Speed to Market Tools for P&C Class Definitions

Purpose: Speed to Market (STM) Tools provide guidance for preparing a filing. Although using the information in this document may not be legally required and does not guarantee that your filing will be approved, it will expedite the review of your filing.

Who should use this document?

Property and casualty insurers submitting rate filings that include complex class assignment rules.

Speed to Market Information

I   General Information

I.A.   Citations relevant to this subject: RCW 48.19.020 Rate standard; RCW 48.19.040 Filing required–Contents–Definition; and RCW 48.18.480 Discrimination prohibited.

I.B.   We object to classes defined by vague terms like Poor, Average, Good, and Excellent.

I.C.   In reviewing risk classifications, we do not seek to tell the Company which risks should go in which class. Our goal is to ensure that the filed definitions are clear enough that we could determine the correct rates and rating factors applicable for any given risk.

I.D.   Generally, you should file class definitions that:
   (1) Use specific, objective terminology
   (2) Are mutually exclusive
   (3) Are complete and self-contained
   (4) Do not requiring the use of non-filed documents or company-specific information
   (5) Can be used to identify the one correct class for any given applicant or policyholder

II STM – Rate Filing Information:

II.A. Vague terms. A common problem with class definitions is the use of word and phrases that are so vague and unclear it is impossible to know for certain what the filer means. Frequently used vague terms and items we commonly object to include:

(1) Qualitative judgment words such as poor, moderate, good, etc.

(2) Words indicating the use of some unspecified standards, such as satisfactory or acceptable

(3) Levels of "concern," such as low concern, moderate concern, etc.

(4) Words indicating a degree: Slightly, significantly, materially, little to no, etc.

(5) References to unspecified industry benchmarks or standards

(6) Proprietary scores, where the rating plan does not show how the score is calculated

(7) References to answers to a questionnaire or an application, if the questions aren't also shown in the rating plan

II.B. Sometimes we object to vague terms and the filer responds by defining these terms using equally vague language. For example:

(1) Example 1a –Wrong

> *Poor*
> *Moderate*
> *Good*

(2) Example 1b – Revised but Still Wrong

> *Poor: A risk with poor loss control procedures, poor loss history, and poor management cooperation*
> *Moderate: A risk with moderate loss control procedures, moderate loss history, and moderate management cooperation*
> *Good: A risk with good loss control procedures, good loss history, and good management cooperation*

(3) In revising the wording, the filer has attempted to replace vague terms with equally vague, but longer definitions. When writing class definitions, keep in mind that they should be detailed and specific enough so that a third party (like an OIC examiner) could use them to assign any risk to the correct class. Ask yourself, "would somebody who is familiar with this type of insurance but not familiar with my company know exactly how to differentiate between poor, moderate, and good loss history?" Imagine a couple example risks and try to use your proposed definitions on them. Do the definitions work by themselves or do you need to make assumptions or use other documentation to figure out the correct class? If you need more than what is in the class definitions, this probably means the class definitions are inadequate.

(4) Example 1c – Almost, but Still Wrong

> *Poor: A risk with no written loss control program; with a three-year loss and defense and cost containment ratio of 100% or more; and that does not participate in our Safety First program.*
>
> *Moderate: A risk with a written loss control program, but with internal loss control training either for only managers or required less often than annually; with at least one claim in three years, but with a loss and defense and cost containment ratio less than 100%; and that allows staff to participate in our Safety First program, but does not require participation.*
>
> *Good: A risk with a written loss control program with training for all staff at least annually; with no claims in the last three years; and that requires staff to participate in our Safety First program.*

(5) Although Example 1c is much better than Example 1b, the definitions in Example 1c do not explain what happens for a risk that has a mixture of characteristics. For instance, which category applies if the risk has no written loss control program (poor) but also has no claims (good)? Whatever process you would use to decide the class assignment in these cases, that process should be detailed in your filed class definitions.

