer time frame. The tables on the following pages present the development of loss and LAE reserves for the personal auto lines (Table 1) and for the homeowner and earthquake lines in runoff (Table 2), for the years 1992 through 2002. The figures in both tables are shown gross of reinsurance.

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. A detailed discussion of loss

reserve development follows the tables.

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1 For a discussion of the reserve ranges considered by management at December 31, 2002, see discussion under Financial Condition.

2 Positive numbers represent increases in loss and LAE expense, while negative numbers represent decreases.

TABLE 1 - Auto Lines as of December 31,

(Amounts in thousands, except claims)	1992	1993	1994	1995	1996	
RESERVES FOR LOSSES AND LOSS ADJUSTMENT EXPENSES, DIRECT	$515,719	$525,892	$552,872	$506,747	$468,257	$
PAID (CUMULATIVE) AS OF:						
One year later	308,211	319,938	329,305	318,273	260,287	
Two years later	374,583	393,731	403,462	392,420	336,538	
Three years later	395,034	410,808	429,595	416,541	354,854	
Four years later	400,230	422,640	435,795	422,393	357,913	
Five years later	401,590	425,021	437,041	423,429	363,068	
Six years later	402,812	425,397	437,052	427,723	362,824	
Seven years later	402,736	425,041	437,015	427,355		
Eight years later	402,415	424,982	436,737			
Nine years later	402,397	424,745				
Ten years later	402,210					
RESERVES RE-ESTIMATED AS OF:						
One year later	470,729	451,054	465,934	440,158	365,566	
Two years later	412,299	429,602	438,672	424,091	366,858	
Three years later	405,696	418,576	439,125	425,404	359,925	
Four years later	402,110	424,630	438,895	424,643	357,607	
Five years later	401,862	425,880	436,397	422,389	377,414	
Six years later	402,671	424,475	435,878	442,024	361,980	
Seven years later	402,074	424,188	451,478	426,719		
Eight years later	401,864	424,603	448,972			
Nine years later	401,978	424,435				
Ten years later	402,001					
REDUNDANCY (DEFICIENCY)	$113,718	$101,457	$103,900	$ 80,028	$106,277	$
Supplemental Auto Claims Data:						
Claims reported during the year for CA only	291,720	315,558	352,182	324,143	294,615	
Claims pending at year-end for CA only	59,178	62,892	70,717	63,142	58,172	

TABLE 1 - Auto Lines as of December 31,

(Amounts in thousands, except claims)	2000	2001	2002

RESERVES FOR LOSSES AND LOSS ADJUSTMENT EXPENSES, DIRECT	$286,057	$301,985	$333,113
PAID (CUMULATIVE) AS OF:			
One year later	268,515	239,099	
Two years later	332,979		
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	352,709	323,791	
Two years later	354,720		
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)	$(68,663)	$(21,806)	
Supplemental Auto Claims Data:			
Claims reported during the year for CA only	323,395	298,417	293,955
Claims pending at year-end for CA only	54,760	50,365	51,488

See Notes 8 and 16 of the Notes to Consolidated Financial Statements

TABLE 2 - Homeowner and Earthquake Lines in Runoff as of December 31, (Amounts in thousands)	1992	1993	1994	1995	1996	
RESERVES FOR LOSSES AND LOSS ADJUSTMENT EXPENSES, DIRECT	$38,822	$51,598	$ 203,371	$ 78,087	$ 75,272	$
PAID (CUMULATIVE) AS OF:						
One year later	19,982	26,936	193,887	55,738	75,100	
Two years later	29,560	34,717	236,406	119,211	100,296	
Three years later	33,333	37,052	295,768	139,792	142,850	
Four years later	34,629	39,504	314,225	180,799	151,342	
Five years later	36,041	40,550	354,324	188,987	174,513	
Six years later	36,747	41,217	362,379	211,771	220,805	

