

Tidbits from the Top

by David S. Medvidofsky, CPCU, CIC, AAI



David S. Medvidofsky, CPCU, CIC, AAI, is vice president of operations for The Main Street America Group; and general manager of Information Systems & Services (ISS). He is a summa cum laude graduate of Franklin Pierce College (B.S. in business management), where he was selected to the Alpha Lambda Sigma National Honor Society. Medvidofsky is active in industry and educational pursuits, including CPCU instruction, and has been published in *National Underwriter*, *CPCU Journal*, *Underwriting Trends*, and *Technology Decisions*. He currently serves as chairman of the CPCU Society's Underwriting Section Committee, and serves on the Governing Committee of the South Carolina Commercial Automobile Insurance Plan, and other insurance industry committees.

It gives me great pleasure to communicate with you as your new Underwriting Section chairman. My predecessor, **Fred Parcells, CPCU**, has left big shoes to fill. I am fortunate that he has also left a talented and committed group of volunteers interested in adding value to the section membership and to the value of the CPCU designation.

As you may know, the Underwriting Section has four main goals. We are committed to:

- provide timely information
- provide educational materials
- provide career development tools
- provide networking opportunities

I will keep these goals in the forefront as your chairman.

One of my favorite "ice-breaker" questions when meeting new insurance professionals is to ask how they started in the business. Reflect for a minute if you will on your start in insurance and what drew you into this industry. In their more candid moments, most people say: "I needed a job and insurance was my best offer." I have been asking this question for many years and have yet to hear anyone say that they've realized a lifelong dream the same as children aspire at an early age to become astronauts, doctors, lawyers, fire fighters, professional athletes, etc. For that matter, even most young adults set their sights on other professions.

Once the stories get beyond "needing a job," I typically hear stories of good people that saw opportunity and became extraordinary professionals through hard work, dedication, and goal setting. It is this drive that is the magnet that draws people to the CPCU designation. Attainment of this goal tells the world that the select

professionals that have attained the CPCU designation are committed to the industry and the customers and stakeholders whom they serve.

In 2004, I celebrate my tenth anniversary of attaining the CPCU designation. I purposely use the word "celebrate" as it symbolizes the achievement in becoming a CPCU both in designation and, more importantly, in practice.

See if any of this has familiarity with your situation: In my early years as a designee, I basked in the recognition that came with achieving a challenging goal. I benefited immediately from the technical knowledge. Then, I came to value the instant respect and credibility that the designation provided. A few years ago I began to look for more—more learning, more friendships, and more service to others. I joined the Underwriting Section to help meet my personal quest for "more."

I have come to realize that attaining the designation was not really an end goal; rather, it was merely my entrant's fee. With that in mind, I hope to continue to lead a section that meets your needs and makes you a more accomplished insurance professional. In turn, I ask that you help me realize my need for "more." You may do this by providing your feedback to make us an even better section:

- What may we do for you to enhance your value to the industry?
- How can we help you to meet and exceed your goals?
- What needs do you have that align with our section's goals?

Please contact me or any section committee member to voice your opinion and to share feedback. I look forward to serving you as the chairman of the Underwriting Section Committee. ■

Drilling Down High-Level Data for Forensic Study of Loss Runs to Improve Underwriting Territory Profitability

by John T. Gilleland Jr., CPCU, AIS, API, AU

Editor's Note: Have you ever noticed that what comes around, goes around and reappears? Perhaps it has a new name, but the basic concepts in our industry don't change much. In the last edition of *Underwriting Trends*, I had asked the question of "What role should we play in securing the future for the insurance industry?" In part, this entails getting "back to basics" and sharpening our underwriting skills to strengthen underwriting profits.

To this end, I am including excerpts from an article written by John T. Gilleland Jr., CPCU, AIS, API, AU, back in 1999, which was updated in 2003. Although too large to print in its entirety (which will be posted on the section web site), I thought some of the generalized underwriting information would be useful.

