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To the NAIC Operational Efficiencies Working Group

Re: "The Basics of Property & Casualty Rate Regulation"

Thank you for the opportunity to again offer comment on the captioned draft chapter for the NAIC's Product Filing Examiners' Handbook. Many of these comments mirror those contained in my September 15, 2005 letter to the NAIC Casualty Actuarial Task Force, although some points have been added or changed.

We appreciate the difficulty of drafting a succinct primer on basic ratemaking principles, and commend all the efforts. Please note we did not painstakingly edit the Draft document nor try to replicate the arithmetical calculations. Instead, I would ask that ISO's big picture concerns be considered.

- *The document, as written, may limit the potential range of actuarial practices and may even stifle innovation*

  First, it is unclear who is the targeted audience for this document. The document is surely too elementary to be useful to an actuary, or even to an experienced actuarial student. Therefore, we assume that it is intended to provide guidance to non-actuaries who are reviewing filings, and this raises a concern. Even though the paper attempts to imply otherwise at times, such a document suggests that the methods described are the *only ways* in which a ratemaking analysis can be performed. The fact is that there is a wide range of ratemaking approaches that are acceptable, and the methodologies described may be only a subset of the viable processes. Should the NAIC put its "seal of approval" on this or a similar chapter, it has the potential to be misused by regulators, perhaps naively, to hinder an insurer's ability to use other acceptable, and perhaps preferred, analyses in its filings. As just one an example, under Historical Data/Definitions of Data Needed/claim counts and exposures, there is the statement "claim counts are needed by accident year" and "exposures are needed by accident year"; this could imply that other compilations of these statistics are inappropriate.

- *Actuarial Standards of Practice already exist that are much more sophisticated and in-depth in dealing with the concepts that are provided in this write-up.*

  Moreover, these standards of practice have been subjected to extensive peer review, including exposure to the entire body of certified actuaries of the American Academy of Actuaries -- and they are periodically evaluated to ensure that they remain state-of-the-art and accurate. Many separate standards exist for the various ratemaking components, such those dealing with data quality, trending procedures, risk classification, etc. This ensures that each component provides appropriate and specific guidance to the actuary and other users of the product. Additionally, standards of practice are very carefully -- almost agonizingly -- constructed to ensure that they meet the proper balance of not hindering an actuary's ability to approach ratemaking assignments with creativity, while still seeking a work product that is actuarially sound, complete, and has been subject to due diligence.

- *If the purpose of the paper is to give only a cursory and general background regarding ratemaking topics, there appear to be many alternative sources already in existence providing adequate reference material.*

  Such sources include, but are not limited to, various study guides, books and other publications currently on the CAS, CPCU, or other syllabus material that serve the same purpose as this chapter. As with the actuarial standards referenced above, this already available material has been subjected to extensive peer review and feedback (including follow-up discussion papers to the original document). And, of course, these other publications would have already been subject to, and cleared, the extensive editing processes that all authors must go through before their work is accepted.

- *The section entitled "Catastrophe or Large Loss Provisions" makes several statements that some might consider unsubstantiated or even incorrect. While ISO does not take a position on these issues, others might -- and so we wanted to call these issues to your attention.*

  a) The Draft states: "The overall rate need should contemplate the catastrophe or large loss occurrences expected in an average year."
  This technically may not be true, as rates are determined with the assumption that they will apply in a set prospective period. In the context of catastrophes, there are some actuaries and scientists who believe that the (long-term) historical average may not be representative for the rate-setting period, and thus expected cost pricing should reflect that aspect.

  b) The Draft states: "Now, it is generally accepted that one needs at least 30 years of data….". ISO is not aware of any set threshold (30 years or otherwise) that the actuarial, underwriting, or regulatory communities would consider as "generally accepted" in this context.

  c) The Draft states: "These models are typically based on the potential loss under various simulations and are, thus, difficult for most regulators to evaluate." State regulators may quarrel with this statement, having conducted what they consider sufficient model and non-model analyses (either in-house or through consultants) prior to the filing being implemented in their state.

In closing, one possible enhancement that might mitigate some -- but not all -- of the above concerns would be to reduce the detail in the chapter itself and supplement it with a bibliography of recommended readings.

Thank you for the opportunity to offer these comments. We hope the Working Group finds these comments useful and can incorporate these thoughts as you move forward.

Very truly yours,

Mary E. Van Sise