Seven years later	36,928	42,318	385,161	257,839		
Eight years later	37,391	42,339	431,154			
Nine years later	37,399	42,455				
Ten years later	37,403					
RESERVES RE-ESTIMATED AS OF:						
One year later	36,549	41,685	253,775	116,741	101,903	
Two years later	36,401	40,189	290,526	142,071	145,635	
Three years later	35,740	39,657	316,256	182,616	150,434	
Four years later	35,788	41,025	355,690	186,631	153,521	
Five years later	36,758	41,205	359,084	190,334	208,533	
Six years later	37,044	41,586	363,260	245,267	261,389	
Seven years later	37,084	42,599	418,407	298,161		
Eight years later	37,556	42,450	458,640			
Nine years later	37,608	42,524				
Ten years later	37,446					
REDUNDANCY (DEFICIENCY)	$ 1,376	$ 9,074	$(255,269)	$(220,074)	$(186,117)	$

(Amounts in thousands)	2000	2001	2002
RESERVES FOR LOSSES AND LOSS ADJUSTMENT EXPENSES, DIRECT	$ 12,379	$ 47,305	$50,896
PAID (CUMULATIVE) AS OF:			
One year later	30,706	58,274	
Two years later	78,647		
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	68,245	103,470	
Two years later	121,176		
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)	$(108,797)	$(56,165)	

See Notes 8 and 16 of the Notes to Consolidated Financial Statements

Auto Lines Reserve Development. As shown in the ten-year development table, the Company's auto lines historically were over-reserved prior to 1999 and have exhibited adverse development for 1999, 2000 and 2001. The period from 1993 to 1999 was quite unusual in that, during that time, the Company experienced declining frequencies and declining severities in its auto line. As Table 1 shows, management did not immediately have confidence in these declining trends and did not immediately lower their reserve estimates.

Much of the decline in trend occurred between 1996 and 1998 because of moderation in health care costs due to greater use of HMO's and laws that were enacted in California that limited the ability of uninsured motorists and drunk drivers to collect non-economic damages. During 1999, the Company assumed that the past trend of declining frequencies and severities would continue. However, in retrospect, it can now be seen that the favorable decline in trends ended and loss costs began to increase. In 2000, the Company continued to underestimate loss severity primarily because of what then seemed to be an acceleration in the pattern of claims payments and the uncertainty inherent in identifying a change in multi-year patterns. In 2001, the Company experienced significant, unexpected development in its uninsured motorist coverage while the actuarial evaluation ranges for most prior accident years were adjusted upward as more data became available. The changes in injury trends affected the entire California market and occurred, to a greater or lesser degree, in virtually every state in the country.

During 2002 and 2001, the Company improved the quality and timeliness of the data available to make initial estimates and periodic changes in estimates and has dedicated more resources to better understand the underlying drivers of the changes in frequency and severity trends as they begin emerging. Management believes the decline in the need for recognition of adverse development in 2002 due to prior accident years for the personal auto lines evidences substantial improvement in the accuracy of its estimation processes. Historically, 21st Century actuaries have not projected a range around the carried loss reserves. Rather, they have used several methods and different underlying assumptions to produce a number of point estimates for the required reserves. Management selects the carried reserve after carefully reviewing the appropriateness of the underlying assumptions.

Homeowner and Earthquake Lines in Runoff. In Table 2, substantially all of the indicated development relates to the earthquake line. Changes relating to the homeowner line, which went into runoff mode in January 2002, are not significant for any of the years shown.

In September 2000, the State of California enacted Senate Bill 1899 ("SB 1899"), a law that affected the entire homeowners insurance industry in California, by allowing earthquake claims barred by contract and the statute of limitations arising from the January 17, 1994, Northridge Earthquake to be reopened during calendar year 2001. This statute is commonly referred to as SB 1899. The Company considers this an unprecedented and unforeseeable violation of its contract rights as guaranteed by Article 1 of Constitution of the United States. In Table 2, the losses created by SB 1899 have been treated as an accident year 1994 event, since they related to the 1994 earthquake, even though the law permitting the claims to be made was not enacted until 2000 and not effective until January 2001. Because of this treatment, Table 2 gives the appearance that the Company's 1994 estimates continue to be wrong. This is not the case, because it was not possible to foresee in 1994 that an unprecedented new law would be effective in 2001, which would reopen these claims.