(6) Example 1d – Right (if Combined with Example 1c):

> *A risk with one or more characteristics considered "poor" will be classified as poor. A risk with no "poor" characteristics and two or three characteristics in the "good" category will be classified as good. All other risks will be classified as moderate."*

(7) If your risk classification rules include this type of wording meant to get around the mixture problem, spend a minute to make sure that you have every possibility covered and that no ambiguity remains. Do not disregard unlikely possibilities, such as risks that have some very favorable traits and some very unfavorable traits. In reviewing your rules, we have to consider all possible combinations of characteristics and make sure that any possible risk has one and only one possible class assignment. Thinking about typical risks or just risks in your current book of business may not be enough.

II.C. Qualifying for multiple classes. When multiple values are used in the same classification scheme, these types of classifications are often incorrectly set up so that risks can satisfy the requirements for more than one class. No risk should qualify for more than one class. The easiest way to fix this is to include a sentence in your rules explaining what happens when a risk meets the standards for more than one class.

(1) Example 2a – Wrong

Basic Rates	Preferred Rates	Super Star Rates
Working capital of at least $250,000	Working capital of at least $500,00	Working capital of at least $1,000,000
Net worth of at least $250,000	Net worth of at least $500,000	Net worth of at least $1,000,000
CPA reviewed financial statements	CPA reviewed financial statements	CPA reviewed financial statements
Minimum of three years under the same management	Minimum of five years under the same management	Minimum of eight years under the same management

Applicants not qualifying for Basic Rates *will be assigned* Standard Rates.

(2) Example 2b – Right

Basic Rates	Preferred Rates	Super Star Rates
Working capital of at least $250,000	Working capital of at least $500,000	Working capital of at least $1,000,000
Net worth of at least $250,000	Net worth of at least $500,000	Net worth of at least $1,000,000
CPA reviewed financial statements	CPA reviewed financial statements	CPA reviewed financial statements
Minimum of three years under the same management	Minimum of five years under the same management	Minimum of eight years under the same management
Does not qualify for Preferred Rates or Super Star Rates	**Does not qualify for Super Star Rates**	

Applicants not qualifying for Basic Rates, Preferred Rates, or Super Star Rates will be assigned Standard Rates.

(3) Another way of correcting Example 2a would be to add a statement under the table such as "Applicants will be assigned to the lowest-rated tier for which they qualify."

II.D. Ranges

(1) Whenever you use ranges of numbers to distinguish between different classes, make sure that your ranges do not overlap or leave out possible values.

(2) Example 3a – Wrong

Class I	Class II	Class III	Class IV
<$5,000	>$5,000 but < or = $10,000	$10,000 - $20,000	$20,000+

(3) What's wrong? In this example, if the value is exactly $5,000, none of the classes would apply. If the value is exactly $10,000 both Class II and Class III would apply. For $20,000, both Class III and Class IV apply. Some filers may find it helpful to use words instead of symbols like <, > and =. Here are two different ways of presenting these ranges correctly:

(4) Example 3b – Right

Class I	Class II	Class III	Class IV
$5,000 or less	More than $5,000 and less than or equal to $10,000	More than $10,000 and less than or equal to $20,000	More than $20,000

(5) Example 3c – Right

Amount is greater than…	But less than or equal to…	Class
$0	$5,000	I
$5,000	$10,000	II
$10,000	$20,000	III
$20,000	-	IV

II.E. An "all other" category

(1) A good, common way to simplify class definitions is to define one of the classes as being applicable when the risk does not qualify for any of the other classes. In this way, you can avoid the need to write a detailed description of the qualifications for one of your classes. See Example 2b, which states, "Applicants not qualifying for Basic Rates, Preferred Rates, or Super Star Rates will be assigned Standard Rates." The specific qualifications for Standard Rates are not shown; instead "all other" risks are assigned to Standard Rates.

(2) Note that only a single all other category can be used at a time. Putting an "all other" category in two or more classes creates ambiguity.

