



Steven G. Lehmann

The commercial lines market is undergoing a sequence of events that is igniting a predictive modeling revolution similar to the pricing revolution taking place in personal lines for the past five years. These events are:

- The continuing growth of captives as an alternative to purchasing insurance commercially.
- The softening market as companies attempt to retain market share.
- The adoption of more refined rating and tiering plans, including credit scores for BOP and commercial auto and more refined rating territories for all lines.

Predictive modeling should be on reinsurers' radar screens as well. In the short term, reinsurers should ask their clients about their predictive modeling efforts in order to assure adequate pricing and avoid antiselection.

Just as Pinnacle has been at the forefront of the personal lines predictive modeling movement, our commercial lines specialists are working with the leading-edge commercial lines carriers to assist them with implementing predictive modeling in their companies.



# Pinnacle News

Volume 3, Issue 1

June 2006

## Allegations at GEICO Spur Need for Rating Plan Analysis

Recent media attention and lawsuits surrounding GEICO's personal automobile rating plan prove that insurers need to carefully consider the actuarial and legal implications of their plans.

Consumer advocates began alleging last winter that GEICO's plan, which considers education and occupation in its rates, has "an adverse and disparate impact on a protected class of people" and, as such, "might" be in violation of federal or states' civil rights laws. This is according to a letter to the National Association of Insurance Commissioners' (NAIC) from the Consumer Federation of America (CFA) and the New Jersey Citizens United Reciprocal Exchange (NJCURE).

GEICO's defense is that education and occupation are not "solely" used as rating criteria but are, rather, used in conjunction with numerous other rating criteria.

Merits of the case aside, the GEICO situation is a reflection of the current boom in rating segmentation being used by personal lines insurance companies across the nation. Auto and homeowners insurers are developing more diverse rating and tiering plans to more accurately reflect the individual insured's risk exposure in an attempt to gain competitive advantage. Needless to say, the more accurate an insured's rates, the greater the likelihood that the insurer will not be adversely selected against and

in fact gain the upper hand against other insurers.

However, in this quest to more accurately rate a risk, insurers must make sure that their new plans can successfully resist challenges such as those being leveled against GEICO.

This means the days of simply "me-tooing" another company's plan are long gone since the imitator exposes itself to these types of attacks without sufficient evidence to support whether its plan is indeed actuarially and legally sound. In the current environment, it is reasonable to wonder how many insurers could defend themselves against the challenges being leveled at GEICO.

The GEICO situation clearly illustrates the necessity of establishing new rating and tiering plans by using modern actuarial techniques such as GLM analyses. This allows an insurer to prove that its resultant plans can pass muster when subject to regulatory, legal or consumer scrutiny.

**...it is reasonable to wonder how many insurers could defend themselves against the challenges being leveled at GEICO.**

## ISS, Pinnacle Launch Fast Track Plus

Insurers can now get customized and timely personal lines trend information in an easy-to-use Excel format on a state, regional or countrywide basis through a new product, ISS Fast Track Plus.

Fast Track Plus makes monitoring emerging claim experience on a quarterly basis easier than ever. Even better, Fast Track Plus can be purchased on a state-by-state or regional basis -

including customized regions to match your company's operational profile, allowing insurers to buy only what they need.

The product was created by Independent Statistical Service, Inc., a wholly-owned subsidiary of the Property Casualty Insurers Association of American (PCI) and enhanced by

*(Continued on page 2)*

## Catastrophe Risk Load - Essential for Primary Insurers



Chris Carlson

The 2006 tornado and hurricane seasons are upon us and the rate levels intended to cover this year's events are set. It's now time to develop next year's rate levels.

Insurers, which have accepted the standard historical five percent profit load for property risk in general, need to rethink that loading. It simply is not large enough for taking on catastrophe risk. Just as the reinsurers charge more for the "use of capital" in covering catastrophes, primary companies willing to expose large amounts of their capital to catastrophe risk must consider the need for, as well as the level of, a required risk load to earn a reasonable rate of return and remain solvent. Just try to buy reinsurance catastrophe coverage with only a profit/risk load of five percent!

Some say the current load is simply a cost to be able to write some of the other lines, such as personal auto. The problem with that reasoning is that personal auto-only writers chose not to serve this market or expose their surplus and/or

shareholders earnings to this risk at this level of return. It is causing multi-line companies (both large and small) to rethink whether they should continue to insure property at any price in areas prone to catastrophes. Fortunately for Florida property insurers, a recently passed law now specifically allows insurers to include a risk load for hurricane exposure.

Insurers would be wise to consider catastrophe risk loads now for use in developing next year's rates in Florida and other cat-prone states and not become distracted by the impact revised model estimates have on rate levels. Developing rates based upon only the average expected annual catastrophe cost is not the end of the process. It does not allow company management nor the regulators to get an understanding of the true rate need or price level.

