Predictive Models, Innovation and Regulation: Markets Constrained – The Insurer's Perspective

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This portion of the general session will address the following

- The premise of how insurers need to operate
- How insurers compete
- Pros/cons of regulation
  - Examples
- Issues in compliance
- Conclusions on regulation in today's environment

The presentation will cover these in terms of personal auto insurance since that is the largest, and one of the most regulated, property/casualty coverages in the U.S.

Premise

Three general premises in operating in this market

1. While large ($160 billion in annual premium), personal auto is not very concentrated. Only two companies have more than 10% market share. Competition is plentiful. Consumers have plenty of choices. Comparison shopping is also easier than it used to be.
2. To do <u>well</u>, my company needs to beat the competition in terms of either "product" or price. Absent any advantage, I am doomed in the long run.
3. I have no incentive to write business at an expected loss.
   Corollary: I don't care who I write as long as the business is profitable and does not cause other strains on my organization.
   Corollary: Because the market is competitive, I can not get away with overcharging a class of business for very long.

How I Compete

There are five areas where I can focus my efforts to beat the competition

1. Lower cost (claims or expenses)
2. Better customer service
3. More effective distribution
4. Better product features
5. Better intelligence

Potential of Better Intelligence

Through predictive modeling, my actuarial department has identified a subset (25%) of a class that presents an opportunity

- Our current class rate is $1,000
- Market price varies between $850 and $1,150
- Indicated subset rate is $700, with a range of $600 to $800

My actuarial department wants me to charge $700. I have overruled them and plan on charging $800. At this price, I maximize my profit. My actuaries submit the filing to the DOI for a new class at a rate of $800. The remainder of the old class will have its rate increased to $1,067 to offset this for an overall 0% rate change.

Roles of Regulation

As a participant in this market, I see four roles to the regulation of the market

1. Solvency – Benefits both insurers and consumers
2. Policy forms – Beneficial to have consistency for comparison shopping
3. Market conduct – Benefits my company if it results in others playing by the rules; also includes limits/restrictions on non-renewals/cancellations
4. Rates – Debatable in many areas
   - Penalizes efficiency
   - Adds costs; delays reactions
   - Discourages innovation (or limits the gains from it)
   - File and use, without public access, is certainly reasonable
   - Monitoring rate changes is also reasonable

Impact of Rate Regulation

- Examples exist of how rate regulation causes consumers to pay more
  - Segments in New Jersey and Massachusetts
  - California territories and overall rate level
- Benefits of deregulation have been evident in New Jersey, South Carolina, and (hopefully in the future) Massachusetts

Impact of Rate Regulation (continued)

- Rate regulation often has unintended consequences
  - Razor thin territories in Michigan under Essential Insurance Act
  - Availability issues in urban New Jersey territories
  - Use of county mutuals in Texas
- Companies are good at complying with letter of regulation, but perhaps not the spirit
- We recognize affordability issues, however:
  - We react to economic realities, not political concerns
  - Cross-subsidies are not a good long run strategy

Better Intelligence Example

- My company has filed for a new class with a proposed rate of $800 versus an indicated rate at the middle of the range of $700
  - Credibility-weighted indications supports the $800 as not being unfairly discriminatory
  - Regulator rejects the credibility approach and says we should charge no more than $700
- Upon hearing this, I instruct my actuary to pull the filing
  - We keep the subset at $1,000, but increase marketing efforts and incentives to this group
  - Change/tighten underwriting for rest of class

Final Thoughts

- While regulation has its place, rates by class are best left to the market to decide
  - As long as line of business is competitive, consumers are ultimately best served by increases in innovation and more choice
- One cannot legislate away knowledge
  - Companies will find a way to use information in a different way