NAIC National Association of Insurance Commissioners & The Center for Insurance Policy and Research

Comment #20 – 1/30/15 – 1:38 p.m.

To: Actuarial Standards Board
(Sent via e-mail to comments@actuary.org)

From: Richard Piazza (LA), Chair, Casualty Actuarial and Statistical (C) Task Force

Date: January 30, 2015

Re: Exposure Draft of Proposed *Actuarial Standard of Practice: Property/Casualty Ratemaking*

Thank you for the opportunity to provide comment on the Actuarial Standards Board's exposure draft of the proposed *Actuarial Standard of Practice: Property/Casualty Ratemaking*. The NAIC's Casualty Actuarial and Statistical (C) Task Force ("Task Force") has reviewed the draft and offers the following comments:

1. From Sec. 1.1 it is not clear how this Actuarial Standard of Practice (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 reviewing rate filing components that pertain to the estimation of future costs?

2. 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.

3. Section 1.1 & 1.2: The statement "This standard is limited to the estimation of future costs…" could be interpreted to limit application of the standard to the overall rate indication and not all the base rates, factors, discounts, etc. Ratemaking is a determination of the rates, factors, etc. ultimately used to determine the premium charged to policyholders. The Standard of Practice should be all-encompassing by applying to the complex methodologies and approaches used in the complete ratemaking process.

4. Sec. 2.1: The definition of "Composite Rating" is not needed given it is not used in the ASOP.

5. Sec. 2.7: In defining "Policyholder" the wording should be singular. We suggest changing the definition 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 is reflected in the experience rating process but also what is already reflected anywhere else in the rating plan. Potential definitions of experience and schedule rating are those used by the International Risk Management Institute (IRMI):
    - **Experience Rating**- "As respects workers compensation, the method in which the actual loss experience of the insured is compared to the loss experience that is normally expected by other risks in the insured's rating class. The resulting experience modification factor is then applied to the premium of the insured. In other casualty lines, the actual loss experience of the insured is generally compared to the actual loss experience of risks in the same industry to again develop a modifying factor for application to the insured's premium."

- **Scheduled Rating**- "Modification of manual rates either upward (debits) or downward (credits) to reflect the individual risk characteristics of the subject of insurance."

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" or "may be 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.

If you have questions, please contact me at 225-342-4689 or RPiazza@ldi.la.gov or Kris DeFrain at 816-783-8229 or kdefrain@naic.org.

cc: Kris DeFrain (NAIC)

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