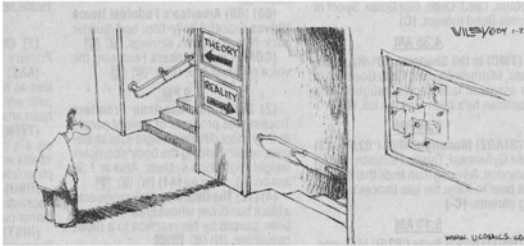


TOWN HALL SESSION
Underwriting Profit and Contingency
Risk Loading in Ratemaking
Section RR-1

A Brief History of Actuarial Pricing



A Short History of Actuarial Pricing

- 1. Budget period – Supply side provision of +5% (+2.5 for WC)
- 2. Investment offset –Calendar year acct (ISO ,Biger-Kahane)
- 3. CAPM return: Returns offset w income at risk-free (Fairley, Hill)
- 4. Include taxes, (Myers-Cohn), 2 tax rates (Hill-Modigliani)
- 5. Perspective: Policyholder, Shareholder (NCCI, Cummins, Taylor)
- 6. PV taxes independent of risk, (Myers, Derrig)
- 7. Insurance is an option (Krauss-Ross, Doherty-Garven, Derrig)
- 8. Insolvency put in prices (Butsic, Cummins-Allen-Phillips)
- 9. Allocate capital (costs):
 - Insolvency put equal at the margin (Myers-Read);
 - Capital and risk management, catastrophes, (Zanjani);
 - Testing prices for frictional costs, (Cummins-Phillips-Lin)

A Short History of Pricing - Comments

- 1. **Budget period** – Supply side provision of +5% (**Company**)
- 2. **Investment Offset**- Calendar year pricing (**Company**)
- 2. **CAPM return**: Returns offset w risk-free income (**Equilibrium**)
- 3. **Include taxes**, Myers-Cohn (**Policyholder**)
- 4. **Perspective**: Policyholder, Shareholder (**Equilibrium**)
- 5. **PV taxes independent of risk**, (**Myers Theorem**)
- 6. **Insurance is an option** (**Price is exchange option value**)
- 7. **Insolvency put in prices** (**Price is less than fully guaranteed price**)
- 8. **Allocate capital** (**Costs**):
 - Insolvency put equal at the margin (**Equilibrium**);
 - Capital and risk management, catastrophes, (**Frictional costs**);
 - Testing prices for frictional costs (**Taxes, RM, Capital**)

Questions for the White Board

1. **Which Risk Metric Should be Used:**
Total Return to Capital or Claim Volatility?
2. **Agree that every dollar of surplus stands behind each and every risk, so allocation is not possible?**
3. **What's the Role of a Competitive Market:**
Profit in the Indicated vs. Filed Rates?
4. **Is there a cost of capital for every line of business in rate filings?**
5. **Does the Quality of Risk Management Affect Price:**
Better Management mean Higher Prices?
6. **How does the financial crisis affect our profit formulations, if at all.**

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