

Part 1 of Washington state comments on Chapter 3, May 13, 2008 draft

These comments pertain to Pages 14-18. Comments on the remainder of Chapter 3 will be submitted later, if the Operational Efficiencies Working Group wants to receive them later.

- The first paragraph refers to the “first two sections” and the “third and fourth sections.” I can’t tell what a “section” is. Part of the problem is the large assortment of fonts and font sizes that are used as headings. If the first two sections are on rating laws and rate standards, why do the two headings (Pages 14 and 15) use two different fonts? (In the Table of Contents, it looks like Rate Standards is a subsection of Rating Laws.) Why is the first all-caps heading on Page 27? Why are the other two headings on Page 27 in different fonts and sizes? These are just examples.

Can we get somebody (preferably NAIC staff) to go through the entire chapter with a view toward making the chapter organization and headings easy to follow?

- Page 14: A better version of the first sentence under Rating Laws would be: “Each state legislature has enacted insurance rating laws, some of which are based on the following NAIC property and casualty model laws:”. (A lot of state laws are still basically the All-Industry Bills of 1947, when the legislatures weren’t getting guidance from these NAIC model laws.)
- Page 14: In the second paragraph under Rating Laws:
 - “Has adopted” would be better than “details.”
 - In the next sentence change “familiarize yourself” to “become familiar” and insert “related” before “regulations.”
 - I suggest deleting the sentence on the NAIC Compendium. An NAIC document is usually not a reviewer’s first source for the laws of his or her own state.
- Page 14: In the third paragraph under Rating Laws, “convience” should be “convenience.”
- Page 14: At the bottom of the page, the bullets need to be continued and applied to No File and Flex Rating.
- Page 14: In the last sentence, delete “increase.”
- Page 15: Inadequate, Excessive, and Unfairly Discriminatory should not be capitalized.
- Page 15: “Excessive” is usually listed before “inadequate,” as in the quote from the CAS Statement of Principles. The first sentence on the page should be revised to match this order.
- Page 15: No need for quotation marks in the first sentence. (And when we do use them, the American style is to put the close-quote after a period or comma. This needs to be corrected throughout Chapter 3.)

- Page 15: Under Rate Standards, the three bullets need to be rewritten, but I'm not ready to draft the re-write. "Too high" and "too low" really don't mean anything by themselves, and some state laws include explanations of what the laws mean by "excessive" and "inadequate." Some state laws say that rates can't possibly be excessive in a competitive market. The discussion of "unfairly discriminatory" in this draft is also problematic. What does it mean to be "a concept based on whether the rates are actuarially justified"? What does "risk is higher" mean?
- Page 15: I like the quote from the CAS Statement of Principles (as Washington regulations include this quote). But when a quotation is indented like this, it doesn't need the quotation marks.
- Page 15: Under Rate Justification and Supporting Data, the first paragraph:
 - In the first sentence "rate need is" should be "costs of the product are."
 - The third sentence would read better if "however" were moved to a position after "in insurance."
 - "Accidents" probably isn't the best term in this paragraph. Events? Occurrences?
 - I suggest deleting "(in some cases even more than ten)."
 - In the last sentence, delete the first comma and "a level of." (What's a level of prediction?)
- Page 15: Under Rate Justification and Supporting Data, the second paragraph:
 - Change "can" to "may." It's not always possible to base rates on prior loss experience.
 - Insert "expected expenses" after "prior loss experience."
 - Change "basics of the concepts" to "basic concepts."
- Page 15: Under Historical Data, there should be a comment that the experience periods are not always calendar years. Depending on the situation, they may be quarters, half-years, rolling four quarters, etc.
- Page 16: Under Earned premiums: Written premium is not always what's collected by the company at the onset of the policy; it's booked by the company, and much of it may be booked at the onset of the policy, but some of it may be booked later. And earned premium should not be defined by what happens when a policyholder cancels. In that situation there is often a short-rate calculation of return premium, so the insurer gets to keep (earn) more than what would have been earned on a pro rata basis.
- Page 16: Under Incurred Losses: "Compensation for expenses that resulted from the accident" is a narrow description and probably not appropriate in general. Punitive damages are rare. And I don't see the point of the sentence: "Losses can be grouped in many ways."
- Page 17: Under Incurred Loss Adjustment Expense: The historical discussion of Annual Statement reporting is probably not necessary. We need clear definitions of DCC and AandO under the current definitions. But we should also note that, if a company is able to attach some of its AandO (for example, fees paid to independent adjusters) to specific claims,

that is perfectly acceptable for ratemaking purposes (and may, in fact, lead to more accurate ratemaking).

- Page 17: Under Other Expenses Incurred: It should be mentioned that expenses are commonly stated as percentages of premium. The discussion of fixed and variable expenses should be moved up here from Pages 27-28.
- Page 17: Under Other Expenses Incurred, the discussion of reinsurance should be either deleted or improved.
 - Another argument against including reinsurance costs is that the individual risk transfer (see the quote on Page 15 from CAS Statement of Principles) for which rates are being made is the transfer of risk from the policyholder to the insurer, not from the insurer to its reinsurer.
 - If the cost of reinsurance is considered, the expected ceded losses should be deducted.
 - We should talk about the net cost of reinsurance. The insurer may receive ceding commissions.
 - Delete “with” from “check with your state’s position.”
- Page 18: Actually, claim counts are not always needed, and many rate filings do not use them. It depends on the insurer’s methods.
- Page 18: Under Exposures:
 - Why say “methodologies” when “methods” is a shorter word with the same meaning?
 - What does it mean to use the exposure amounts appropriately? How is our reader supposed to know what uses are appropriate?
- Page 18: Under Number of Years of Historical Data Needed:
 - Better: “There is a trade-off between stability and responsiveness . . .” (Remove the capital letters and the quotes.)
 - Some state laws have requirements relating to how many years of data must be used.
- Page 18: Under Segregation of Data: Let’s not mention the idea of reconciling rate filing data to Schedule P. Yes, it’s theoretically possible, but it would usually involve combining data from many unrelated products and many states. It’s rarely done, and usually pointless. Let’s not give our reader the idea that maybe it should be done.