



Steven G. Lehmann

This year's record-breaking hurricane season will contribute to higher reinsurance costs and a hardening of regional property insurance markets as we look to 2006. Here's what else we see coming:

- More sophisticated pricing will continue in personal auto, including more refined symbols and territories.
- Personal auto frequencies will hold steady with higher gas prices offsetting a stronger economy.
- The Federal Trade Commission will release its study on credit score rating, but it will not end the controversy with both sides citing the findings to support their case.
- Loss reserves will continue to see significant increases.
- For commercial lines, the predictive modeling wave will make significant advances in auto, workers' compensation and businessowners.
- More focus on risk transfer issues as the recent NAIC changes take hold.
- Increasing use of by-peril rating and more refined territories for homeowners and businessowners.

Pinnacle will be at the forefront of these pricing and re-serving changes for both personal and commercial lines.



Pinnacle News

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The Aftermath of Katrina Raises Modeling Concerns

The hurricane seasons of 2004 and 2005 forever changed countless lives, homes and businesses impacted by storms like Katrina, Rita and Wilma. Even more troubling, many meteorologists predict more cyclonic activity in the Atlantic Ocean and Gulf of Mexico in the coming decade.

The rising costs from the recent hurricanes, coupled with predicted future storm devastation, will challenge insurers and reinsurers to re-think past assumptions.

Catastrophe models have provided a disciplined and scientific approach to pricing primary and reinsurance exposure. However, many experts question whether the models need to be adjusted to reflect higher long-term average exposure and whether a climatic adjustment should be made to reflect the current warm phase that began in 1996.

Other questions to address include:

- What is the correct industry Annual Aggregate Loss (AAL)?
- Do catastrophe models reflect that figure?
- Are risk loads commensurate with the return requirements both at the primary and reinsurance level?
- Is there sufficient capital for the 1 in 250 year event?
- Can models be relied upon for these extreme events?

- Has company exposure been assessed and disclosed sufficiently to meet Sarbanes-Oxley obligations?

Insurers and reinsurers also need a proactive catastrophe management strategy to reduce exposure to catastrophe losses, preserve surplus and sharpen their competitive edge.

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Bracing for Hurricane Costs

Total insured catastrophe losses averaged 4% of industry property premium from 1973 to 1998 and 14% from 1989 to 2004, according to a Pinnacle analysis of data from Property Claims Services, a unit of the Insurance Services Office and AM Best. For 2005, catastrophe losses will range from 60% to 80% of approximately \$100 billion property premium, based on current industry estimates of various storms.

Given recent climactic and demographic shifts, the amount for AAL could reasonably range from \$14 to \$20 billion. On average for the years 2002 to 2004, Pinnacle estimates that direct industry property results produced an underwriting profit of \$23 billion before catastrophe losses. What remains to be seen is, will this be enough to cover catastrophe losses and still leave sufficient net profits?

Next Pinnacle Monograph Covers 2005 SAO Changes

The National Association of Insurance Commissioners recently made significant changes to the requirements for the Statement of Actuarial Opinion (SAO). Such changes include a new Actuarial Opinion Summary document which must be submitted to the appropriate state's insurance department by March 15, 2006. Other changes include a process for changing the Appointed Actuary, new regulatory guidance

and an attestation requirement for risk transfer in reinsurance contracts.

More critical information about these changes will be available in a soon-to-be published monograph written by Principal Joe Herbers, who serves on the American Academy of Actuaries' Committee on Property / Liability Financial Reporting (COPLFR).

Wisconsin Supreme Court Decision Could Raise Insurance Costs, Pinnacle Forecasts



One of the medical malpractice insurance industry's last remaining medical malpractice environments viewed as "currently okay" is in danger of losing that stability due to a Wisconsin Supreme Court decision last summer.

A Pinnacle forecast of the impact of the Wisconsin Supreme Court's decision in *Ferdon vs. Wisconsin Patients Compensation Fund* suggests that health care providers' medical malpractice insurance costs could increase by 18% to 22%. This includes a 12% to 15% rise in insurance company premiums and up to a 150% increase in Wisconsin Patient Compensation Fund (PCF) assessments. The PCF will soften the blow for insurers but not for health care providers.