SB 1899 allowed a one-year window (calendar year 2001) for claimants to bring additional insurance claims and legal actions allegedly arising out of the January 17, 1994, Northridge Earthquake. Prior to the enactment of this law, such claims were considered by previously applicable law to be fully barred, or settled and closed. Any additional legal actions with respect to such claims

were barred under the policy contracts, settlement agreements, and/or applicable

statutes of limitation. As a result of the enactment of this unprecedented legislation, claimants asserted additional claims against the Company allegedly related to damages that occurred in the 1994 earthquake but which were now being reported seven years later in 2001. Plaintiff attorneys and public adjusters conducted extensive advertising campaigns to solicit claimants. Hundreds of claims were filed in the final days and hours before the December 31st deadline. During 2001, the Company recorded an additional $70 million of pre-tax losses related to the 1994 earthquake, including $50 million in the fourth quarter of 2001 to cover the indemnity and inspection portion of the claims. The Company lacked sufficient information to record a reasonable estimate of the related legal defense costs until the third quarter of 2002, at which time an additional provision of $46.9 million was recorded. In the first two quarters of 2002, an additional $11.9 million of legal defense costs were expensed as they were paid.

Prior to the passage of SB 1899, the Company recorded significant changes in estimates relating to the 1994 Northridge Earthquake: $57 million in 1995, $40 million in 1996, $25 million in 1997 and $40 million in 1998. Those changes were recorded; as new information became available indicating that previous estimates were insufficient. Smaller earthquake provisions were recorded in 1999 and 2000 as the number of cases dropped to a few remaining lawsuits. By the end of 2000, before SB 1899 became effective in January 2001, approximately 50 earthquake claims out of an initial 35,000 homeowner earthquake claims remained to be resolved, and fewer than 50 were in litigation.

Management has reviewed the adequacy of the remaining SB 1899 reserves at the end of 2002. Based on that review, no further provisions were deemed to be required as of December 31, 2002. The Company continues to caution that the recorded estimates for earthquake loss and loss adjustment reserves resulting from SB 1899 are subject to a greater than normal degree of uncertainty for a variety of reasons.

First, determining in 2001 and subsequently whether alleged damage was caused or exacerbated by a 1994 earthquake is inherently difficult. Company experts and experts representing claimants could have materially different views of both causation and the necessity and cost of a particular method of repair. The purpose of the one-year time period in the policy is precisely to avoid the problems inherent in attempting to adjust property damage claims after substantial time has elapsed and subsequent events have occurred, such as additional earthquakes, normal settling and cracking, poor maintenance, etc. In the event of a difference of opinion, an expensive mediation or litigation process is needed to obtain resolution. Results from this process, particularly if trial by jury is involved, are subject to a wide range of possible outcomes.

Second, Company adjusters have frequently been prevented from taking recorded statements or examinations under oath of claimants. In many instances, subsequent statements allow adjusters to materially reduce their estimates. It is possible that the litigation discovery process might provide similar results for SB 1899 claims. Similarly, the Company's actions against alleged fraudulent claimants, adjusters, or attorneys, such as the action against Unlimited Adjusting, could favorably impact reserves if claims are proven fraudulent.

Third, more than two-thirds of the Company's remaining earthquake claims are in litigation. Many suits seek extracontractual and punitive damages as well as contractual damages far in excess of the Company's estimates; the Company views such outcomes as being remote. Therefore, a reserve for potential extracontractual or punitive damages has not been established. Extracontractual and punitive damages, if assessed against the Company, could be material in an

individual case or in the aggregate. In addition, the Company may choose to settle litigated cases for amounts in excess of its own estimate of contractual damages to avoid the expense and/or risk of litigation.

