The Actuarial Profession
making financial sense of the future

GENERAL INSURANCE PRICING SEMINAR

13 JUNE 2008, LONDON

Conflicting Objectives

Putting Commercial Lines Pricing in Context

The commercial opportunity

- Stakeholder statement (GRIP Report)
  - "we want to see actuaries getting closer to the business and adding value"
- Strong recruitment in reinsurance, company and London markets
- Method and scope of actuarial work have evolved more slowly than in Personal Lines (PL) because of
  - lack of data
  - mistrust
  - lack of involvement
  - case negotiated nature of business
- Value is generated through knowing
  - the cost of risk (current focus of actuaries)
  - behaviour of competitors (underwriter pricing discretion)
  - behaviour of customers (underwriter pricing discretion)
  - behaviour of underwriters (measurement and management)

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Questions we will discuss

Technical / educational direction for the profession

- What roles do actuaries typically carry out in CL pricing and underwriting today?
- What are the best areas for actuaries to concentrate on in the future? How will we maximise our value in the CL pricing and underwriting process?
- Improve what we do today?
  - Extend to include results from ICA process
  - Improve integration of Cat models or extreme events
- Improve knowledge of market practice, products and coverage
- Look at buyer behaviour? Model the cycle?
- Build models that explicitly recognise what underwriters consider in arriving at commercial decisions?
- Build models that test appropriateness of underwriter decisions

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Questions we will discuss

- Can / should we move into the performance measurement / management space?
  - Alignment of shareholder and underwriter incentives
    - What motivates the underwriter?
    - Balance short and long term needs
- Become the process owners
- Professional Standards
  - Are we at risk of engaging in “advocacy” to the extent that professional standards will be weakened?
  - Is there any need for standards?
    - What do we know from US and elsewhere?

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Setting the context
Evolution of Pricing Techniques

	PL	CL
1970’s	Case negotiation, limited stats, simple rate cards	1970’s
1980’s	GLM’s, Portfolio Pricing, Cost Plus, complex rating	1970’s
1990’s	CMA, Geo-coding Behaviour Analysis, Individual pricing	Limited transfer of PL techniques from 1980’s, Geo-coding
2000’s	1990’s techniques at industrial strength	Smaller CL automated, otherwise close to CL 1990’s approach
Next decade	Customer Analysis, The next big thing?	?

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Setting the context
Interested parties

Customers

Competition *Suppliers*

Managers *Rating Agencies*

Regulators *Brokers*

Staff *Shareholders*

Investment Analysts

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Setting the context
Conflicts between company and customers

Common good in compulsory classes	*Preserving proprietary information advantage*
Trust in fairness of pricing (transparency and consistency)	*Aligning company and distributor incentives*
Avoidance of market failure	*Managing the cycle*

Setting the context
Drivers of the cycle

- Claims / pricing leads and lags
- Fixed costs
- Shock losses
- Capital flows / stock market returns
- Balancing short and long term objectives
  - Attempts to drive out competition
  - Exploitation of expense advantage
  - Competitive intensity / rivalry
  - Need to preserve market share / franchise value

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Setting the context
Cyclical factors

- Companies are subject to a use it or lose it pressure on capital
  - analysts do not like excess capital
  - choice is to write business or increase dividend
  - management is usually loath to surrender capital or market share
- As an example, Lloyds capacity reduction in 2008 is consistent with the level of rate softening
- Companies need to be present in a meaningful way as the cycle bottoms (i.e. at least a watching line)
  - short term pressure to keep writing even at uneconomic rates
  - applies both at account / segment level and in the management of the overall enterprise value
- Pressure to cover some or all of the fixed cost burden

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Setting the context
Customer Behaviour

- Policyholder / broker behaviour vary through the cycle
  - Lapse propensity increases in a soft market
  - Brokers prefer "smoother" pricing, unless they are under attack
  - Cycle (up and down) increases policyholder mistrust
    - Increase = Insurer is ripping me off
    - Reduction = Insurer ripped me off last year
- Buying behaviour varies between companies
  - Who has the buying decision?
    - Finance
    - Risk Management
    - Broker
  - How long is the key decision maker in the job?
  - How frequently do they re-market their insurance program?
  - One-stop-shop or more complex

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Actuaries in CL Pricing
What are people doing today?

- Typical involvement at case level is working with underwriters or brokers to give advice on technical price
  - Expected losses and percentile distribution
  - Reinsurance costs and extreme events
  - Capital allocation and links to ICA process
  - Evaluation of variations in terms conditions limits and deductibles
  - Expense loads
  - Latent claims loads, where applicable
- Involvement at account level varies
  - Target loss ratios, price monitoring
  - Business planning
  - Reinsurance (capacity planning, CAT modelling)
  - Capital management

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