



Consumer Federation of America

April 27, 2021

Department Action Required to Ensure That Insurance Rates Are Fair and Not Excessive Now That Actuarial Society Rescinded Principles

Dear Commissioner,

As you know, the Casualty Actuarial Society (“CAS”) rejected the unanimous request of the NAIC’s Casualty Actuarial and Statistical Task Force (“CASTF”) to reverse its rescission of the Statement of Principles Regarding Casualty/Property (“P/C”) Insurance Ratemaking (“SOP”), which I detailed in my March 29, 2021 letter to you. This places the burden of ensuring that auto, home, and other rates are risk-based squarely upon the state insurance departments.

In order to prevent final rates from becoming untethered from the principles and standards that have long required cost-based rates, it is critical that you act to ensure that P/C rates do not become excessive, inadequate or unfairly discriminatory. A bulletin, such as that drafted below, will reinforce these basic principles by instructing insurers filing rates in your state to certify that filed rates are based on the cost of risk and no other factors.

Background

For over three decades, actuaries in the United States have looked to the CAS SOP for guidance when preparing rate filings for submission to you in P/C lines such as auto and home insurance.

While the SOP included some other material, the heart and soul of the SOP were the succinct Four Principles themselves. With straightforward clarity, they required that final rates, the rates that would be charged to your constituents, be based on the cost of risk and nothing else. These Principles were the only actuarial guidance applicable to final P/C rates filed in the United States.

Since 2013, some insurers have sought to amend the SOP in order to allow carriers to move prices away from the risk-based level. They sought to use algorithms such as price optimization, which would raise rates above the risk-based level based upon the individual consumer’s shopping habits. As price elasticity of demand, which this technique deployed, is not a measure of the cost of risk transfer, the SOP did not allow for it.

But the insurers failed in attempts to alter the language of the SOP in large measure due to the outcry of regulators, particularly the NAIC’s Casualty Actuarial and Statistical Task Force (“CASTF”). A second attempt at writing standards that would remove the cost-based requirement was made by the insurers who pushed for a new Actuarial Standard of Practice (“ASOP”) to be published by the Actuarial Standards Board (“ASB”). This attempt also failed after regulators and others once again strongly objected.

Given this background, it was surprising that, on December 22, 2020, CAS rescinded the SOP without regulator, or any other, input. Even its own members were kept in the dark. CAS claimed that the rescission was needed due to overlap and confusion between the SOP and the ASB Actuarial Standards of Practice (“ASOP”). But this was not a valid argument since no ASOP applies to final rates (only the CAS SOP did) and no ASOP requires rates to be tied to the cost of risk and nothing else (also, a unique feature of the SOP).

On March 9, 2021, CASTF unanimously voted to request that CAS reverse its rescission, saying “the Statement of Principles regarding Property and Casualty Insurance Ratemaking is too important of a document and too widely cited and relied upon to be rescinded at this time...The Ratemaking SOP complimented state laws that require rates to be related to risk and which provide regulators their authority to challenge rates that are not. The rescindment might open the door to attacks on these rate regulatory laws.”

The CAS Board rejected the CASTF request at their March 27, 2021 meeting.

CAS Admits Its Rescission Puts the Burden of Insuring That Rates Are Fair and Not Excessive Solely On Insurance Departments

In its April 1, 2021 notice of rejection (which did not even acknowledge CASTF or its concerns), CAS did point out that the burden now is shifted entirely to the states. It wrote, in part:

The Board also reviewed an analysis of state insurance regulations, specifically related to the most oft-cited section of the Ratemaking Principles that defines when a rate is “not excessive, inadequate, or unfairly discriminatory.” The analysis found that almost all 50 states plus the District of Columbia specifically state that rates should not be excessive inadequate, or unfairly discriminatory in their filing regulations, and in fact, this language preceded the Statements of Principles. 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 Robinson-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.

In other words, with Principle 4 now removed, the cost-based mandate of the McCarran-Ferguson Act embodied in the laws of most states will become the sole protection against excessive, inadequate and unfair insurance prices. Those words in the state rating laws now are no longer strongly supported by the cost-based principles of the rescinded SOP as a professional standard for insurance industry actuaries.

This removal of principles creates a serious problem for oversight of P/C insurance rates in your state. Your state’s actuaries will likely soon face a rate filing that is not cost based but contains a certification by the insurer’s actuary that the filing complies with every actuarial standard in the ASOPs. The problem is that this certification is meaningless in terms of the filed final rates to be charged to policyholders since no ASOP applies to final rates. Therefore, the certified rates could easily be significantly adjusted away from cost-based levels.

Action Required by Your Department

In order to ensure that auto, home and other P/C insurance rates are not excessive, inadequate or unfairly discriminatory, you must act to strengthen your department’s review of rate filings under the new regime. The first step you should take is to create a certification that applies to final rates, which assures that the statutory standards of filed rates being not excessive, not inadequate and not unfairly discriminatory is met.

CFA calls upon you to issue a Bulletin to P/C insurers along the following lines:

This Department is aware that the Statement of Principles Regarding Property and Casualty Insurance Ratemaking has been rescinded by the Casualty Actuarial Society. However, that does not alter our rating laws, which require that rates be [incorporate applicable statutory language such as “not excessive, not inadequate and not unfairly discriminatory”].

This bulletin is to advise you that we will regulate, and ask that you file, property and casualty insurance rates only after applying the following Principlesⁱ:

The following Principles to apply to property/casualty rates filed in (state name):

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. 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.

When making future property/casualty insurance rate filings, please have your actuary or other executive certify that the above Principles were followed in preparing the filing.

ACTION REQUIRED BY THE NAIC

Beside the action we have sought in your state and each other state, the Consumer Federation of America has, as we indicated in our earlier letter to you, urged the NAIC CASTF to “indicate its intent to continue to rely upon those (rescinded CAS) principles in regulatory processes.”

If you have any questions or comments, please let me know.

Thank you.

Yours truly:



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cc: Kris DeFrain of NAIC, for distribution to CASTF

ⁱ These principles are taken verbatim from the rescinded CAS SOP.