Rate and Form Regulation – The Latest from the NAIC (And Alabama)

CAS RPM
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TOPICS

- BIG DATA – What's the issue?
- PRIVATE FLOOD – What needs to be addressed?
- CAPPING RULES – Is it Price Optimization?
- HOMEOWNERS BY-PERIL RATING – Why Do It?
- IBHS FORTIFIED™ STRUCTURES – What & Why
- PET PIEVES REGARDING FILINGS

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BIG DATA

- NAIC Big Data Task Force Charges:
  - Obtain a clear understanding of:
    - What data is collected
    - How it is collected
    - How it is used by insurers and third parties in marketing, rating, underwriting and claims.
    - Ensure data is being used in a manner compliant with state insurance laws & regs.
  - Review current regulatory frameworks used to oversee insurers' use of consumer and non-insurance data. If appropriate, recommend:
    - Changes to model laws/regs
    - Regulation of data vendors & brokers
    - Regulatory reporting requirements
    - Consumer disclosure notices

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BIG DATA

- NAIC Big Data Task Force Charges:
  - Propose a mechanism to assist states in conducting technical reviews of complex models used by insurers.
    - Perform as a consultant to states, not an additional regulatory layer for filings.
    - Simplifies model review for insurers.
  - Assess data needs and required tools for regulators to appropriately monitor the marketplace and evaluate underwriting, rating, and marketing practices.
    - Propose a means to collect, house and analyze needed data.

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BIG DATA

- Insurers are always looking for better ways to differentiate classes of insureds so as to get the edge on competitors.
- So what are some of the issues?
  - What are the sources of data being used? (Facebook, LinkedIn, medical records, etc.)
  - How accurate is the data?
    - Unlike credit report errors, how can the insured correct errors from these sources?
  - Do insureds have a right to know what data is used to evaluate them?
    - Should disclosures be required to identify any data that had an adverse impact on the insured?
  - Though data used in models may be a good predictor statistically, do some run contrary to good public policy and therefore should be excluded?
  - Do models get too granular and represent some form of undesirable price optimization?

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PRIVATE FLOOD

- NAIC supports facilitating increased private sector involvement in flood insurance as a complement to the NFIP.
- NAIC suggests several changes:
  - Explicitly permit surplus lines carriers to write residential flood, not just commercial flood.
  - Current proposed rules mandate the acceptance of a private flood policy that is “at least as broad as” the coverage under a SFIP.
    - Need to explicitly permit a private flood policy to be tailored to a specific property and still be accepted by lenders.
    - Continue to permit mandatory flood exemption for detached structures not used as a residence.
    - In cases where personal property is not secured by a loan, allow consumers flexibility in selecting amount and coverage for personal property rather than match the coverage specified in the SFIP.
    - Do not establish rules, such as cancellation notice requirement, that would conflict with state laws or regulations.
  - Permit flood to be added by endorsement to a property policy rather than only be a stand-along flood policy.
  - Proposed agency rule permits lenders to accept private flood policies from “mutual aid societies”. Need to require that these entities demonstrate that they meet a specified exemption to a state’s insurance code or licensing rules.

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PRIVATE FLOOD

- Some are concerned that private flood carriers will "cherry-pick" the policies they insure, but this should be accepted, as the greater policy goal should be that consumers have choices and affordable options.

- Some other industry issues:
  - Availability of NFIP claims data to insurers to help with ratemaking.
  - Flexibility of regulators regarding insurers' use of flood models; possible need for frequent rate changes as knowledge increases.
  - NFIP needs to permit WYO insurers to compete.
  - Will captive agents have access to other markets?
  - Impact on capital requirements / RBC and rating agency evaluations.
  - Address whether/how state residual markets and guaranty funds will respond if necessary.
  - Will availability of flood reinsurance be stable / sustainable?

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CAPPING RULES

- Capping rules are generally used in Personal Auto, Homeowners, LTC, and sometimes BOP.
  - For example, cap renewal increases <u>due to a filing</u> at 35% per year for two renewals, then release the cap at the third renewal.
    - Don't cap increases due to change in coverage elected by the insured.
  - Capping rules are complicated to implement when rate increases are adopted annually or the insured changes coverage.
    - Does the cap apply to all increases from prior years' filings <u>and</u> this year's filing?
- Some states believe that "capping rules" should not be permitted as they violate statutes that require rates to not be excessive, <u>inadequate</u>, or <u>unfairly discriminatory</u>.
  - Capping clearly causes some insureds' premiums to be temporarily inadequate.
  - Capping causes like insureds to be charged differently if they are new vs. renewal.
  - Technically, statutes refer to <u>rates, not premiums</u>. Capping rules do not cap rates, only premiums.

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CAPPING RULES

- Other states believe that public policy calls on regulators to help maintain a more stable pricing environment for consumers.
  - Decades ago ISO used a 5-year transition rule when they changed the GL rating base from square footage to sales for some classes of business, and states accepted this transition rule.
- Capping rules are typically based solely on the size of an insured's renewal premium increase. However, some insurers are developing models to determine which insureds' premium should be capped, based on the insured's characteristics and not just the size of increase.
  - This approach deviates from a general public policy approach and smacks of Price Optimization.
  - The CASTF Price Optimization White Paper states it believes the following practices are inconsistent with rating statutes:
    - Price elasticity of demand at the individual level;
    - Propensity to shop for insurance;
    - Retention analysis at the individual level;
    - Propensity to file complaints or ask questions.
    - For this reason, models may mask that they are trying to measure these practices.
- Another issue to consider: If an insured's premium has been capped, and thus there will be another increase for the insured at the next several renewals, should the insurer be required to disclose this fact to the insured? Is it misleading to not disclose?
  - LTC insurers currently typically disclose what the future increases will be.