Fourth, additional Northridge Earthquake claims have been filed in 2002 outside of the reporting window established by SB 1899. The Company currently has approximately 40 such claims that are apparently based on alternative legal theories. Thus, the Company could continue to receive additional Northridge Earthquake claims in the future that may require additional reserves.

Finally, actual expenses for legal defense costs are susceptible to a wide range of outcomes depending on a variety of factors including plaintiff strategies, future judicial decisions, the percentage of cases which settle, and the period of time cases remain outstanding before settlement. The possibility of reaching mass settlements of cases with particular attorneys or law firms presents the opportunity to substantially reduce estimates for legal defense costs. On the other hand, the inability to settle a substantial majority of cases for reasonable amounts would materially increase amounts needed for legal defense costs.

COMPETITION

The personal automobile insurance market is highly competitive and is comprised of a large number of well-capitalized companies, many of which operate in a number of states and offer a wider variety of products than the Company. Several of these competitors are larger and have greater financial resources than the Company on a stand-alone basis. Based on direct premiums written for 2001 (latest publicly available information), the Company is the seventh largest writer of private passenger automobile insurance in California. The Company's main competition comes from other major writers who concentrate on the good driver market.

Market shares in California of the top ten writers of personal automobile insurance, based on direct premiums written per A.M. Best, for the past five years were as follows:

December 31,	2001	2000	1999	1998	1997
21ST CENTURY INSURANCE GROUP	6%	6%	6%	6%	6%
State Farm	13	13	14	15	16
Farmers	12	13	14	15	15
Allstate	11	10	9	8	8
California State Auto Association	10	10	10	10	11
Auto Club of Southern California	9	9	9	8	7
Mercury	8	8	8	7	7
USAA	3	3	3	3	3
GEICO	3	3	2	2	1
Progressive	2	2	3	2	2

REINSURANCE

A reinsurance transaction occurs when an insurer transfers or cedes a portion of its exposure to a reinsurer for a premium. The reinsurance cession does not legally discharge the insurer from its liability for a covered loss, but provides for reimbursement from the reinsurer for the ceded portion of the risk. The Company periodically monitors the continuing appropriateness of its reinsurance arrangements to determine that its retention levels are reasonable and that its reinsurers are financially sound, able to meet their obligations under the agreements and that the contracts are competitively priced.

The majority of the Company's cessions are with AIG subsidiaries, which have

earned A.M. Best's highest financial rating of A++. The A.M. Best financial ratings of the Company's other reinsurers range from A- to A+. The Company's reinsurance arrangements are discussed in more detail in Note 9 of the Notes to Consolidated Financial Statements.

The Company's net retention of insurance risk after reinsurance for 2003(1) and the preceding five years is summarized below:

	Contracts Incepting During					
	2003	2002	2001	2000	1999	1998
Auto and motorcycle lines	100%	97%(2)	94%	92%	90%	90%
Personal umbrella policies(3)	10	10	16	37	36	36
Homeowner line in runoff	0	0	94	92	0	0

The Company also has catastrophe reinsurance agreements relating to the auto line with Endurance Specialty Insurance Ltd., Folksamerica Reinsurance Company and Transatlantic Reinsurance Company, which reinsure any covered events up to $30.0 million in excess of $15.0 million.

