

CS-19: Rate Monitoring

2009 CAS Seminar on Reinsurance

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Munich Re America
Munich Re Group



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Rate Monitoring . . .

**Simple in Concept,
Difficult in Practice**



Rate Monitoring Overview

- “90% of putts that are short don’t go in.” – Yogi Berra



- Many portfolio rate monitors fall short of the goal of explaining and predicting (along with loss trend) changes in expected loss ratios.

Rate Monitoring Overview

- Most companies claim that they are “managing the underwriting cycle.”
- If many rate monitors fall short, can they effectively do this?

Rate Monitoring Overview

- All rate monitors are not equal!
- Basic considerations when building a rate monitor:
 1. Renewal rate change
 2. New business adequacy/ Lost business adequacy
 3. Capture changes in limits & attachment points, contract term, share and commission
 4. Capture changes in other terms and conditions
 5. Capture changes in underwriting standards

Rate Monitoring Overview

1. Renewal Rate Change

- How are renewal rate changes calculated?
- How are individual rate changes weighted together to get the portfolio rate change?
- What is the current retention ratio and what has it been historically?
- Are any policies excluded from the calculation?

Rate Monitoring Overview

2. New business adequacy / Lost business adequacy

- How are changes in new business adequacy/ lost business adequacy incorporated into rate change?
- In the recently released (4/16/2009) market survey of The Council of Insurance Agents & Brokers (CIAB), “*Commercial Market Flat, But Kept Its Tread in First Quarter**,” one broker said:

“[Insurers are] trying to keep renewals flat but cutting like heck on new business opportunities.”

* Available at www.ciab.com

Rate Monitoring Overview

3. Capture changes in limits & attachment points, contract term, share and commission

- Are changes in limits and attachments captured in the rate change?
- Are contract term and share changes captured in the rate change?
- Are commission changes captured in the rate change? If so, how have average commissions changed over time?

Rate Monitoring Overview

4. Changes in other terms and conditions

- Have there been any material changes in other terms and conditions?

5. Changes in underwriting standards

- Have there been any material changes in underwriting guidelines, appetite (class, coverage, territory) or risk selection approach (loss control, premium auditing, etc.)?

Rate Monitoring Overview

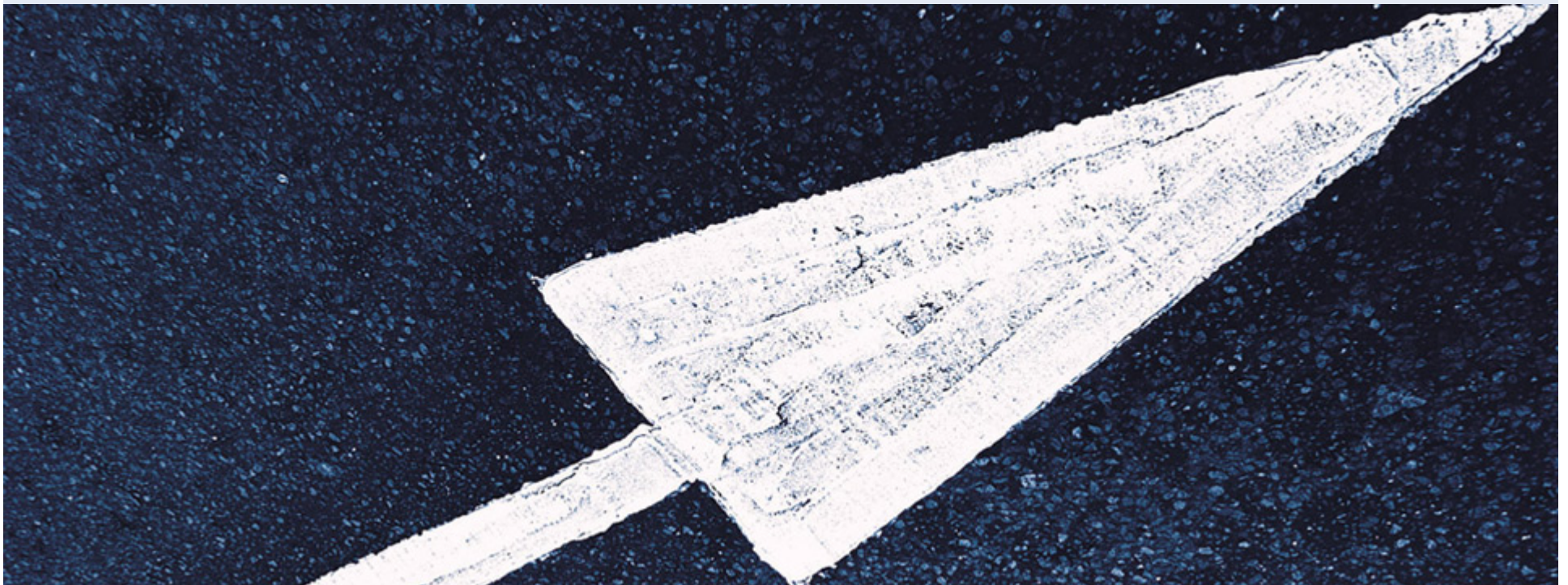
- Overall, a rate monitor should be a leading indicator that can help predict what loss ratio to expect on business written.
- External view of importance of rate monitoring – the rating agency view:



