Insurance Rating Variables: What They Are and Why They Matter

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Casualty Actuarial Society

- World’s only actuarial organization exclusively focused on property and casualty risks.
- 100+ year track record in training P/C actuaries
- Nearly 9,000 members worldwide, and growing
- Vibrant, growing community with deep and extensive resources to help CAS members, candidates, and students advance their careers; with strong employer support
Since 1960, the Insurance Information Institute (I.I.I.) has been the trusted source of unique, data-driven insights on insurance to inform and empower consumers. We serve consumers, media and professionals seeking insurance information.

The I.I.I.’s sole focus is creating and disseminating information to empower consumers. We neither lobby nor sell insurance. We provide objective, fact-based information about insurance – information that is rooted in economic and actuarial soundness.
What is a rating variable?

Rating variables are the characteristics of individual policyholders that can help approximate the cost of their risks.

The CAS and I.I.I. published a white paper to help legislators, policymakers, the media, and public understand:

• How rating variables work;
• How they are regulated; and
• Why they are indispensable to keeping insurance prices fair and affordable.
Four criteria for an effective rating variable

• Statistically significant
• Easy to administer
• Consumer considerations
• Regulation
Statistical Criteria

• Rating variable should show a **significant difference** in cost to insure various groups of people

• Data should be **homogenous** – meaning that all members of a group have very similar characteristics

• Data should also be **credible** – meaning that the group is large and stable so an accurate cost estimate may be developed
Operational Criteria

• Data should be
  • Objective
  • Easily verifiable
  • Inexpensive to administer

• Currently, obtaining driver skill is either inaccurate or difficult to obtain.

• This may be changing as telematics programs become more widespread
Desire for insurance to be affordable, especially for mandatory insurance like auto liability or homeowners.

Regulators and consumers prefer variables that exhibit a clear relationship where the rating variable has an obvious impact on losses.

There is a desire that rating variable are controllable by the policyholder.

Consumers may not be willing to give private information like telematic driving history.
Regulation

• Most states do not allow excessive, inadequate, or unfairly differentiation between two policyholders.

• State and some federal laws prohibit using variables that indirectly impact protected groups based on race, nationality, religion, etc.
Impact of Restrictions

Three possible outcomes if a rating variable is restricted:

1. Another variable will become more predictive and may act as a proxy for the restricted variable.
2. Policyholders with lower risk will subsidize policyholders with higher risk.
3. A policyholder with higher risk may find a harder time finding insurance.
Final Thoughts

• The use of rating variables allows actuaries and companies to price products fairly in the marketplace.

• Rating variables allow consumers more choice.

• Actuaries, insurance companies, and regulatory organizations should continue to work together on how rating variables are best used to make sure rates are both actuarial sound and not unfairly discriminatory.
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