The Need for a Better Decision-Making Process

Traditionally, property and casualty underwriters have relied upon their company and/or regional exception underwriting eligibility guidelines whenever evaluating applications, renewals, referrals, and change requests. These guidelines are often set when a company or a product is initially rolled out. Most guidelines are not updated to reflect analysis of markets' performance. Therefore, rates are usually the only things that get updated/revised when loss ratios increase. Many underwriters assume their rates will be adjusted appropriately to market trends. We suggest guidelines be adjusted much more often than rates.

Guidelines are static; markets are volatile. Use of guidelines that do not reflect current market conditions will not enable underwriters to react to their markets' pressures, characteristics, events, or trends. Lack of market analysis and tailored underwriting action permits inception and continuation of negative

underwriting results trends. Growth and profitability are the key underwriting results/objectives.

We need "acceptability" guidelines to help underwriters know how to react more profitably to risks that are eligible but have adverse characteristics or tendencies. Underwriters who manage their books of business in reaction to their markets' trends work to make eligible exposures more acceptable because they know what is and is not likely to be profitable in their markets. This article proposes that any book of business' growth and profitability should be managed in a new way. Our use of the term "managed" is meant to indicate we expect underwriters to:

- **Learn** about whatever is relevant to improving their underwriting territory's performance.
- **Plan** how they can act as agents of change/improvement.
- **Do** the right things for the right reasons at the right times in the right ways.

Management techniques such as MBO, goal setting, process improvement, and statistical analysis should be considered for use when evaluating, planning, and working to improve any book of business. Underwriters should use much more than just program eligibility guidelines and gut feeling to underwrite. Underwriters should constantly develop market acceptability guidelines that serve specific purposes for limited times. Acceptability guidelines should change as markets change.

What Does Portfolio Management Mean?

The article in its entirety (on the web) outlines analytic approaches for evaluating underwriting territories and reacting wisely. There are two descriptions of processes. The first description is very basic and at a high

level. The second is very detailed and has three examples. This material describes one of several approaches to do what is called "portfolio management underwriting" in the Insurance Institute of America's API 28 and 29 courses as well as its Focus Series self-study workbook titled *Personal Insurance Portfolio Management*.

Traditional portfolio management was developed by financial investment managers. It is a school of thought that was developed and has evolved to help investment portfolio (groups of stocks and bonds) managers to do things like reduce the financial impact of unfavorable market swings. Portfolio management of investments helps minimize the impact of a few declining stock and bond values on an investment manager's portfolio of stocks and bonds. *Portfolio management underwriting* helps underwriters minimize the impact of a few unprofitable policies on an underwriter's book of business.

Investment managers generally follow four rules when applying portfolio management principles. These are relevant to underwriting concerns too.

- Carefully determine what your benchmarks (comparables) should be. Measure your portfolio's performance in relation to relevant benchmarks. Take corresponding actions to get your portfolio to perform so that the benchmarks are achieved or exceeded. This means *gap analysis*¹ should generate the beginnings of an action plan targeted at specific needs.
- Analyze your benchmarks in terms of what risks are generally expected, usually unacceptable, and may be tolerable if conditions are right. This means portfolio managers should be knowledgeable enough to be consistent when setting goals, making decisions, and being flexible in their negotiating and planning.

- Know that you may be wrong about the benchmarks, your analysis, and, in turn, your actions. This means learn from customers, peers, and leaders. Your use of benchmarks, models, and analysis should improve quickly and continuously as you gain more experience, receive feedback from customers, hear advice from peers, and get coaching from your leaders.
- Use “insurance” by blending negatively correlated items into your portfolio. This means, don’t let clients or yourself be lulled into assuming any one type of investment vehicle or strategy is the best or only offer of wealth.