STATE REGULATION OF INSURANCE COMPANIES

Insurance companies are subject to regulation and supervision by the insurance departments of the various states. The insurance departments have broad regulatory, supervisory and administrative powers, such as:

- Licensing of insurance companies, agents and customer service employees
- Prior approval, in California and some other jurisdictions, of rates, rules and forms
- Establishment of capital and surplus requirements and standards of solvency
- Nature of, and limitations on, investments insurers are allowed to hold
- Periodic examinations of the affairs of insurers
- Annual and other periodic reports of the financial condition and results of operations of insurers
- Establishment of accounting rules
- Issuance of securities by insurers
- Restrictions on payment of dividends
- Restrictions on transactions with affiliates

Currently, the California Department of Insurance ("CDI") has primary regulatory jurisdiction over the Company, including prior approval of premium rates. The CDI typically conducts a financial examination of the Company's affairs every three years. The most recently completed triennial examination, for the three years ended December 31, 1999, did not require the Company to restate its 1999 statutory financial statements. In general, the current regulatory requirements in the other states in which the Company is a licensed insurer are no more stringent than in California.

In addition to regulation by the CDI, the Company and the personal lines insurance business in general are also subject to legislative, judicial and political action in addition to the normal business forces of competition between companies and the choices of consumers.

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1 Based on programs currently in place, the Company does not expect these retention levels to change during 2003.

2 Effective September 1, 2002, the Company entered into an agreement to

cancel future cessions under its quota share with AIG. The treaty would have ceded 4% of premiums for the auto and motorcycle lines to AIG in the remainder of 2002 and would have declined to 2% in 2003. After September 1, 2002, 100% of auto and motorcycle premiums are retained by the Company.

3 Personal umbrella coverage is only available to the Company's auto customers. Approximately 1% of the auto customers have umbrella coverage.

To the Company's knowledge, no new laws were enacted in 2002 by any state in which the Company does business that are expected to have a material impact on the auto insurance industry. However, under the preceding Insurance Commissioner, the State of California began hearings for the purpose of implementing generic rating factors in connection with the Commissioner's authority to approve insurance rates, including the rating of auto insurance. The draft regulations made public by the CDI focus on restricting an insurer's rate of return rather than on the price charged by the insurer to the consumer. The Company believes adverse regulations could negatively affect the Company's profitability.

HOLDING COMPANY REGULATION

The Company's subsidiaries are also subject to regulation by the CDI pursuant to the provisions of the California Insurance Holding Company System Regulatory Act (the "Holding Company Act"). Many transactions defined to be of an "extraordinary" nature may not be effected without the prior approval of the CDI. In addition, there are limits on the subsidiaries' dividend paying capacity. An extraordinary transaction includes a dividend which, together with other dividends or distributions made within the preceding twelve months, exceeds the greater of (i) 10% of the insurance company's policyholders' surplus as of the preceding December 31 or (ii) the insurance company's statutory net income for the preceding calendar year. The California code further provides that property and casualty insurers may pay dividends only from unassigned surplus.

The insurance subsidiaries currently have $21.6 million of statutory unassigned surplus that could be paid as dividends to the parent company without prior written approval from insurance regulatory authorities in 2003. However, given the current uncertainty surrounding the taxability of dividends received by holding companies from their insurance subsidiaries (see further discussion in Item 3 of this report and Note 14 of the Notes to Consolidated Financial Statements), it is unlikely that the Company's insurance subsidiaries will make any dividend payments to the parent in 2003. There is no assurance that the related tax issue will be favorably resolved in the near term, in which case the Company faces the prospect of raising additional capital at the holding company level, cutting or ceasing dividends to stockholders, or having to pay the additional tax on dividends from the insurance company to the holding company.

Cash and investments at the holding company were $7.0 million at December 31, 2002, compared to $52.8 million at December 31, 2001. The decline in the parent's cash and investments is primarily due to the payment of dividends and the repayments of intercompany balances. On December 19, 2002, the Company declared a $1.7 million dividend to stockholders of record on December 30, 2002, which was paid January 17, 2003. If necessary, the Company believes it can access the capital markets should the need arise for additional capital to support its growth and other corporate objectives.

EFFECTS OF EVENTS OF SEPTEMBER 11, 2001

The Company has no direct exposure from the events of September 11, 2001. However, some of the Company's reinsurers do have such exposure, which could impact their ability to meet their obligations to the Company. Based on information received from its reinsurers, the Company does not consider any of

its reinsurance recoverables to be of doubtful collectibility.