II.F.   Do not file underwriting guidelines

(1) Distinguish between underwriting guidelines and class definitions. We use the term "underwriting guidelines" to refer to how the insurer decides whether or not to write the risk in the first place. Contrast this with class assignment, which pertains to how much premium the insurer will charge the risk. Underwriting guidelines are about risk selection and do not need to be filed (and should not be filed). Class definitions are about how you know which rating factor to apply, assuming that you have already decided to write the risk.

(2) Many times, insurers appear to want to include underwriting guidelines as part of the class definitions.

Example 4a – Wrong

Hazard	Low	Medium	High
Characteristics	**No losses in the last three years;** Has been in business for 10 or more years	**No losses in the last three years;** Has been in business for less than 10 years but more than 3 years	**No losses in the last three years;** Has been in business for 3 or less years

(3) Notice in these definitions that "No losses in the last three years" is a requirement for all three hazard levels. This means that the trait is essentially an underwriting guideline, because no risk is eligible if it had any losses in the last three years. To fix this, remove the underwriting guideline.

Example 4b – Right

Hazard	Low	Medium	High
Characteristics	Has been in business for 10 or more years	Has been in business for less than 10 years but more than 3 years	Has been in business for 3 or less years

(4) Whenever your class definitions repeat the same requirement for every class, you have likely included an underwriting guideline that should be removed. It might be helpful for only your own internal purposes to develop class definitions with an extra category called "ineligible." This is only to help you sort out your intentions, not for filing purposes. Again, do not file underwriting guidelines. For example, you could add a column like this:

Example 4c – Internal Use Only; Do Not File

Hazard	Low	Medium	High	**Ineligible**
Characteristics	Has been in business for 10 or more years	Has been in business for less than 10 years but more than 3 years	Has been in business for 3 or fewer years	**Any risk with an insured loss in the last 3 years**

II.G.   Borderline risks, not typical risks

(1) When you write the definition for the class that is the best (lowest hazard, lowest rating factor), you should describe the worst possible risk that would still qualify for this classification. A good indication that this suggestion has not been followed is if the class definitions use words like, "typically," or "generally."

Example 5a – Wrong

Tier	Preferred	Standard
Traits	Preferred risks **typically** have no claims in the last 5 years; **Generally characterized** by having low debt and strong income	Any risk that doesn't qualify as Preferred

Example 5b – Right

Tier	Preferred	Standard
Traits	All of the following must be true: The risk either had no claims in the last 5 years, or had one claim for less than $5,000 in loss payments and reserves;	Any risk that doesn't qualify as Preferred

| | Debt to equity ratio less than or equal to 50%; and

No annual operating losses in the last two years. | |

II.H.   Company placement rules

(1)   If you are filing a rating plan for a group of affiliated companies, you do not need to file rules that specify which risks will be written by which company. You will still need to support differences in rates between companies, and supporting these rate differences may require you to discuss your company placement procedures. But even in that case, this discussion would be part of your rate support attached to the Supporting Documentation tab, not part of your filed rating plan attached to the Rate/Rule Schedule tab.

II.I.   Use your filed rates

(1)   Whenever you make a change to your class definitions in your filing, be sure to consider how this will impact your rating software and underwriters. Did you make changes to your definitions that merely clarified what you originally intended, or did the changes you made to your rating plan actually change which risks would be assigned to each tier? If your rating system is automated/software-driven, your programmers/IT staff may be a good resource for helping to resolve objections about your class definitions. Obviously, if you make changes to your filed class definitions, your software will need to be revised accordingly. You don't want your rules to say 'less than' when your software is actually checking 'less than or equal to.' If rating is more of a manual process, you may need to involve your underwriters during the filing review process, to get their input on how to make class definitions specific and objective. When the filing is ultimately approved, make sure to actually use the approved version of the rating plan.

Contact Us

For filing related questions, feedback or suggestions contact the Rates & Forms Help Desk:

(360) 725-7111

rfhelpdesk@oic.wa.gov