These and other financial portfolio management principles should be learned, modified, and applied whenever P&C underwriters want:

- consistency in decision making
- certainty that their actions are tied to reason/logic
- more impact on their markets’ profitability with less effort
- logical decision-making processes that are easily defended
- support from front-line personnel, managers, and executives
- enhanced and updated eligibility guidelines used to determine acceptability

What Does *Forensic Analysis* Mean?

Actions should be performed in response to recognition of poor underwriting results demonstrated by worsening frequency and/or severity trends. It was labeled *forensic analysis* when I introduced it in 1998 because it helps dissect books of business to determine the causes of death (poor performance) for books of business. Unprofitable accounts’ histories are analyzed so underwriters can learn, plan, and do better underwriting. They will:

- Learn which characteristics should prompt constructive reactions when reviewing applications, renewals, referrals, and change requests for coverage. Plan how to handle each

- relevant characteristic profitably. Do what they plan.
- Learn which type of accounts/policies should be non-renewed if they cannot be modified or rehabilitated. Plan how to modify, rehabilitate, and non-renew constructively. Do what they plan.

According to **Connor Harrison, CPCU**, director of underwriting education at the AICPCU/IIA, portfolio management underwriting is performed in response to statistical analysis of profitable (typical standard) accounts and is done by insurers and organizations such as Fair Isaac. Profitable accounts are analyzed to determine what characteristics should be looked for when considering applications for coverage. I call this prenatal (before birth of the policy) portfolio management underwriting. This type of portfolio management underwriting requires different philosophy, skills, tools, and workers than what most desk underwriters have at their disposal. This article is written to help front-line underwriters, desk underwriters, and marketing representatives who do not have the resources of a Fair Isaac or ChoicePoint. Therefore, a concentration on prenatal portfolio management underwriting is beyond the scope of this article. This article recommends use of data describing unprofitable exposures from five-year loss runs so front-line underwriters, desk underwriters, and marketing representatives can learn how to operate more profitably without re-underwriting entire books of business.

Some insurers have proven pristine and non-standard risk exposures can be insured profitably. Therefore, this article recommends we not shy away from our insureds whose acceptability seems to be deteriorating or has definitely deteriorated. We should use a blend of portfolio management principles and actions on attractive and unattractive business.

What Is Drilling Down a LOB?

Statewide and regulated loss ratios, premium volumes, and growth rates are high-level measurements that summarize a book of business’s or segment’s underwriting results. These measurements do not point to specific underwriting problems. These measurements do indicate whether or not underwriting results should be investigated further.

Drilling down measurements is a technique used in many industries to move from high-level summary information down to low-level/front-line details. Applied to underwriting territory management, drilling down a line of business (LOB) begins with loss ratio analysis and ends with policy-level details such as coverages applied and claim triggers. Decision makers should drill down LOBs by comparing a geographic area’s or an agency’s LOBs with each other and industry standards to find which LOB(s) is/are not profitable enough or not growing enough. The LOB with the poorest performance should be analyzed the most and first to discover which segment(s) of the LOB contain problems.

The automobile LOB can be broken up by location, usage, vehicle type, driver age, and longevity. The homeowner LOB can be broken up by year built, location, owner’s credit history, and construction type. Market segments are broken up so problem solvers can find which type of risk is performing worst and react wisely. The worst performing type of risk is analyzed in more ways. Effort is put forth to discover what actions, conditions, events, etc. are in common with other exposures. Decision makers (e.g., region underwriters) work to find what underwriting actions should be taken by the insurer’s or agency’s team to begin to earn better underwriting results from the worst performing type(s) of risks covered by the problem LOB.

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First Illustration of the Process

Table 1 offers an introductory explanation of the three levels of analysis required to drill down into a book of business. ■

Endnote

1. The term gap analysis, as used here, means discovering, describing, and debugging the difference between a market's goals and its results. Gap analysis seeks to answer questions such as:
 - What is the difference between an underwriter's vision/plan and the underwriter's market's performance?

- What has caused the difference between an underwriter's vision/plan and the market's performance?
- What are the most likely remedies for the gap's causes?