NON-VOLUNTARY BUSINESS
Automobile liability insurers in California are required to participate in the California Automobile Assigned Risk Plan ("CAARP"). Drivers whose driving records or other relevant characteristics make them difficult to insure in the voluntary market may be eligible to apply to CAARP for placement as "assigned risks." The number of assignments for each insurer is based on the total applications received by the plan and the insurer's market share. As of December 31, 2002, the number of assigned risk insured vehicles was 2,436 compared to 1,750 at the end of 2001. The CAARP assignments have historically produced underwriting losses. As of December 31, 2002,

this business represented less than 1% of the Company's total direct premiums written, and the underwriting losses were $0.5 million in 2002, $0.7 million in 2001 and $0.7 million in 2000.

Insurers offering homeowner insurance in California are required to participate in the California FAIR Plan ("FAIR Plan"). FAIR Plan is a state administered pool of difficult to insure homeowners. Each participating insurer is allocated a percentage of the total premiums written and losses incurred by the pool according to its share of total homeowner direct premiums written in the state. The Company's FAIR Plan underwriting results for 2002, 2001 and 2000 were immaterial. However, a major shortfall in FAIR Plan operations, such as might be caused by a catastrophe, could result in an increase in costs. Participation in the current year FAIR Plan operations is based on the pool from two years prior. Since the Company ceased writing direct homeowners business in 2002, the Company will continue to receive assignments in the calendar year 2003 and 2004.

EMPLOYEES
The Company had approximately 2,600 full and part-time employees at December 31, 2002. The Company provides medical, pension and 401(k) savings plan benefits to eligible employees, according to the provisions of each plan. The Company believes that its relationship with its employees is good.

ITEM 2. PROPERTIES

The Company leases approximately 400,000 square feet of office space for its headquarters facilities, which are located in Woodland Hills, California. The lease term expires in February 2015, and the lease may be renewed for two consecutive five-year periods.

The Company also leases office space in 14 other locations, of which 9 locations are in California primarily for claims-related employees. The Company anticipates no difficulty in extending these leases or obtaining comparable office facilities in suitable locations.

On December 31, 2002, the Company entered into a sale-leaseback transaction for $15.8 million of equipment and leasehold improvements and $44.2 million of software. The leaseback transaction has been accounted for as a capital lease. For a summary of the Company's lease obligations, see discussion under Item 7 of this report and Notes 7 and 11 of the Notes to Consolidated Financial Statements.

ITEM 3. LEGAL PROCEEDINGS

In the normal course of business, the Company is named as a defendant in lawsuits related to claim and insurance policy issues, both on individual policy files and by class actions seeking to attack the use of various databases,

vendors and claims practices generally. Many suits seek generally unspecified extracontractual and punitive damages as well as contractual damages far in excess of the Company's estimates. The Company cannot estimate the amount or range of loss that could result from an unfavorable outcome on these suits. It denies liability for any such alleged damages and believes that it has a number of valid defenses to the litigation. The Company has not established reserves for potential extracontractual or punitive damages, or for damages in excess of estimates the Company believes are correct and reasonable. Nevertheless, extracontractual and punitive damages, if assessed against the Company, could be material in an individual case or in the aggregate. The Company may choose to settle litigated cases for amounts in excess of its own estimate of contractual damages to avoid the expense and/or risk of litigation. Other than possibly for the contingencies discussed below, the Company does not believe the ultimate outcome of these matters will be material to its results of operations, financial condition or cash flows.

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On December 9, 2002, the Company commenced an arbitration proceeding against Computer Sciences Corporation ("CSC") arising out of CSC's obligation to provide insurance company information technology software and other software programs to the Company. CSC has filed a counterclaim in the proceeding. In the third quarter of 2002, the Company wrote off $37.2 million of its investment in CSC software. The arbitration will be conducted by the American Arbitration Association.

