



May 4, 2021

Memo to NAIC's Casualty Actuarial and Statistical Task Force
From J. Robert Hunter, FCAS, MAAA, Director of Insurance

**THOUGHTS ON PROPERTY/CASUALTY INSURANCE RATEMAKING IN THE WAKE
OF CAS'S REFUSAL OF CASTF'S STATEMENT CALLING FOR REINSTATEMENT
For discussion at your May 11, 2021 meeting**

According to a recent Reuters article,¹ NAIC's Casualty Actuarial and Statistical Task Force ("CASTF") will consider establishing its own set of principles for setting rates for property and casualty insurance. "The task force will discuss the issue on its May conference call," spokeswoman Laura Kane told Reuters.

CFA strongly supports such action by CASTF.

CASTF has already issued a strong statement in favor of retaining the four Principles as actuarial guidance. This was embodied in your letter to the Casualty Actuarial Society ("CAS") dated March 9, 2021. In that letter you asked CAS to reinstate the Principles, calling on them to reverse their rescission of the Statement of Principles Regarding Property/Casualty Insurance Ratemaking ("SOP"). In other words, CASTF has already made clear that it wants the SOP Principles to be in place for guidance to America's actuaries.

CFA proposes that you follow this up with a similar statement now, recommending that all actuaries, and particularly regulatory actuaries, continue to follow the Principles. Your statement might read something like this:

CASTF recommends that all actuaries and, in particular regulatory actuaries, continue to be guided by the following ratemaking principles, adopted verbatim from the recently rescinded CAS SOP:

Ratemaking is prospective because the property and casualty insurance rate must be developed prior to the transfer of risk.

Principle 1: A rate is an estimate of the expected value of future costs.

Ratemaking should provide for all costs so that the insurance system is financially sound.

Principle 2: A rate provides for all costs associated with the transfer of risk.

¹ Consumer Watchdog Urges Tougher U.S. Oversight of Insurance Costs, Discrimination, Reuters, April 29, 2021.

Ratemaking should provide for the costs of an individual risk transfer so that equity among insureds is maintained. When the experience of an individual risk does not provide a credible basis for estimating these costs, it is appropriate to consider the aggregate experience of similar risks. A rate estimated from such experience is an estimate of the costs of the risk transfer for each individual in the class.

Principle 3: A rate provides for the costs associated with an individual risk transfer.

Ratemaking produces cost estimates that are actuarially sound if the estimation is based on Principles 1, 2, and 3. Such rates comply with four criteria commonly used by actuaries: reasonable, not excessive, not inadequate, and not unfairly discriminatory.

Principle 4: A rate is reasonable and not excessive, inadequate, or unfairly discriminatory if it is an actuarially sound estimate of the expected value of all future costs associated with an individual risk transfer.

To the extent that some may want to go further than this and adopt a model law or seek to update the principles in response to changes in the marketplace or other such ideas, we suggest that CASTF also seek guidance from the C Committee on next steps after the statement is adopted. This would determine whether new charges should be adopted for CASTF's further action. If the C Committee charges CASTF to consider modifications to the Principles, this will likely require a much longer process – please recall that both CAS and ASB spent several years in similar efforts but were unable to find sufficiently common ground among stakeholders to adopt new standards for final ratemaking.

CASTF should simply issue a statement maintaining the Principles, a position already taken in your March 9, 2021 letter to CAS, even if the Principles may eventually be modified in response to a new charge, because, otherwise, no actuarial guidance on final rates will exist for a long period pending creation of any charge and CASTF's later work on that theoretical charge.

RATIONALE FOR AN IMMEDIATE CASTF STATEMENT

The language of these Principles is short, elegant and has effectively guided the actuarial profession for almost 35 years. They have been the foundation of cost-based pricing requirements in insurance since they memorialized and helped define state laws requiring that rates be not excessive, inadequate, or unfairly discriminatory. For decades, these Principles have worked to guide regulators' assessment of insurers' final rate selections and protect consumers from arbitrary and unfair premium charges.

The nation needs immediate guidance for final rates as, since December 22, 2020, no actuarial guidance is in place for final rates. Promptly adopting a statement of support for continued use of the well-tested Principles, already part of the DNA of most ratemaking actuaries, is a wise first step.

Furthermore, recommending continued use of the Principles is well within the current charges of CASTF to assist regulators by proposing changes related to ratemaking issues (Charge 1.A.1),

monitoring actuarial developments and considering their regulatory implications related to the CAS SOP (Charge 1.B.1), and facilitating discussions among regulators related to rate filing issues (Charge 1.C). These charges were clearly sufficient for CASTF to issue its March 9, 2021 statement calling on CAS to reverse the rescission.

One last point in favor of a CASTF statement comes from CAS itself in its April 1, 2021 rejection of CASTF's request to reverse the rescission. CAS pointed out that final rates are mandated to be cost-based according to the legislative history of the McCarran-Ferguson Act and the SOP mirrored that mandate. As CAS put it:

"A paper published on the NAIC website, "[Principles of State Insurance Unfair Discrimination Law](#)," describes the origins of the "not unfairly discriminatory" statutes. "The unfair discrimination statutes resulted from the 1945 McCarran-Ferguson Act's direction to the states to implement cost-based pricing requirements for insurer discrimination practices. Senator McCarran explained that his 'bill would...prevent...unjust discrimination'; it did so, the NAIC explained, by requiring the states to pass laws patterned after 'the rationale of' the Robertson-Patman Anti-Discrimination Act [of 1936], a consumer protection law under which, 'if the costs are the same, the seller cannot discriminate price.' Principle 4 in the 1988 Ratemaking Principles mirrors this cost-based mandate."

Expecting that the continued rescission might lead to action by the NAIC and/or individual states, I raised the possibility of regulators using the rescinded Principles at the March 27, 2021 meeting of the CAS Board of Directors. Here is an excerpt from my personal, very unofficial "minutes" of that meeting:

I said that the regulators wanted to know if the CAS would object if they adopted the rescinded SOP as their own. They discussed this and they indicated in somewhat fuzzy terms that they would not object.

CFA strongly supports a CASTF statement calling for continued use of the rescinded Principles as guidance to all actuaries and other P/C ratemakers or, at least, as guidance to regulatory actuaries and insurance department rate analysts. This should be done now, at the May 11, 2021 CASTF meeting.