Table 1
Drilling Down Local Markets at a Glance

Level of Analysis	What Questions Should be Asked?	Type of Analysis	Basic Action Steps
High-Level Analysis	How does our market compare with other markets? How does our market compare with our goals?	Compare our market's summary information such as "LRs" against other markets.	Excluding official catastrophe loss data: <ul style="list-style-type: none">• Calculate our market's LR, growth rates, retention ratios, frequency, and severity measurements for the last five years.• Diagram our market's and comparable markets' trends.• Compare these trends to past and current goals for the market.• Determine whether or not our market compares well or poorly to comparable markets and our market's goals.
Intermediate Levels of Analysis	Which line of business (LOB) needs attention now? Which LOBs have best and worst UW results?	Compare summary information such as frequency and LR measurements for each line of business.	Excluding official catastrophe loss data: <ul style="list-style-type: none">• Calculate each line of business's LR, growth rates, retention ratios, frequency, and severity measurements for the last five years.• Diagram the calculations' trends.• Select the relevant LOB with the most relevant (positive or negative) trends. This is the target LOB.
	Which segments need to be learned from? Which segments are influencing the targeted LOB most?	Segment the poorest performing LOB so you can analyze individual parts.	<ol style="list-style-type: none">1. Break the targeted LOB up in several ways so you can manipulate and analyze it from several viewpoints.2. Calculate five-year data measurements for each segment listed above. Calculate the LRs, growth rates, retention ratios, and average number of losses/policy.3. Diagram the calculation trends.4. Select the segments with the best and worst trends. These should be the few segments that are influencing your market the most.
Low-Level Analysis	What type of peril or exposure or combination of factors is causing the LOB's poor performance?	Review claims data such as itemized (detailed) lists of policies for smaller (1K to 10K) groups of policies.	Examine the one to three most influential segments of the targeted LOB. The poorest performing segments should receive attention as soon as possible so profitability is improved as quickly and significantly as possible.

Catastrophic Loss Seminar at the 2003 Annual Meeting and Seminars

Editor's Note: At the CPCU Society's 2003 Annual Meeting and Seminars held in New Orleans, we had some excellent presentations on CAT modeling by Matthias Weber, Ph.D., and Michael J. Stone, J.D. Since the presentations were in PowerPoint format, we have decided to post them on the web at the Underwriting Section site, <http://underwriting.cpcusociety.org>.

To peak your interest, I thought I would include the following . . .

■ **Matthias Weber, Ph.D.**, is head of property underwriting for Swiss Re America. He joined Swiss Re Zurich as an expert for natural perils in 1992, and in 1997, supported Swiss Re New Markets in developing Swiss Re's first Cat Bond. Following a series of promotions, Weber became regional executive for the Western Region in 2000. In that capacity he was responsible for all of Swiss Re's client relationships in the 11 western states. Since 2001, he heads the property underwriting segment of U.S. Direct. Weber graduated from the Swiss Federal Institute in Zurich with an M.S. in physics, and holds a Ph.D. in natural sciences.

■ **Michael J. Stone, J.D.**, is president and COO of RLI Corp., Peoria, IL, with overall responsibility for all operations of RLI Corp's Insurance Subsidiaries, RLI Insurance Company, and Mt. Hawley Insurance Company. Stone joined RLI as vice president, claims, in 1996 and was named senior vice president and executive vice president in 1998. He spent the prior 18 years with Travelers Insurance Company in Hartford, CT. Stone received his J.D. magna cum laude from the University of Louisville.

CAT Remodeling— A Reinsurer's Perspective

The CAT Remodeling—A Reinsurer's Perspective presentation provides insights on Event Loss-Frequency Relationships as well as CAT risk management. How do deductibles, sublimits, co-insurance, and exclusions impact the equation? The CAT risk management goal is to avoid unacceptable loss burdens and optimize returns and diversification by CAT accumulation control, risk adequate pricing, and performance measurement.