Insurance industry reserves may also experience significant adverse development of up to \$35-\$40 million as a result of the court's ruling.

The court's ruling in the *Ferdon* case found that the state's cap on non-economic damages was unconstitutional. The 4-3 decision found that the cap violates the state's equal protection guarantees.

Higher rates and loss reserves, along with the uncertainty created by the absence of a cap on non-economic damages, will add to market instability. This volatility could reduce the availability of affordable coverage as insurers respond to the uncertainty with more conservative pricing and underwriting.

To learn more about Pinnacle's Wisconsin Analysis, contact Rob Walling by sending an e-mail to rwalling@pinnacleactuaries.com or calling (309) 665-5010 or by visiting www.pinnacleactuaries.com.

The Aftermath of Katrina... (continued)

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An effective catastrophe strategy includes a plan for collecting and verifying exposure data providing a foundation for:

- Managing accumulations
- Risk-based pricing that includes developing and enforcing underwriting guidelines to reduce adverse selection
- Product design, such as higher deductibles or excluding wind damage

- Post-catastrophe claim strategies that encourage claims adjusters to reach insureds efficiently
- Reinsurance optimization: purchasing too little reinsurance risks insolvency while buying too much endangers competitive position

For more information, contact Rich Lino by calling (609) 896-2940 or sending an e-mail to rlino@pinnacleactuaries.com.

Many experts question whether catastrophe models need to be adjusted

Lehmann Named President-Elect of the American Academy of Actuaries



Steven G. Lehmann

Steven G. Lehmann, MAAA, FCAS, FSA, FCIA, principal and consulting actuary of Pinnacle, was elected president-elect of the American Academy of Actuaries on Oct. 11. As president-elect, Lehmann will be a member of the Academy's presidential advisory committee, executive committee and its board of directors.

Lehmann has previously served as vice president of the Academy's Casualty Practice Council and on the Academy Board of Directors. He also is a past president of the Casualty Actuarial Society (CAS), a fellow of the Society of Actuaries and

the Canadian Institute of Actuaries, and an honorary fellow of the Institute of Actuaries (United Kingdom).

Based in Washington, D.C., the Academy is a non-profit professional organization representing actuaries in all areas of practice in the United States. The 15,000-member organization's mission is to assist in developing public policy through independent and objective information analysis and education and to support high actuarial standards.

Adding Extra “Punch” to Your Personal Lines Underwriting Process

If you're not happy with your personal lines underwriting results or believe you are being “out priced” and “out selected” by your competitors -- and perhaps even your agents -- it may be time to rethink your underwriting processes.

Traditional underwriting/pricing approaches, which attempt to fit larger groups into broad rating categories, are being out maneuvered by more sophisticated processes that offer more numerous and thinner slices of price. These better reflect the individual risk -- often at a more competitive price.

Thanks to the amount and quality of information now available to underwriters (for example CLUE and credit), there is a wealth of internal and external information available. By using predictive modeling techniques, underwriters and actuaries can use a multitude of prices that better reflect the characteristics presented by each individual risk.

Risks are not very cooperative and do not fit neatly into large groups. Grouping risks into larger pricing groups usually requires applying the old “One Strike and You're Out” approach. This does not allow for much recognition of risk differences, resulting in risks representing very different exposures being placed in the same rating tier.

Current predictive modeling techniques, however, allow multiple tiers and price points that better recognize a multitude of risk characteristics including credit, past losses, tenure, and source of business. And, unlike the “One Strike and You're Out” approach, this strategy recognizes positive characteristics of each risk.

When looking at personal lines underwriting results, here are some factors to consider:

1. When was the last comprehensive examination of your company's underwriting processes? Concepts, processes and procedures tend to “leak” over time. Whether utilizing an internal team or engaging outside help, start with the premise that over time, only good processes produce good results.
2. Use “Fair Process,” which gives employees a stake in the outcome, as a foundation for assessment and change.
3. Your competitors have the same opportunity to access information and develop sophisticated pricing and underwriting systems. Good execution will determine the winners. Market knowledge and good instincts are the intangibles that can make the difference.
4. Develop a sound definition of acceptable results. This will help when assessing the costs and efforts associated with any changes. Understand the impact upon your customers and business partners.
5. Be a good historian. Organizations learn by doing. Always seek to develop an understanding of what your company is doing well and where it falls short, which is the basis of all future successes.