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HOMEOWNERS BY-PERIL RATING

- Many insurers are already rating this way, providing rates for as many as 12 different perils.
- Alabama has mandated (Reg. 152) that personal property insurers must begin quoting / issuing policies that display separate rates / premiums for:
  - Hurricane
  - Other Wind & Hail
  - All Other Perils
  - Reg goes into effect 1/1/18 for Homeowners, 1/1/19 for Dwelling Fire & EC.
- Premiums by peril must be displayed separately on the dec page and/or billing statement.
  - Rates for voluntary endorsements that apply to more than one peril group do not have to be separated by peril.

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HOMEOWNERS BY-PERIL RATING

- Why require it?
  - Hurricane vs. Other Wind vs. AOP exposures vary greatly by rating territory
    - Wind pure premium is ~80% of total pure premium on the coast and ~40% upstate, but it varies within county as well.
  - Loss costs for the different perils are already determined separately by Actuaries:
    - Hurricane models
    - Severe Storm models
    - Historical non-wind loss experience
    - Rather than combining them to create the all-perils rate, leave them separate.
  - Insurers are permitted to exclude wind coverage, and premium credits were not accurate.
    - Two homes with wind pure premium of 90% and 60% respectively of total premium received the same average wind-exclusion credit of 75%.

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HOMEOWNERS BY-PERIL RATING

- Why require it?
  - Many rating variables are more significant predictors for one peril's losses than for another, such as:
    - Credit Score
    - Alarm systems
    - Claims-free discounts or claim history surcharges
    - Deductible credits
    - Fire Dept. rating
    - Roof shape, materials
  - So rating factors for these variables need to be different for the different perils.

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HOMEOWNERS BY-PERIL RATING

- Why require it?
  - Helps rates better comply with "not excessive, inadequate, or unfairly discriminatory" for the insured.
  - Provides a better match of rate to propensity for loss and to reinsurance cost for the insurer
    - Should improve profitability
    - Should reduce adverse selection
  - Helps insured make more informed decision as to whether to purchase a wind-only policy from the Windpool.
  - Ensures homeowners receive the proper discount for fortifying their homes against wind.

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IBHS FORTIFIED™ STRUCTURES

- **What is this?**
- Insurance Institute for Business & Home Safety (IBHS) at www.disastersafety.org has researched and developed standards to strengthen homes and smaller commercial structures against hurricanes and high wind & hail.
  - IBHS FORTIFIED™ BRONZE (Mainly the roof)
  - IBHS FORTIFIED™ SILVER (Mainly windows & doors)
  - IBHS FORTIFIED™ GOLD (Roof to wall to foundation attachments)
  - IBHS FORTIFIED FOR SAFER LIVING™
- Structures built to these standards are certified by an IBHS Evaluator to be in compliance with the standards.

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IBHS FORTIFIED™ STRUCTURES

- By statute, insurers in Alabama must provide discounts (Bulletin 2016-07) ranging from 20% to 60% of the wind premium for homes or commercial structures built or retrofitted to these standards.
  - Statute now in effect on the coast.
  - Statute goes into effect statewide on 1/1/18.
- Discounts are applied to both the Hurricane premium and the Other Wind & Hail premium

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IBHS FORTIFIED™ STRUCTURES

- **Why pursue this?**

- Having fortified structures yields **more resilient communities.**
  - Reduces amount of debris, reducing landfills and clean-up cost to FEMA, states and municipalities.
  - Reduces displacement of workers to alternative locales, thus preserving the workforce available to continue business operations.
  - Reduces ALE and business interruption costs to insurers.
  - Reduces lost state and local tax revenues caused by closed business operations.
  - Preserved communities reduces loss of tourism dollars.
  - Increases the attractiveness of a locale to future business developers.
  - Reduces insurers' reinsurance costs.
  - Reduces homeowner's damage, thus perhaps their out-of-pocket cost (deductible).

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IBHS FORTIFIED™ STRUCTURES

- Some municipalities are beginning to adopt these fortified standards in their building code.
  - If they do, Ordinance & Law coverage in property policies will require insurers to repair damaged homes to this fortified standard.

- Given all of the benefits to the housing stock being converted to the fortified standard, insurers should consider repairing roofs to the IBHS Bronze level even if the building code does not require it:
  - Lowers future AAL, PML, and reinsurance cost.
  - Provides a significant marketing edge, increasing new business and renewal retention.
  - Future rate filings will recapture this additional cost.
  - It serves the public good!

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PET PIEVES

- Thick filings should always include a Table of Contents for ease of finding documents.

- Provide a Summary: A few clear, concise statements (not 4 pages long) of "what" the filing is accomplishing. Save the "how" or "why" for later in the document.
  - Especially identify here any new variables or models being introduced.

- When you provide several different metrics for determining, say, trend, clearly indicate which metric you selected and why. This holds for other metrics as well.

- Read all of the filing instructions / rules in SERFF before you make a filing in order to avoid some Objection Letters. We have no desktop rules; they are all in SERFF.

- Submit spreadsheets in Excel format as well as PDF so as to permit us in our review to alter your assumptions if necessary to see the impact on your indication. This will speed up the review of your filing.

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