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A newsletter from Lighthouse Consulting, LLC

Keeping you off the rocks

Calculating Rate Change

The trade press regularly reports on rate change in commercial insurance. It is a rear view indicator of the market's forward direction. Reinsurers may find it a helpful macro indicator but it doesn't drill down into market segments or individual companies. Insurers know that rate change on their book is an important metric. How can a reinsurer know if their cedant's rate change calculation is appropriately conservative? Here are some thoughts based on our audits.

The Simple Way

Renewal rate divided by expiring rate. That's it, and should be as easy as that for most insurers. But life isn't always that simple; things can change at renewal.

Adding or Deleting Coverage

So the insured buys, say flood coverage, at renewal. For rate change it should simply be a matter of reducing the renewal premium by the new flood premium. How about if they buy flood coverage, but decide to delete Business Income? Oh, and then they increase the Extra Expense limit. Things are starting to get complicated, but there is more.

Adding or Deleting Locations

Should not be a problem because the account TIV is adjusted. That is, unless the insured uses different rates for different locations. So, they may delete an unprotected location with a high rate and add a protected location with a low rate. All other things being equal this would look like a rate decrease.

Changing Deductibles or Attachment Points

The premium change on non-cat deductibles is in a rating table but a change in cat deductible requires time consuming re-modeling. The premium effect from a change in attachment point on layered programs is very complicated.

"We don't calculate rate change"

Huh? That was my first reaction. E&S companies who write mostly cat cover may not care about rate change but evaluate the strength of their book by model metrics. To evaluate these companies we compare expiring modeling metrics to renewal modeling metrics, in addition to the simple way.

And then there are ...

Change in producer commission? Rate decrease due to risk improvements? Is new business included? Do they exclude anything from rate change calculation?

What's a reinsurer to do?

First, go through these questions with your client. You should feel comfortable with answers like rating tables, premium scales, actuaries, etc. You should feel less comfortable with answers like underwriting judgment. Second, ask them how often they need to make these adjustments. You wouldn't expect many for a standard lines market, but more from E&S companies or those in the shared/layered market.

Best yet...

Get an audit. Fudging on rate change is like not counting all your strokes in golf. It speaks to character.

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