A.M. Best Supplemental Rating Questionnaire (SRQ)

(available at www.ambest.com)

Rate Monitoring Issues for Umbrella Liability



Rate Monitoring Issues for Umbrella Liability

- Commercial umbrella policies provide additional limits over and above primary policies, typically a mixture of auto liability, general liability and employers liability.

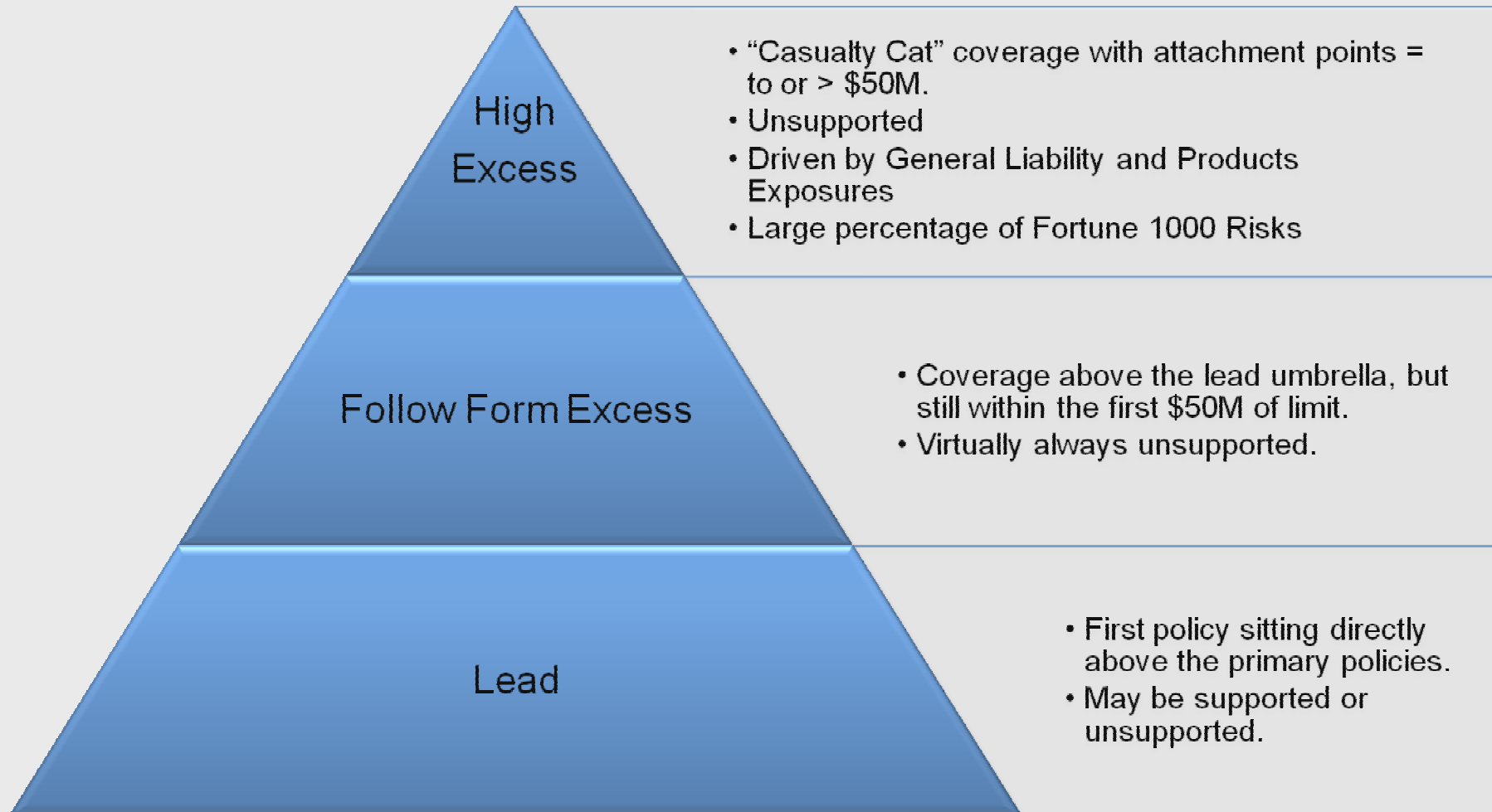
- Umbrella is not a line of business, but a coverage, that can have broad, non-homogenous exposures that vary depending on:
 1. Market approach
 2. Insurer type
 3. Account size
 4. Layer position

