Insurance Rating Variables: What They Are and Why They Matter

National Council of Insurance Legislators (NCOIL)

2019 Annual Meeting

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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

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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.

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Four criteria for an effective rating variable

- Statistically significant
- Easy to administer
- Consumer considerations
- Regulation

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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

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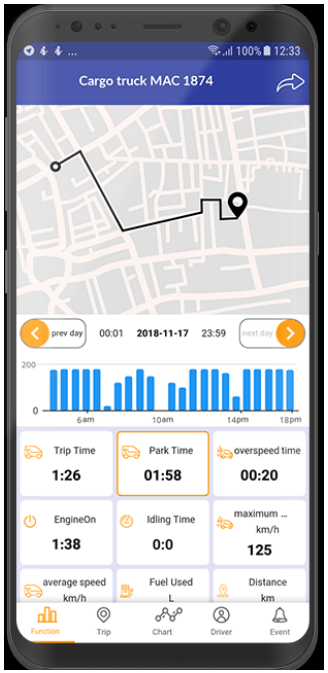
Operational Criteria

- 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



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Consumer Considerations

- 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

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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.

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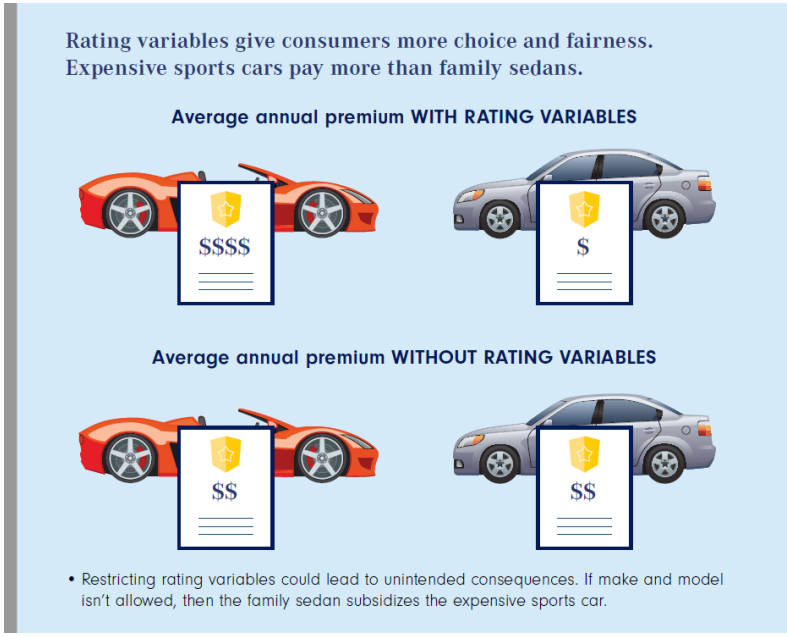
Impact of Restrictions

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.



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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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