Bryan Speck, individually, and on behalf of others similarly situated v. 21st Century Insurance Company, 21st Century Casualty Company, and 21st Century Insurance Group, was filed on June 20, 2002 in Los Angeles Superior Court. The plaintiff seeks national class action certification, injunctive relief, and unspecified actual and punitive damages. The complaint contends that 21st Century uses "biased" software in determining the value of total-loss automobiles. The plaintiff alleges that database providers use improper methodology to establish comparable auto values and populate their databases with biased figures. 21st Century and other carriers allegedly subscribe to the programs to unfairly reduce claim costs. This case is consolidated with similar actions against other insurers for discovery and pre-trial motions. 21st Century intends to vigorously defend the suit with other defendants in the coordinated proceedings.

Thomas Theis, on his own behalf and on behalf of all others similarly situated v. 21st Century Insurance, was filed on June 17, 2002 in Los Angeles Superior Court. Plaintiff seeks national class action certification, injunctive relief and unspecified actual and punitive damages. The complaint contends that after insureds receive medical treatment, 21st Century uses a medical-review program to adjust expenses to reasonable and necessary amounts for a given geographic area. The plaintiff alleges that the adjusted amount is "predetermined" and "biased," creating an unfair pretext for reducing claim costs. This case is consolidated with similar actions against other insurers for discovery and pre-trial motions. 21st Century intends to vigorously defend the suit with other defendants in the coordinated proceedings.

On October 10, 2002, a Los Angeles Superior Court granted the Company's motion for summary judgment in the matter of 21st Century Insurance Company vs. People of the State of California ex rel. Bill Lockyer, Attorney General et al. The court determined that the Company's April 21, 1999, settlement with the

California Department of Insurance ("CDI") with respect to regulatory actions arising out of the 1994 Northridge Earthquake was fully valid and enforceable. The Court denied the Attorney General's motion seeking to have the settlement declared void and unenforceable, a result that may have allowed the CDI to reinstitute regulatory proceedings with respect to the Company's handling of claims arising out of the 1994 Northridge Earthquake. The CDI has appealed the ruling.

SB 1899, effective from January 1, 2001, to December 31, 2001, allowed the re-opening of previously closed earthquake claims arising out of the 1994 Northridge Earthquake. The Company's first constitutional challenge to SB 1899 came to an unsuccessful result on April 29, 2002, when the United States Supreme Court refused to hear the Company's case (see Note 16 of the Notes to Consolidated Financial Statements). A subsidiary of the Company, 21st Century Casualty Company, filed a new challenge to the constitutionality of SB 1899 on February 13, 2003. The viability of this case is being reviewed as a result of a subsequent Ninth Circuit Court of Appeals decision. The Company currently has lawsuits pending against it in connection with claims under SB 1899; many of these lawsuits have multiple plaintiffs. Damages in excess of the Company's reasonable estimates for these claims could be material individually or in the aggregate.

The Company has filed a civil complaint against California-based Unlimited Adjusting Company ("Unlimited") and its principal Jung Ho Park ("John Park"). The suit alleges Unlimited and John Park illegally induced insureds into filing additional unnecessary and fraudulent claims with the

Company stemming from the 1994 Northridge Earthquake. The Company is ultimately seeking up to $10 million in compensatory damages.

In December of 2000, a statute that allowed a tax deduction for the dividends received from wholly owned insurance subsidiaries was held unconstitutional on the grounds that it discriminated against out-of-state insurance holding companies. Subsequent to the court ruling, the staff of the California Franchise Tax Board ("FTB") has decided to take the position that the discriminatory sections of the statute are not severable and the entire statute is invalid. As a result, the FTB is disallowing dividend-received deductions for all insurance holding companies, regardless of domicile, for open tax years ending on or after December 1, 1997. Although the FTB has not made a formal assessment for tax years 1997 through 2000, the Company anticipates a retroactive disallowance that would result in additional tax assessments.