Rate Monitoring Issues for Umbrella Liability

Market Approach	Supported vs. unsupported umbrella - Supported business assumes that the underlying primary policies are written by the same company as the umbrella/excess policy.
Insurer Type	Regional (small) vs. national (large) companies or Admitted vs. non-admitted (E&S) companies
Account Size	Small to middle market business vs. large national accounts
Layer Position	Umbrella and lead excess vs. higher attaching excess

Rate Monitoring Issues for Umbrella Liability

Layer Position



Rate Monitoring Issues for Umbrella Liability

- Commercial umbrella falls outside of the actuarial purview of industry advisory rating organizations. Therefore, there are no “industry” loss cost changes published.
- Lead umbrella pricing generally consists of a collection of rating factors, auto unit rates and minimum layer premiums.
- The first million of umbrella limit is usually a function of the primary premium.
- Umbrella limits greater than \$1M are usually a function of lower reference layers (i.e. the first million).

Rate Monitoring Issues for Umbrella Liability

- The standard notion of a rate change is not well defined for umbrella
- Rating factors used for umbrella/excess policies generally provide underwriters with great pricing flexibility



This can lead to a compounding effect of price changes by layer

Rate Monitoring Issues for Umbrella Liability

Fictitious Umbrella Rating Plan (For Illustrative Purposes Only)

ISO Table	Rating Factors for First \$1 million of Umbrella					
	1	2	3	A	B	C
Low End	10%	16%	21%	14%	20%	25%
High end	14%	20%	25%	18%	24%	30%

Rating Factors for Layers Above 1st \$1 Million of Umbrella:

Layer premium should be 50% to 60% of preceding layer premium

Schedule Rating +/- 25%

Minimum Premium
per \$1M Layer Band 1,000

Rate Monitoring Issues for Umbrella Liability

Rating Example (For Illustrative Purposes Only)

			Account #1
Layer	Base	Year 1 Factor	Year 1 Premium
Primary		1.00	50,000
1 xs P	Primary	0.19	9,500
4 xs 1 xs P	1 xs P	1.31	12,403
5 xs P			21,903

		Account #2
		Year 1 Premium
		10,000
		1,900
		4,140
		6,040

				Account #1	Price Change
Layer	Base	Year 2 Factor	Year 2 Premium		
Primary		0.95	47,500		-5.0%
1 xs P	Primary	0.18	8,574		-9.8%
4 xs 1 xs P	1 xs P	1.22	10,500		-15.3%
5 xs P			19,074		-12.9%

		Account #2	Price Change
		Year 2 Premium	
		9,500	-5.0%
		1,715	-9.8%
		4,047	-2.2%
		5,762	-4.6%

Rate Monitoring Issues for Umbrella Liability

- In addition to the basic considerations for rate monitoring (slide 6), the following considerations apply to umbrella:
 1. Underlying mixture of exposure to the umbrella– both in terms of the historical shift in mix and in terms of how to combine rate changes for sub-coverages (AL/GL/EL)
 2. Impact of minimum premiums on umbrella rate change – will vary by umbrella layer
 3. Changes in re-rated primary premium on unsupported umbrella.

Rate Monitoring Issues for Umbrella Liability

Testing Rate Monitor

- Compare to changes in average price per million (PPM) by limit and attachment bands
- Review changes in average layer factors
- Compare to benchmark rate index (i.e. CIAB)
- Underwriting audit / file review

Thank you very much for your attention.

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