



WHAT MAKES A
GOOD RATE
FIKLING

A Pennsylvania Perspective

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A Pennsylvania Perspective

This presentation will:

- Review the Historical Context;
- Examine the legal / regulatory requirements;
- Consider the actuarial / technical considerations;
- Explore the tension between competitive and public concerns that affect the process.

A Pennsylvania Perspective : Historical Context

- Mid 1980's
- Thousands of individual rate filings for each insurance department actuary to review



A Pennsylvania Perspective : Historical Context



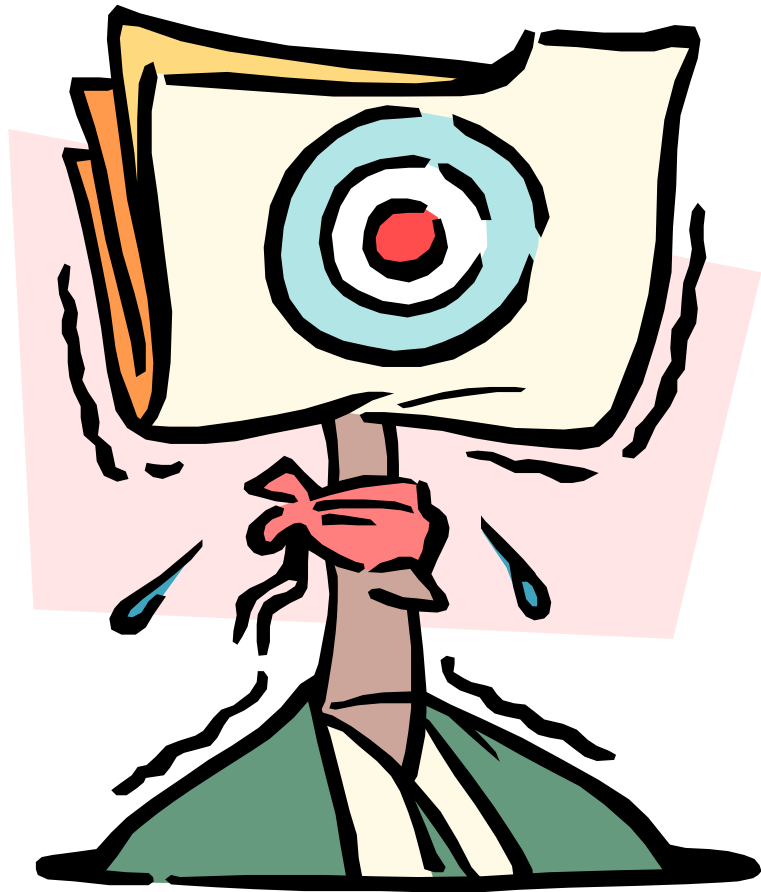
Review standard

(officially)

Rates neither:

- Excessive,
- Inadequate,
- Or unfairly discriminatory

A Pennsylvania Perspective : Historical Context



Review standard
(unofficially)

Don't
Screw
Up!

A Pennsylvania Perspective : Historical Background

Crisis:

- Filings backup
- Companies threaten to “deem”



A Pennsylvania Perspective : Historical Context



- Solution:
 - Rely on competition in competitive markets to regulate markets to statutory standard

A Pennsylvania Perspective : Historical Context

- Success:
 - Competition works!
 - All parties happy
 - More time for staff to deal with big picture issues
 - Competition encourages innovation in the market place



A Pennsylvania Perspective : Legal and Regulatory Requirements

Casualty & Surety Rate Act:

The purpose of this Act is to promote the public welfare by regulating insurance rates to the end that they shall not be excessive, inadequate or unfairly discriminatory; to enable authorized insurers to meet all requirements of the insuring public of this Commonwealth, and to authorize and regulate cooperative action among insurers in rate making and in other matters within the scope of this Act. Nothing in this Act is intended (1) to prohibit or discourage reasonable competition, or (2) to prohibit or encourage uniformity in insurance rates, rating systems, rating plans or practices. This Act shall be liberally interpreted to carry into effect its purposes as herein set forth.



A Pennsylvania Perspective : Legal and Regulatory Requirements

All rates shall be made in accordance with the following provisions:

- (a) Due consideration shall be given to past and prospective loss experience within and outside this Commonwealth, to physical hazards, to safety and loss prevention factors, to underwriting practice and judgment to the extent appropriate, to catastrophe hazards, if any, to a reasonable margin for underwriting profit and contingencies, to dividends, savings or unabsorbed premium deposits allowed or returned by insurers to their policyholders, members or subscribers, to past and prospective expenses both country wide and those specially applicable to this Commonwealth, and to all other relevant factors within and outside this Commonwealth.



A Pennsylvania Perspective : Legal and Regulatory Requirements

All rates shall be made in accordance with the following provisions:

- b) The systems of expense provisions included in the rates for use by any insurer or group of insurers may differ from those of other insurers or groups of insurers to reflect the requirements of the operating methods of any such insurer or group with respect to any kind of insurance, or with respect to any subdivision or combination thereof for which subdivision or combination separate expense provisions are applicable.