Natural catastrophes don't necessarily need to be catastrophic. But, this requires:

- data and information
- scientific, technical, and statistical methods
- guidelines and control mechanisms
- focused, highly-trained CAT risk managers with a lot of expertise

RLI—Management of Catastrophic Risk Exposure in Today's Market

Management of catastrophic risk exposure is heavily impacted by:

Corporate Philosophy

- controlled concentration of risk
- adequate pricing for capacity
- front-line underwriter is key
- expertise and knowledge
- relationships
- tools

Industry Considerations

- rating Agencies
- reinsurer relationships
- dynamics of models
- finding and retaining talent
- empowering the underwriter
- market trends

The focus of the presentation takes us to translating corporate philosophy into underwriting practices. How do we utilize corporate exposure reports? How do we get from analytics to impacting what happens at an underwriter's desk?

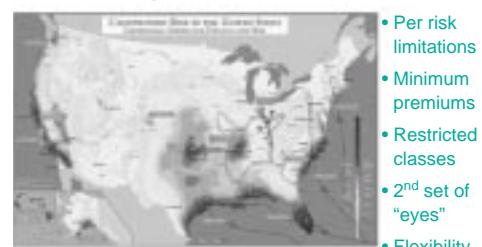
Do you know what the Probability of Exceedance may represent?

Probability of Exceedance, Cumulative & Critical Exposure, AAL



What are the impacts of underwriting guidelines?

Underwriting Guidelines



Catastrophe management is not an event, but rather a continuous cycle.

Catastrophe Management Cycle



The presentation goes on to discuss using catastrophe analysis tools in the underwriting process especially as it relates to earthquake and use of portfolio reports.

Visit the Underwriting Section web site, <http://underwriting.cpcusociety.org> for additional information. ■

The CPCU Society Presents . . .

“Reach for the Stars!”

**60th Annual Meeting and Seminars
Los Angeles, CA, October 23-26, 2004**



Join other CPCUs, new designees, and industry VIPs in Los Angeles for the best in education, networking, and leadership the property and casualty insurance industry has to offer—and to “Reach for the Stars!”

- ★ Focus your continuing education on the skills—and CE credits—you need to succeed, with **more than 20 Property and Casualty Insurance Track seminars** to choose from.
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- ★ Meet CPCU Society members, colleagues, and industry leaders who can influence your success at **an exciting variety of Special Events**.
- ★ Open your eyes, your heart, and your mind to a radical redefinition of the leadership skills you and your organization need with **2004 Keynote Speaker Tom Peters**, renowned business thinker, speaker, and best-selling author.
- ★ Celebrate 60 years of CPCU Society success at special **60th anniversary celebratory and recognition events** throughout the Annual Meeting.

Register Today!

It's the professional development event of the year. For the latest information about this year's meeting, to register online, or to download the registration form, visit the CPCU Society web site, www.cpcusociety.org. If you have any questions or if you'd like to request a registration form, contact the Member Resource Center at (800) 932-CPCU, option 5, or e-mail us at membercenter@cpcusociety.org.



Viewpoint: Perspective from the Insurance Industry Leadership

Editor's Note: As part of an ongoing process of conducting interviews of CEOs throughout the country, we had an opportunity to catch up with Bob Moone. Following are Bob's responses to some of our questions.

■ **Robert H. Moone, CPCU**, is chairman, CEO, and president of the State Auto Insurance Companies. He joined State Auto in 1970 in the commercial underwriting department. He had received a bachelor of arts degree in psychology from The Ohio State University four years earlier.

His career in field underwriting included various commercial lines supervisory and management roles at State Auto, culminating in a branch underwriting manager position in 1980. After assuming posts as manager of sales development, director of marketing, and director of sales and marketing in the 1980s, Moone became executive vice president of Insurance Operations in 1993. He was elected president and COO in 1996, and added CEO to his title in 1999.

