14. (1.25 points)

An insurer proposes to increase rates by 6.0% where many individual policy impacts will be above 10%. The insurer proposes a capping rule that will restrict premium changes at the policy level to plus or minus 10.0%.

a. (0.5 point)

Identify two problems that a capping rule may cause for an insurer.

b. (0.75 point)

Explain why an insurer would propose a capping rule in light of the problems identified in part a. above.

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Exam 5 Question #14

a. 1. Insurer will not be charging what they should be to keep the fundamental insurance equation in balance and earn their target underwriting profit.

   2. Systems limitations-need to program this rule into computer systems. Can get complicated as to what gets capped and what doesn't and how this changes the rating algorithm

OR

   1. May cause need for premium transition

   2. Insurer may not get all the rate needed

OR

   1. Can cause rates to be inadequate

   2. Can be subject to adverse selection

b. May have a concern that they will not retain policyholders if they raise rates substantially at renewal-may cause insureds to shop- Also might be regulation reasons-restrictions on the amount of rate increase a policyholders can see at each renewal

OR

Keep customers from getting shocked at renewal and shopping.

OR

An insurer would propose a capping rule in light of the problems in (a) to maximize the retention. An insurer might be able to get an increase in rate in the future which will make rates adequate again. The more profitable business they retain the more profits they will enjoy in the long run.

points were not awarded. Many candidates who chose credit score lost points for saying the levels were “fully credible”, as opposed to “good credibility” which leads to a different discussion and also lead to candidates losing points in Part C.

c. To receive full credit, candidates needed to correctly calculate the full credibility standard, calculate the credibility using the square root rule, calculate the company indicated relativities, credibility weight the company relativities with the competitor relativities, and finally re-base the credibility weighted relativities. The most common mistake here was claiming full credibility, not recognizing that the 400 full credibility standard refers to claim count and not exposure. For candidates who calculated the indicated company relativities relative to the total pure premium, a common mistake was not calculating the revenue neutral competitor relativities as well. Additionally, some candidates missed the instruction to use the competitor’s relativities as the complement of credibility.

12. In general, the response to this question was poor. Many candidates recognized the small data volume but incorrectly went about combining alarm types or deductibles into one category. This was often accompanied by a calculation of a proposed factor by weighted the GLM output. Time was unnecessarily lost by this calculation. Another common error was candidate’s often recognized unintuitive output that seemed to be the result of sparse data but yet still proposed to select the predicted factor.

13. Many candidates received full credit on this question. Some common mistakes that were made on this problem:

- Forgetting fixed expense is in the numerator.
- Treating the loss elimination ratio as the excess loss ratio. If the candidate used the incorrect LER “correctly” (applied the deductible processing and credit risk loads to the losses under the deductible, the excess risk margin to the losses above the deductible, and used the losses above the deductible in the numerator) candidates still received some partial credit.
- Applying the ALAE % to excess losses.

14.

a. Candidates not receiving partial credit on often restated the same item twice or two sides of the same item. To receive full credit, 2 separate ideas were necessary.

b. On part b, very few candidates only received partial credit. Examples of full credit statements include:

- “An insurer’s retention may decline if a rate cap is not adopted.”
- “State laws may require a maximum rate change be followed for all policies.”

15. This question was answered poorly with few candidates receiving full credit.