Learn more by contacting Chris Carlson at (614) 734-8366 or writing [ccarlson@pinnacleactuaries.com](mailto:ccarlson@pinnacleactuaries.com).

## ISS, Pinnacle Launch Fast Track Plus (*continued*)

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Pinnacle Actuarial Resources, Inc. from Fast Track data filed with regulators by PCI, Insurance Services Office and National Independent Statistical Service.

Fast Track Plus maximizes Fast Track data with easy-to-read graphs that display trends and compare individual state experience to countrywide figures. In addition, the product includes exponential and straight line of best fit projections for the claim cost, claim frequency and pure premium data.

To make the findings even more useful, Fast Track Plus provides a quarterly analysis by Pinnacle Actuarial Resources, Inc. Pinnacle's analysis provides an in-depth examination of emerging trends and the reasons underlying these changes. Fast Track Plus is offered on an Excel platform, allowing insurers to completely eliminate the costs of manual input and automated calculation of a variety of loss trends.

To purchase Fast Track Plus, contact LeRoy Boison by calling (516) 746-7149 or writing [lboison@pinnacleactuaries.com](mailto:lboison@pinnacleactuaries.com).

**Fast Track Plus provides Fast Track data on an Excel basis with better functionality**

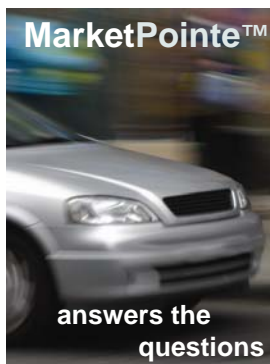
## MarketPointe Reveals Profitability, Competitive Position

Competitive analysis is not what it used to be. Insurance scoring, tiering and other proprietary rating techniques have grown more popular, making accurately assessing a competitor's rates more difficult than ever.

Enter MarketPointe™, a new product developed by Pinnacle that reveals an auto insurer's detailed competitive position in the marketplace. MarketPointe™ reports detail your company's market share by ZIP code, vehicle characteristics (make, model, model year, vehicle type, etc.),

certain insured risk characteristics (age, gender, marital status, etc.) and demographic characteristics. By providing models that show your company's most successful market segments and project potential market penetration, MarketPointe™ data uncovers the truth about how competitive differences have translated into market penetration differences.

Learn more by contacting Roosevelt Mosley at (309) 665-5010 or writing [rmosley@pinnacleactuaries.com](mailto:rmosley@pinnacleactuaries.com).



## Tall Fences Make Better Group Self-Insured Neighbors

by Robert J. Walling, III, FCAS, MAAA

When it comes to group-self insurance programs, the old adage that tall fences make good neighbors takes on a new meaning.

Regardless of the group's structure, some of the most contentious issues relate to differences between members. These differences - ranging from the member size to historical loss differences - often just need the right boundaries.

There are simple, but effective, approaches to dealing with these issues. Differences can be addressed through adjustments to limits, deductibles and self-insured retentions (SIRs), which maintain fairness between large and small members. Another effective approach is to vary SIRs directly with expected losses, which uses an actuarial estimate of expected losses for each member to establish the member's SIR.

Of course, every member cannot have better-than-average experience. A key difficulty in maintaining program cohesiveness is a member with consistently poor loss experience. Try using aggregate deductibles to force the member to meet an annual aggregate retention, in addition to SIRs, before coverage commences. This should compel the member to focus on loss frequency causes or face direct financial consequences.

Rating plans are also key in designing and maintaining group self-insurance programs. Self-insurance programs constantly strive to strike a balance between rates being responsive to member experience and being stable and predictable. Experience modification and self-rating meet these goals.

The experience modification approach compares the historical losses for each member to their expected losses. This approach responds to each

member's actual loss experience and directly influences its premium levels. Programs using this approach should ensure that the sum of the experience-rated funding levels match the overall funding need for the group.

Self-rating is a different approach that reaps similar results by separately computing funding for a frequency loss layer and a severity loss layer. The frequency layer has a relatively large number of smaller claims that result in stable historical loss levels and predictable future loss levels. The severity layer has fewer, but larger losses that fluctuate more and make predicting future losses more difficult, making reliance on industry benchmarks necessary.

An alternate approach is to balance responsiveness and stability with credibility weighting. An amount of claims or exposures are identified to see if the size of risk is big enough to be self-rated. Funding for members that do not meet the standard are a weighted average of their self-funded estimate and a complement, usually the program-wide average or an external benchmark. This approach tempers the experience of individual members with less than the requisite number of exposures for full credibility with the experience of the group. This method can help avoid large yearly premium swings.

