Consumer Federation of America

March 29, 2021

Protection Against Unfair and Excessive Rates Removed by Actuarial Group
Despite Unanimous Request by Regulatory Actuaries, CAS Refuses to Undo Action

Dear Commissioner,

On March 9, 2021, the NAIC's regulatory actuaries (CASTF) unanimously voted to request that the Casualty Actuarial Society (CAS) reverse their rescission of the Principles actuaries have followed for decades in establishing the premiums policyholders pay for coverage. The CAS Board rebuffed the CASTF request at their March 27, 2021 meeting.

For more than 30 years, these Principles were enshrined in the Casualty Actuarial Society's (CAS) Statement of Principles Regarding Property/Casualty Ratemaking, as follows:

> Ratemaking is prospective because the property and casualty insurance rate must be developed prior to the transfer of risk.
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> *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.

These principles have been the foundation of cost-based pricing requirements in insurance since they memorialized and help define state laws requiring that rates be not excessive, inadequate, or unfairly discriminatory. For decades, these Principles have worked to guide regulators' assessment of insurers' final rate selection and protect consumers from arbitrary and unfair premium charges.

But, with no public notice and no opportunity even for CAS member input, let alone regulator and public input, the Board of the CAS rescinded the Statement of Principles (SOP) on December 22, 2020, arguing that the SOP were "redundant" with other actuarial standards of practice (ASOPs) adopted by the Actuarial Standards Board. In fact, no ASOP addresses the final selected rates to be charged to policyholders, so no "redundancy" exists. ASB tried to produce an ASOP for final rates but was unable to do so because of "significant differences of opinion within the profession."[1]

Why would some actuaries revolt against their own principles? It is difficult to understand, except in light of their employers' interests. While insurers cite risk-based pricing when it suits their purpose (e.g., to defeat proposals to rein in rating factors that unfairly target communities of color), they don't want to be held to a cost-based pricing standard at other times (e.g., when they seek to utilize algorithms for price optimization and customer lifetime value that conflict with the SOP).

The SOP was the only statement and guidance for actuaries regarding the cost-based requirement for the final rates charged consumers. By rescinding the SOP, the CAS has given insurers a green light to deviate from cost-based pricing and utilize the algorithms that have long been prohibited in the US. For example, more than 20 states banned the use of price optimization techniques, a non-actuarial algorithm that increases premiums above the actuarial indication, even for state-mandated auto insurance, for people who are unlikely to shop frequently according to third-party data. Use of price optimization results in different premiums for identical risks, thereby creating unfairly discriminatory rates in conflict with the cost-based standards CAS suddenly rescinded.

[1] As ASB said in December 2017, in transmitting ASOP 53 to actuaries and to the public, *"the ASB quickly realized that there are significant differences of opinion within the profession regarding certain aspects of ratemaking, including pricing, price optimization methodologies, and rate filing requirements, that would need to be reconciled before a comprehensive standard of practice on ratemaking could be developed. Therefore, to create a standard of practice for the core aspects of ratemaking that could be issued in a reasonable amount of time, the ASB has chosen to develop this ASOP to pertain solely to the development or review of future cost estimates for prospective property/casualty risk transfer and risk retention."*

This is not the first CAS effort to surreptitiously clear space for insurers to set final rates outside of the cost-based pricing standards that have long-governed property and casualty insurance ratemaking. In the most recent CAS ratemaking text used to educate new actuaries, there are lessons on how to differentiate prices among consumers based on Price Optimization as well as on hypothetical expectations about tenure with the company and future purchases of products that the consumer might make.[2] Needless to say, the deviations from cost-based pricing tend to harm the most vulnerable consumers, generally, and communities of color, particularly.

The CAS has shown itself to be not the disinterested, professional credentialing organization it claims to be but simply another insurer trade association. Despite a strongly-worded letter from the regulatory actuaries on the CASTF, who unanimously voted to urge the CAS to reverse the rescission, the CAS Board rebuffed the regulatory actuaries with demeaning comments that more "education" of those who disagreed with the action was needed.

Given these actions by the CAS to undermine the critical role of cost-based pricing memorialized in the SOP and the glaring impact on regulators' efforts to address systemic racism in insurance, we urge the CASTF, the NAIC and state Departments of Insurance to take the following steps:

1. The full NAIC should reiterate CASTF's statement of disagreement with the CAS action to rescind the SOP. NAIC should also indicate its intent to continue to rely upon those principles in regulatory processes.

2. Treat the CAS like any other industry-trade association at CASTF meetings -- no special role for or routine presentations by the CAS on "professionalism" or any other topic at CASTF or other NAIC meetings.

3. Scour NAIC model laws and state laws for references to property/casualty "sound actuarial principles" and remove or replace these references with language of the rescinded SOP.

4. Redouble the N'IC's efforts to identify and stop insurers' use of non-cost factors in underwriting, pricing, claims settlement, and antifraud and examine insurers' practices for proxy discrimination against protected classes.

We ask that CASTF put this matter on their next meeting agenda and begin the process of adopting the rescinded Principles as an interim set of standards for actuaries (or, at least, for regulatory actuaries) to follow in making/approving final insurance rates in America.

[2] Basic Ratemaking, Fifth Edition, May 2016, Willis Towers Warson, CAS.

Sincerely,

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Director of Insurance

cc: Kris DeFrain, FCAS, MAAA, CPCU
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