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ADVENTURES IN RATE CAPPING

ACTUARIAL AND BUSINESS CONSIDERATIONS

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Agenda

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- What is Rate Capping?
- Pros and Cons
- Regulatory Perspective
- Rate Capping Design
- Post-Implementation
- Rate Indications Under Capping
- CY Financial Projections

What Is Rate Capping?

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Under rate capping, a customer's renewal rate change may be capped at a maximum percent increase (or decrease) at each renewal until the approved rate level is reached.

Example:

Current Prem.: $1000	Renewal Prem.: $1400	Rate Cap: 20%

- Premium at first renewal: $1200
  - Min($1400, $1000 x 1.20)
- Premium at second renewal: $1400
  - Min ($1400, $1200 x 1.20)

Benefits of Rate Capping

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Less Disruptive

- Always improving rating algorithm to be more accurate
  - Allows gradual introduction of significant rating plan changes
- Customer preference for stable rate changes
- Lower complaint levels

Improved retention

- Assumes large rate changes cause customers to leave

Appropriate new business rates

- Gets the right rates on the street

Drawbacks of Rate Capping

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Complex

Need for more actuarial, IT and testing resources

Unfair?

Disparate treatment of new & existing customers

Disruptive

Insureds can get multiple rate changes

Suboptimal?

Rates different than modeled rates

Possible anti-selection?

Regulatory Perspective

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State Philosophies Differ		
Support	**Set Limits**	**Will Not Approve**
• Fewer large increases = more happy consumers	• Capping increases okay, but not decreases • Must roll off within defined timeframe (ex. 2 yrs) • Limits on rate indications	• Consider it disparate treatment of new and existing customers

Capping Decreases

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Maintain total revenue

Revenue lost to capping increases is salvaged by also capping decreases

Unfairly discriminatory?

Renewal customers don't get the lower rate that new business customers get

- Other mechanisms do the same thing (company placement, tiering, NB discounts)
- At least capping eventually moves customers to the new rate level

Prior rates were OK, new rates are OK, shouldn't a rate in between be OK?

Rate Capping Design

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Capping Structure

Cap at a coverage level? Vehicle level? Policy level? Customer level?

Situations to Address

Customer Initiated	Company Initiated	Exposure Shift
• Coverage changes • Adding/removing vehicles/drivers • Driving activity • Moving • Discount changes	• Subsequent rate changes • Tiering • Company placement • Discovery period changes	• Customer aging • Model year aging • Other distributional shifts

Post-Implementation

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Actuarial/Product

- Calculating uncapped premium
- Calculating on-leveled uncapped premium, both segmented and in aggregate
- Calculating on-leveled capped premium

IT

- Maintaining capped and uncapped premium in systems
- Validating and correcting rating errors

Customer

- Communicating to customers why they continue to see increases

Rate Indications Under Capping

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Should indication be based on capped or uncapped premium?

Capped	Uncapped
How much more/less premium you need than you are currently bringing in.	How much more/less premium you need than your filed rates.
Benefit: Tells you if you're currently bringing in enough money to cover costs	Benefit: Applies directly to filed rates.
Drawback: What do you apply the indicated rate change to?	Drawback: Doesn't answer if current income is adequate to cover costs.

Indications should be based on uncapped premium,
but more analysis is needed…

CY Financial Projections

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Financial projections ensure company is bringing in enough premium to cover costs in near term

- Must reflect capped premium
- Requires estimating cap “unwind”, premium trend impact
- Mismatch with Actuarial projections used in rates requires understanding and explanation

Q&A – Initial Questions

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- With rate capping being so complex, how do you make sure that regulators and customers understand it?
- How long should capping last?
- How much does the customer need to know?

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Additional Q&A