BUILDING A SUCCESSFUL RATE MONITORING PROGRAM

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Words of Wisdom

"All models are wrong; some, though, are more useful than others and we should seek those."

-McCullagh & Nelder, "Generalized Linear Models"

"Oh, people can come up with statistics to prove anything, 14% of people know that."

-Homer Simpson

No industry standard

There is no industry standard for a rate/price change calculation, which means that all monitors are not the same.

However, they should all have the same goal: along with trend, rate/price change should help explain and predict changes in expected loss ratios and profitability from one period to another.

Agenda
Price Monitoring

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1. Why do we do it?
2. Individual Price Monitoring – Understanding the Moving Pieces
3. Example of an Individual Price Monitoring Tool
4. Portfolio Price Monitoring Exercise
5. Portfolio Price Monitoring
6. Questions?

Price Monitoring
Why do we do it?

- We need to understand how rate levels are changing over time while attempting to adjust for exposure changes
- Helps us project historical loss ratios to a future period for profitability and forecasting purposes
- Lets us know whether or not target rate changes are being achieved
- Allows for measuring whether returns on equity are being achieved

Bottom Line:

- Critical to the mutual success of the carrier and program administrator/MGA

Individual Renewal Price Monitoring

(1) 2012 Premium	$10,000	
(2) 2013 Premium	$10,500	This is not +5%
Changes to renewal		
(3) Exposure	+4%	
(4) Limits & Attachments	+10%	
(5) Terms & Conditions	-2.5%	
(6) Re-Rated 2012	$11,154	= (1)x[(3)+1]x[(4)+1]x[(5)+1
(7) Rate Change	-6%	=(2)/(6)-1

Note: numbers for illustration purposes only

Individual Renewal Price Monitoring

(3) Changes in Exposure – need to be accounted for

Capturing shifts in class codes? Restaurant with versus without dance floor

Vehicle radius changes? Local versus Intermediate

Receipts? 100,000 versus 80,000

Payroll? 500,000 versus 600,000

Inflation vs. True Growth? TIV - inflation or an addition to the building

Victim of misclassification or exposure reduction?

Safeguards in place? Loss Control, Premium Audit, Review of Financials, Delegations of Authority, Self Audit Reviews, Carrier Audits, Referral Process, Emerging threats within book (Construction Defect etc.)

Note: numbers for illustration purposes only

Individual Renewal Price Monitoring

(4) Changes in Limits

$500,000 to $1,000,000

If not adjusted, are policies with changes removed from the calculation?

(5) Changes in Terms & Conditions

Coverage extensions and exclusions ?

Is there an explicit premium charged for the coverage?

Is the length of the policy period the same?

Note: numbers for illustration purposes only

Rate Change Tool

Open Estimated Rate Change spreadsheet

Portfolio Price Monitoring Exercise

	ABC Insurance Program	XYZ Insurance Program
2012 ELR	60%	65%
2013 Loss Ratio Trend	2%	2%
2013 Rate/Price Change	+5%	+5%
Who has the lower 2013 ELR?	?	?

Note: numbers for illustration purposes only

Lets ask some questions

Question #1: Do you monitor new and renewal business or renewals only?

ABC Insurance Program: Renewals Only

XYZ Insurance Program: Renewals Only

Question #2: What percentage of your business is renewals?

ABC Insurance Program: 70%

XYZ Insurance Program: 95%

Note: numbers for illustration purposes only

Lets ask some questions…continued

Question #3: Do you adjust your calculation for limits and deductible changes?

ABC Insurance Program: No, any renewal with a limit and/or deductible change is removed from the calculation. 50% of our renewals have a limit and/or attachment change.

XYZ Insurance Program: Yes

Are we still confident that ABC’s 2013 ELR is lower?

Note: numbers for illustration purposes only

Portfolio Price Monitoring

	All Renewals
(1) 2012 Premium	$10,000,000
(2) 2013 Premium	$10,300,000
Changes:	
(3) Exposure	+3%
(4) Limits & Attachments	+2%
(5) Terms & Conditions	+3%
(6) Re-Rated 2012	$10,821,000
(7) Rate Change	-5%

Note: numbers for illustration purposes only

Portfolio Price Monitoring
Phase of market cycle

Where are we now?

Soft or softening marketplace

New business loss ratios worse than renewal. Impact may be significant. The “winners” curse.

Hard or hardening marketplace

New business loss ratios may be close to or better than renewal

Portfolio Price Monitoring
Changes in Portfolio Mix

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New Business:

New business may be priced at a different level than renewal business

- What?

Even if priced at the same level, may have different loss ratios than renewals

- Less information on new business
- Why are they changing carriers?

It's important that underwriters recognize the differences in new business.

Portfolio Price Monitoring
Changes in Portfolio Mix

Has the mix changed?

- Retention ratios (renewal/prior year total)
- New business ratios (new/total)

Has the adequacy of new business changed?

- Compare to a benchmark (final modification factor, expiring or manual rate)
- A benchmark allows for tracking both new and renewal business, determines if one is priced stronger than the other.

How do recent loss ratios for new and renewal business compare?

Portfolio Price Monitoring
Changes in Portfolio Mix

Are there indications that new business adequacy may change going forward?

- Change in underwriting guidelines
- Change in classes and/or territories
- Change in definition of an acceptable risk
- Change in risk selection process
- Declination ratios, hit ratios
- Change in loss control usage
- Where are we in the cycle?

Questions?

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