Moone has served on the Insurance Education Foundation Board from 1996 to 1999, and currently sits on several non-profit community boards. He holds the Chartered Property Casualty Underwriter (CPCU) insurance designation.

State Auto is a multi-line property and casualty insurer operating in 26 states, primarily in the Midwest and South. Founded in 1921, State Auto is rated A+ (Superior) by the A.M. Best Company, the premier authority on insurance company stability and solvency in the United States.

How long do you expect the hard market to last?

I believe there will be a continuation of escalating commercial pricing through, at least, 2004. Clearly, the pace of increases has diminished, but there is little likelihood of a return to the insanity of the soft market days.

What is your company's position on credit scoring? Why?

We use credit scoring in those states where permitted and within the guidelines established by the various departments of insurance. We see this as a basic fairness issue, where pricing is based on loss expectancy. Elimination of subsidy among discrete market segments is one of our objectives.

What is the single largest external threat that you foresee for the industry from an underwriting perspective?

Increased regulatory involvement growing out of the efforts of uninformed (or perverse) activists. The movement to use the insurance mechanism for "social engineering" is alive and may be gaining momentum.

What is the single greatest opportunity that you project for the industry from an underwriting perspective?

If companies can maintain focus on disciplined underwriting and responsible pricing there is a chance to overcome industry-wide reserve deficiencies, provide stable markets for consumers, and return value to shareholders.

How has technology transformed the way in which your company conducts business (or has it changed it at all)?

We have become much more efficient. Over the past seven years the company has doubled in size and our productivity (as measured by written premium per employee) has increased by 25 percent. More than 50 percent of our new personal lines applications and change requests are now received via agency upload.

What advice would you give to current underwriters looking to position themselves for the future?

Earn their CPCU designation and work hard at carrying out their company's strategies. If they do not agree with or support those strategies, find another company that is more aligned with their own.

What is your prediction for the future of the independent agent system?

We see no signs of the demise of the independent agency system. It will continue to be populated by fewer, but much larger, agencies. The commercial lines segment is dominated by independent agents and recent studies suggest growth in the personal segment as well. We will continue to distribute exclusively through independent agents. ■



The Underwriting Section is proud to announce that it will sponsor an informative seminar at the 2004 Annual Meeting and Seminars in Los Angeles!

Alternative Risk Markets—Not So Alternative Anymore

Tuesday, October 26, 10 a.m. - Noon

What You Will Learn

Recent marketplace events have propelled the property and casualty industry into rapid and successive market cycles. At the same time, mergers and acquisitions and other economic influences have disrupted some markets. As the selection of risks and markets becomes ever more important, understanding specialty segments will be critical for all insurance professionals. Attend this session to learn about available alternative risk markets: what they are, how they were created, and what purpose they serve.

Presenters

George Estes

Discover Re

Richard G. Rudolph, Ph.D., CPCU

Seaver, Rudolph & Associates

James L. Sandner, CPCU

Brokers' Risk Placement Service, Inc.

John Shea, CPCU

Tangram Program Managers

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Underwriting Trends Editor

U.K. "Rick" Becker, CPCU
Nationwide Insurance Group
7545 Midlothian Turnpike
Richmond, VA 23225
Phone: (804) 675-3585
Fax: (804) 675-3592
e-Mail: beckerr@nationwide.com

Underwriting Section Chairman

David S. Medvidofsky, CPCU, CIC, AAI
Information Systems and Services Corp.
55 West Street
Keene, NH 03431
Phone: (603) 358-1359
Fax: (603) 358-1167
e-Mail: medvidod@msagroup.com

Sections Manager

John Kelly, CPCU
CPCU Society

Managing Editor

Michele A. Leps, AIT
CPCU Society

Production Editor/Design

Joan Satchell
CPCU Society
CPCU Society
PO Box 3009
Malvern, PA 19355-0709
(800) 932-2728
www.cpcusociety.org

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CPCU Society
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