For many businesses, group self-insurance is a great way to gain control over risk. Applying the appropriate boundaries builds tall fences to make better group self-insured neighbors.

Learn more by contacting Rob Walling at (309) 665-5010 or writing [rwalling@pinnacleactuarries.com](mailto:rwalling@pinnacleactuarries.com).



Robert J. Walling

...some of the most  
contentious issues  
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between members

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at (614) 734-8366 or [ccarlson@pinnacleactuarries.com](mailto:ccarlson@pinnacleactuarries.com).

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To learn more about

Pinnacle visit

[www.pinnacleactuarie.com](http://www.pinnacleactuarie.com)

## Pinnacle News Briefs

### Pinnacle Expands Its Consulting Team

**Laura Maxwell, FCAS, MAAA**, joins Pinnacle as a Consultant in its San Francisco office. Having more than 15 years experience in the property/casualty insurance industry, Maxwell's expertise includes personal and commercial lines rate indications, class plan development and loss reserve analyses. She has worked for Milliman, Inc., The National Council on Compensation Insurance, Inc. and the New Jersey Department of Banking and Insurance. A graduate from Moravian College with a B.S. degree in Mathematics, she is a Fellow of the Casualty Actuarial Society and a Member of the American Academy of Actuaries. Contact Laura by calling (415) 439-5225 or writing [lmaxwell@pinnacleactuarie.com](mailto:lmaxwell@pinnacleactuarie.com).



Laura Maxwell

### Pinnacle Helps CARICOM Countries Set Up Catastrophe Funding Facility

Pinnacle is helping the Caribbean Catastrophe Risk Insurance Initiative create a catastrophe funding facility. The facility, which is being set up with seed capital from the International Monetary Fund of the World Bank, will provide a risk pooling mechanism for Caribbean countries exposed to potential major catastrophic events.

Assistance from Pinnacle Principals **Shawna Ackerman** and **Chuck Emma** included training and developing a dynamic financial analysis model to simulate future financial scenarios. For more information, contact Shawna Ackerman by calling (415) 439-5226 or writing [shawnaa@pinnacleactuarie.com](mailto:shawnaa@pinnacleactuarie.com) or Chuck Emma by calling (630) 262-0954 or writing [cemma@pinnacleactuarie.com](mailto:cemma@pinnacleactuarie.com).

### Pinnacle Report Analyzes Workers' Compensation in Nevada

Legislative reform and a new private competitive state fund rescued Nevada's once troubled workers' compensation system, according to an analysis conducted by Pinnacle and commissioned by the National Foundation for Unemployment Compensation & Workers' Compensation.

To read "An Analysis of the Impact of Workers' Compensation Reform in Nevada: A Report to The Republican Governors Association," visit [www.pinnacleactuarie.com](http://www.pinnacleactuarie.com). For more information, contact Rob Walling by calling (309) 665-5010 or writing [rwalling@pinnacleactuarie.com](mailto:rwalling@pinnacleactuarie.com).

### Pinnacle Announces New Principals

Pinnacle is pleased to announce that **LeRoy Boison, FCAS, MAAA, LLC** and **Roosevelt Mosley, FCAS, MAAA** have become principals with Pinnacle after serving as consultants for several years.

LeRoy is a graduate of Fordham University with a B.A. degree and has more than 35 years' experience in the property/casualty insurance industry, which includes serving as senior vice president of Insurance Services Office.



LeRoy Boison

Roosevelt holds a B.S. degree in actuarial science and another in statistics from the University of Michigan and has more than 12 years' experience in the property/casualty insurance industry. His industry and consulting experience has been focused on predictive modeling and personal lines.



Roosevelt Mosley

Contact LeRoy by calling (516) 746-7149 or writing [lboison@pinnacleactuarie.com](mailto:lboison@pinnacleactuarie.com) and Roosevelt by calling (309) 665-5010 or writing [rmosley@pinnacleactuarie.com](mailto:rmosley@pinnacleactuarie.com).

## Upcoming Events

### [VCIA Annual Conference](#)

**August 10, 2006 - Burlington, Vermont**

"Understanding of captive operations and broad experience with financial issues of reinsurers" panel discussion moderated by Pinnacle's Rich Lino.

### [NAMIC Annual Convention](#)

**September 17, 2006 - Tampa, Florida**

Pinnacle will present "Market Segmentation and Pricing Points-How Mutual Insurers Can Unleash the Power of Predictive Modeling."

### [Coming This Fall...](#)

- Pinnacle's **Predictive Modeling Seminar**
- Pinnacle's **Loss Reserves Seminar**

For more information about upcoming events, please visit the seminars/events section at [www.pinnacleactuarie.com](http://www.pinnacleactuarie.com).