

The Driving Forces Behind Rate Change

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If you upgrade your Ford Focus to a Mustang before your next auto insurance renewal, would you expect to pay more? After all, you still only have one car. I don't think anyone would be surprised to pay more in this situation. So why then do design firms and contractors get surprised by a premium increase when their annual fees/revenues remain the same, but they are performing work in different disciplines or doing different kinds of projects than last year?

The year over year exposure change is more than just a change in the rating basis. It's the change in the firm's entire risk profile. As a dramatic example, suppose a firm does \$10 million of civil engineering work one year, but the next year that same firm does \$10 million of structural engineering work. The firm will pay more in year two simply because they are engaging in a discipline with more risk.

This is the basic underlying concept of what actuaries mean by exposure-adjusted rate change. If the premium charged in the second year only reflected the move from civil work to structural work, the exposure-adjusted rate change would be zero. We fundamentally need to charge additional premium for the type of work that is more likely to give rise to more severe claims simply due to the nature of the work.

On top of that, we also need to charge more for the rising cost of claims over time because of inflation. Inflation can take the form of economic inflation, which we are seeing reflected in the rising cost of goods and services these days. It can also take the form of social inflation, which is a term meant to include things like larger jury awards and a broader definition of what it means to meet the standard of care when rendering professional services.

At Berkley Design Professional, we've given our underwriters the tools and training needed to identify and discuss in detail the different components of premium changes at renewal time. Breaking this down into risk profile or exposure changes and inflationary changes provides more transparency into our pricing. Our goal is long-term sustainable pricing so that we can be here to protect our policyholders for many years.

So next time you are working with one of our underwriters on a renewal, ask them to explain the components of the exposure-adjusted rate change. They'll know you were cornered by an actuary at a cocktail party! 😊



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