The amount of any such possible assessments and the ultimate amounts, if any, that the Company may be required to pay, are subject to a wide range of estimates because so many ostensibly long-settled aspects of California tax law have been thrown into disarray and uncertainty by the action of the courts. In the absence of legislative relief, years of future litigation may be required to determine the ultimate outcome. The range of possible loss, net of federal tax benefit, ranges from close to zero to approximately $20.8 million depending on which position future courts may decide to uphold or on whether the California legislature may decide to enact corrective legislation. The Company believes it has adequately provided for this contingency.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON STOCK AND RELATED STOCKHOLDER MATTERS

(a) PRICE RANGE OF COMMON STOCK

The following table sets forth the high and low bid prices for the common stock for the indicated periods.

	2002		2001	
	HIGH	LOW	High	Low
Fourth Quarter	$14.24	$ 9.60	$19.45	$14.43
Third Quarter	19.67	9.15	19.33	16.20
Second Quarter	21.80	17.70	18.44	15.99
First Quarter	19.50	15.82	18.66	13.26

(b) HOLDERS OF COMMON STOCK

The approximate number of holders of common stock on December 31, 2002 was 617.

(c) DIVIDENDS

Quarterly dividends of $0.16 per share were paid for the first and second quarters of 2000. Dividends of $0.08 per share were paid from the third quarter of 2000 through the third quarter of 2002. The dividend for the fourth quarter of 2002 was lowered to $0.02 per share.

The Company's Board of Directors considers a variety of factors in determining the timing and amount of dividends. Accordingly, the Company's past history of dividend payments does not assure that future dividends will be paid.

ITEM 6. SELECTED FINANCIAL DATA

The selected financial data presented below as of the end of and for each of the years in the five-year period ended December 31, 2002, are derived from, or supplemental to, the Company's consolidated financial statements. The consolidated financial statements as of December 31, 2002 and 2001, and for each of the years in the three-year period ended December 31, 2002, are included in Item 8 of this report.

All amounts set forth in the following tables are in thousands, except for ratios and per share data.

Years Ended December 31,	2002	2001	2000	1999	1998
PERSONAL AUTO LINES DATA					
Direct premiums written	$995,794	$898,862	$881,212	$ 855,783	$ 860,811
Ceded premiums written(1)	(18,902)	(56,205)	(72,675)	(86,974)	(87,453)
Net premiums written	976,892	842,657	808,537	768,809	773,358
Net premiums earned	924,559	838,489	803,770	770,234	773,158
Loss and LAE ratio(2)	82.9%	88.1%	90.8%	77.4%	74.8%
Expense ratio - GAAP(3)	15.6	14.9	14.2	12.3	10.5
Combined ratio(4)	98.5%	103.0%	105.0%	89.7%	85.3%

ALL LINES DATA					
Direct premiums written	$998,248	$929,315	$910,720	$ 880,531	$ 885,617
Ceded premiums written(5)	(32,949)	(60,359)	(78,592)	(111,718)	(111,904)
Net premiums written	965,299	868,956	832,128	768,813	773,713
Net premiums earned	924,559	864,145	825,486	770,423	772,864
Total revenues	981,295	914,078	869,762	832,681	870,650
Loss and LAE ratio	89.4%	96.7%	90.8%	78.6%	81.0%
Expense ratio - GAAP(3)	15.5	15.0	14.4	12.9	10.2
Combined ratio(6)	104.9%	111.7%	105.2%	91.5%	91.2%
NET (LOSS) INCOME	$(12,256)	$(27,568)	$ 12,945	$ 87,528	$ 101,072
(LOSS) EARNINGS PER SHARE					
Basic	$ (0.14)	$ (0.32)	$ 0.15	$ 1.00	$ 1.36
Diluted	(0.14)	(0.32)	0.15	1.00	1.19
DIVIDENDS DECLARED AND PAID	0.26	0.32	0.48	0.64	0.58