A Pennsylvania Perspective : Legal and Regulatory Requirements

All rates shall be made in accordance with the following provisions:

- c) Risks may be grouped by classifications for the establishment of rates and minimum premiums. Classification rates may be modified to produce rates for individual risks in accordance with rating plans which establish standards for measuring variations in hazards or expense provisions, or both. Such standards may measure any differences among risks that can be demonstrated to have a probable effect upon losses or expenses.



The Pennsylvania Experience: Legal and Regulatory Requirements

All rates shall be made in accordance with the following provisions:

- (d) Rates shall not be excessive, inadequate or unfairly discriminatory. No rate shall be held to be unfairly discriminatory unless, allowing for practical limitations, it clearly fails to reflect with reasonable accuracy the differences in expected losses and expenses. A rate is not unfairly discriminatory because different premiums result for policyholders with like-loss exposures but different expense factors, so long as the rate reflects the differences with reasonable accuracy. A rate is not unfairly discriminatory if it is averaged broadly among persons insured under a group, franchise or blanket policy.



The Pennsylvania Experience: Legal and Regulatory Requirements

All rates shall be made in accordance with the following provisions:

- (e) This section shall not be construed to prohibit rates for automobile insurance which are based, in whole or in part, on factors, including, but not limited to, sex, if the use of such a factor is supported by sound actuarial principles or is related to actual or reasonably anticipated experience; however, such factors shall not include race, religion or national origin.



The Pennsylvania Experience: Legal and Regulatory Requirements

§ 1184. Rate filings

- (a) Every insurer shall file with the commissioner every manual of classifications, rules and rates, every rating plan and every modification of any of the foregoing which it proposes to use in this Commonwealth. ...

When a filing is not accompanied by the information upon which the insurer supports such filing, and the commissioner does not have sufficient information to determine whether such filing meets the requirements of the act, he may require such insurer to furnish the information upon which it supports such filing.



A Pennsylvania Perspective : Legal and Regulatory Requirements

§ 1184. Rate filings

Any filing may be supported by (1) the experience or judgment of the insurer or rating organization making the filing, (2) the experience of other insurers or rating organizations, or (3) any other factors which the insurer or rating organization deems relevant. A filing and any supporting information shall be open to public inspection after the filing becomes effective.



A Pennsylvania Perspective : Legal and Regulatory Requirements

- (f) Under such rules and regulations as he shall adopt the Commissioner may, by written order, suspend or modify the requirement of filing as to any kind of insurance, subdivision or combination thereof, or as to classes of risks, the rates for which cannot practicably be filed before they are used. Such orders, rules and regulations shall be made known to insurers and rating organizations affected thereby. The Commissioner may make such examination as he may deem advisable to ascertain whether any rates affected by such order meet the standards set forth in subsection (d) of section three.



A Pennsylvania Perspective : Actuarial Considerations

Analytic framework for
actuarial
considerations:

- AAA risk classification
statement of principles



A Pennsylvania Perspective : Actuarial Considerations

Purpose:

To achieve and maintain viable insurance systems, the process of risk classification should serve three primary purposes. It should:

- protect the insurance system's financial soundness;
- be fair; and
- permit economic incentives to operate and thus encourage widespread availability of coverage.

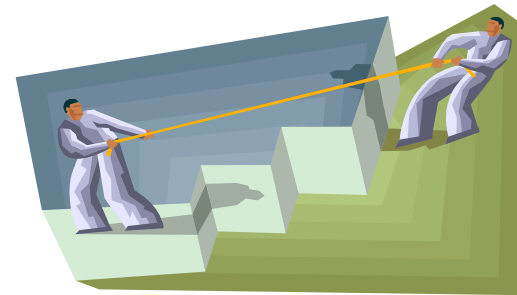


A Pennsylvania Perspective :

Source of Tension:

Regulatory Conflict

- Rely on market place competition (*Economic Incentive*)
- Some notion of *public acceptability*



A Pennsylvania Perspective : So, the Answer is?

What makes a good rate filing:

- Clear, succinct and efficient.
- States succinctly at the beginning what is being proposed and its effect(s).



A Pennsylvania Perspective : So, the Answer is?

- Provides all information and support that the department requires.
- The filing is not the forum to debate the regulatory process!



A Pennsylvania Perspective : Conclusions?



- **Modern ratemaking, with its use of Predictive Modeling, credit scoring and complex catastrophe models, is a highly complex process likely not completely, and / or well, understood by many participants in the marketplace.**

A Pennsylvania Perspective : Conclusions?



- **Competition will dramatically accelerate the frequency and complexity of future rate changes. (The stock market paradigm is a model of where this market is heading.)**

A Pennsylvania Perspective : Conclusions?



- **The exigencies of efficient markets and efficient regulation will respond with a new ‘filing’ process.**