For more information about this topic or Pinnacle's management consulting services, contact David Harris by calling (352) 242-0624 or writing dharris@pinnacleactuaries.com.



Dave Harris

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Pinnacle's Seminars Help Attendees Stay Ahead of Trend Lines

Attendees at Pinnacle's seminars are getting the must-know information they need to stay on the cutting edge of market trends.

At the Market Segmentation and Pricing Points Management seminar last October, speakers discussed predictive modeling applications, reinsurance trends, more sophisticated pricing analyses, and the impact of customer expectations on the insurance process.

Pinnacle again offered its Predictive Modeling and Applications Seminar last November, which included discussion on credit, vehicle classification, territory developments and alternative techniques for competitive analysis.

Meanwhile, Pinnacle's Loss Reserving Seminar in December helped attendees explore the effects of loss reserves on insurer credibility and tackle the ever-increasing complexity of loss reserving requirements.

For more information about market segmentation and predictive modeling seminars, contact Roosevelt Mosley by calling (309) 665-5010 or sending an e-mail to rmosely@pinnacleactuaries.com. Concerning loss reserving seminars, contact Chuck Emma by calling (630) 262-0954 or sending an e-mail to cemma@pinnacleactuaries.com.

Pinnacle also provides **on-site, customized seminars** to meet individual customer needs.

For more information, contact Roosevelt Mosley at rmosely@pinnacleactuaries.com or (309) 665-5010.

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To learn more about

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Pinnacle News Briefs

Pinnacle Expands Its Consulting Team

Chris Carlson, FCAS, MAAA, joins Pinnacle as a Consultant at its new Columbus, Ohio office. Having more than 25 years experience with a major national insurer, his areas of responsibility have included ratemaking for homeowners and personal auto products and reserve analysis assignments in commercial lines and assumed reinsurance. A graduate of the University of Oregon with a B.S. degree in Mathematics, Chris is active with the Casualty Actuarial Society and the American Academy of Actuaries. Contact Chris by calling (614) 734-8366 or writing ccarlson@pinnacleactuaries.com.



Pinnacle Forecasts Medical Malpractice Cost Increases

Pinnacle's forecast that a Wisconsin Supreme Court decision on medical malpractice would raise insurance rates there generated considerable interest and media coverage last summer. *BestWeek*, *Medical Liability Monitor* and *American Medical News*, published by the American Medical Association, featured comments by Pinnacle Consultant **Robert Walling**, who developed the analysis. To obtain a copy, please visit www.pinnacleactuaries.com.

Pinnacle Consultants Discuss SAS Insurance Score Data Mining

Pinnacle consultants **Shawna Ackerman** and **Roosevelt Mosley** were invited to discuss data mining applications for insurance scores at the SAS M2005. M2005 brings together data mining experts from many industries. At the conference, held last October, Ackerman and Mosley explained how to determine an optimal policy structure using renewal insurance scoring and the steps insurers can take to develop a customized insurance score.

Pinnacle Adds Columbus, Ohio Location

To better serve clients in and around Ohio, Pinnacle has opened an office in Columbus. The Columbus office is located at 5650 Blazer Parkway, Suite 179, Dublin, OH 43017. The office's phone number is (614) 734-8366.

Herbers Presents at Academy Actuarial Opinion Seminar

Pinnacle consultant **Joe Herbers** served as a faculty member at the American Academy of Actuaries' Effective Property and Casualty Loss Reserve Opinions seminar. The first of its kind by the Academy, the seminar grew out of a confluence of events, including high profile market insolvencies, actuarial credibility issues raised by some rating agencies and the ever-increasing demands being placed on the Appointed Actuary because of changes to the Statement of Actuarial Opinion (SAO). As one of eight presenting faculty members, Herbers also explained SAO development and considerations.



Upcoming Seminars

Mark your calendar and watch the seminars/events section of our website for more information!!!

Pinnacle will be offering the following seminar on:

► Predictive Modeling

April 2006 in Atlanta, Georgia



Pinnacle wishes you a safe and happy holiday season!