

Comment #17 – 1/29/15 – 12:31 p.m.

These are my comments on the ASB's exposure draft of an ASOP on Property/Casualty Ratemaking:

1. From Sec. 1.2 it is not at all clear how this ASOP would apply to regulatory actuaries in their review of rate filings submitted by insurers for insurance department review and approval. The standard “applies to all actuaries when performing professional services with respect to . . . reviewing . . . property/casualty insurance rates. . . . Such professional services may include . . . regulatory activities . . .” On the other hand, “This standard is limited to the estimation of future costs and does not address other considerations that may affect the price charged to the policyholder, such as marketing goals, competition, and legal restrictions.” The rate filings that regulators review are almost always affected by marketing goals, competition, and legal restrictions. So does that mean that this ASOP does not apply to rate filing review? Or does it apply, but only to the review rate filing components that pertain to the estimation of future costs?
2. The concept of “legal restrictions” should be a given in any actuary's ratemaking work. Legal restrictions are not a kind of “add-on” to the ratemaking process. Rather, they need to be recognized from the start. If, for example, credit scoring is prohibited in a certain jurisdiction, this ASOP should not apply only to ratemaking work that is unaffected by this legal restriction. Nobody does that kind of ratemaking work; there is no point in doing ratemaking that ignores legal restrictions.
3. The second paragraph of Sec. 1.2 refers the actuary to Sec. 4 when the actuary “departs from the guidance set forth in this standard in order to comply with applicable law.” Sec. 4, however, deals only with actuarial communications and disclosures. The ASOP lacks an explicit statement that, when the ASOP's guidance conflicts with the law, the law must prevail. Such a statement should be added.
4. Sec. 2.1: The definition of Composite Rating is not needed. I do not believe the term is used elsewhere in the ASOP—not even in the exposure base discussion in Sec. 3.5.
5. Sec. 2.7: The term to be defined, Policyholder, is singular, but the definition starts out plural (“Individuals or entities”). I suggest changing the wording to “An individual or entity that pays an insurance premium . . .”
6. Sec. 2.10: The definition of Schedule Rating needs to be broadened. Individual risk characteristics can relate to future expenses, not only to future loss and loss adjustment expense experience. And schedule rating should exclude not only what's reflected in the experience rating process but also what's already reflected anywhere else in the rating plan.

7. In Sec. 3.5 the term reasonably proportional is too restrictive. The term proportional indicates a straight-line relationship between exposure units and expected losses. But in many cases the relationship is different—a concave curve, for example, where the first exposure unit is the most costly, and the marginal cost for each additional exposure unit becomes less and less.

8. The second paragraph of Sec. 3.5 says that the use of a composite exposure base is “often appropriate.” The ASOP’s use of the word often makes this practice seem more common than it actually is. Insurers typically use this approach for a small fraction of their policies, and for commercial lines only. It would be better to write “sometimes appropriate.”

9. In today’s ratemaking environment Sec. 3.7.1 is oversimplified. Insurers frequently use rate stability rules (a.k.a. transition rules or premium-capping rules) with the result that the effects of a rate change on a particular date are essentially spread out over a period of years. In adjusting premiums to a consistent level it is essential to account for the remaining effects of previous rate changes to which rate stability rules were applied.

10. Sec. 3.7.3 includes the words not limited to, but underwriting and marketing changes are omitted from the list. They are worth mentioning, and they may affect the mix of business. Item b. in the list could be expanded to read “underwriting, marketing, and mix of business changes.”

11. Sec. 3.17 has a slight grammatical inconsistency, in that Some policyholders is plural, and that policyholder is singular. This could be remedied by changing “Some policyholders have . . .” to “A policyholder may have . . .” Also, the term policyholder should be in bold face here, because it is defined in Sec. 2.7.

I hope these comments are helpful.

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