business automobile book of business will include policies that were not written up to AmberRock's standards.

If AmberRock's underwriting staff plans to incorporate Singlewing's policies into AmberRock's existing book of business, they might be willing to accept the risk characteristics as they are currently written. However, they might determine that reunderwriting Singlewing's portfolio to the same underwriting guidelines applied by AmberRock would provide the best opportunity for profitable results. Assuming the latter is the case, AmberRock must determine the cost of reunderwriting and any loss of written premium resulting from nonrenewals (if permitted by the states in which the policies are written). In some situations, the costs associated with acquiring a book of business are greater than a company can assume and still remain profitable.

APPLYING THE REUNDERWRITING PROCESS

To successfully complete this activity, you should first have mastered the following subject areas:

- Purpose of Reunderwriting a Book of Business
- Sources Used to Identify the Need to Reunderwrite a Book of Business

The effectiveness of reunderwriting a book of business depends on the ability to correctly identify the problem or problems within a book of business and to choose the appropriate corrective activity. Because of the limitations in the possible corrective actions that are available to resolve problems, analyzing and identifying the problems are crucial. If staff members make an error in identification and take corrective action based on that error, a significant amount of time may pass before the actual cause of the problem can be identified and effective action taken. By the time effective action can be taken, loss results may have deteriorated. These activities, by requiring you to consider the facts provided and answer the Knowledge to Action questions, will help you make the transition from understanding the concepts of reunderwriting to applying that understanding to real life scenarios.

Case Facts

AmberRock Insurance Company writes commercial lines policies across the eastern half of the United States. You are a member of AmberRock's home office underwriting staff. You analyze the company's premium, policies in force (PIF), and loss results on a monthly basis. You are concerned about a rising loss ratio in AmberRock's businessowners policy (BOP) book of business. Looking at premium, PIF, and loss results as compared to goals for the first six months of the year, you have noted that loss counts are trending well above goal. Based on this information, you must identify any underlying problems and recommend corrective actions to improve the underwriting results. See the exhibit "Six-Month Results for AmberRock's BOP Book of Business."

Six-Month Results for AmberRock's BOP Book of Business

	Premiums				Policies					Losses					
	Written percent of goal (000s)		Earned percent of goal (000s)		PIF	New policies	Retention	Incurred percent of goal (000s)		Loss count percent of goal		Average loss	Loss ratio
Annual Goals (Monthly goals are an even distribution of annual goals throughout the year.)													
	$7,000		$6,650		16,471	3,294	80%	$4,300		3,909		$1,100	65%
YTD Results													
Jan.	$ 583	100%	$ 554	100%	15,976	275	80%	$ 394	110%	358	110%	$1,100	71%
Feb.	$1,167	100%	$1,086	98%	16,059	1,043	81%	$ 781	109%	710	109%	$1,100	72%
Mar.	$1,715	98%	$1,613	97%	16,108	1,290	80%	$1,161	108%	1,143	117%	$1,015	72%
Apr.	$2,263	97%	$2,150	97%	16,388	1,675	81%	$1,562	109%	1,642	126%	$ 952	73%
May	$2,858	98%	$2,715	98%	16,553	2,059	81%	$1,989	111%	2,248	138%	$ 885	73%
June	$3,465	99%	$3,292	99%	17,294	2,471	81%	$2,430	113%	2,834	145%	$ 857	74%
	Written and earned premiums are roughly on target for YTD results compared to the annual goals. The earned premium is about 95% of written premium because this is a line of business that is growing.				Retention is on target YTD. However, at six months, the new policy count has reached 75% of the annual goal. These new policies have been reviewed and are determined to meet underwriting guidelines.			Through six months, incurred losses are 13 percent above the YTD goals, and the number of losses is 45 percent above the YTD goals. The result is a loss ratio, which is substantially above goal and increasing.					

[DA08525]

Case Analysis Tools

Loss results for the first half of the year for AmberRock Insurance Company's BOP book of business will be used as the basis for identifying trends and underlying problems that are creating a variance between AmberRock's goals and results.

Overview of Steps

Keeping a book of business on track to achieve established goals requires timely identification and correction of negative trends. As an AmberRock staff underwriter responsible for underwriting results, you will complete these steps:

- Analyze the book of business
- Identify problems
- Identify possible corrective actions
- Select corrective actions
- Implement corrective actions
- Monitor the book of business

Step 1: Analyze the Book of Business

To analyze a book of business for the purpose of identifying problems, you must first determine how to organize available data to identify patterns. Begin by reviewing loss results for the first half of the year. See the exhibit "Six-Month Loss Results for AmberRock's BOP Book of Business."

Six-Month Loss Results for AmberRock's BOP Book of Business

	Losses					
	Incurred (000s)	Percentage of goal	Loss count	Percentage of goal	Average loss	Loss ratio
Annual Goals (Monthly goals are an even distribution of annual goals throughout the year.)						
	$4,300		3,909		$1,100	65%
YTD Results						
Jan.	$ 394	110%	358	110%	$1,100	71%
Feb.	$ 781	109%	710	109%	$1,100	72%
Mar.	$1,161	108%	1,143	117%	$1,015	72%
Apr.	$1,562	109%	1,642	126%	$ 952	73%
May	$1,989	111%	2,248	138%	$ 885	73%
June	$2,430	113%	2,834	145%	$ 857	74%

Through six months, incurred losses are 13 percent above the YTD goals, and the number of losses is 45 percent above the YTD goals. The result is a loss ratio, which is substantially above goal and increasing.

[DA08533]

AmberRock established an earned premium goal of $6.65 million and a year-end loss ratio goal of 65 percent. To achieve this goal, based on targeted earned premiums and loss ratio, AmberRock established a goal of $4.3 million in incurred losses. Knowing average loss results for prior years, AmberRock estimated a $1,100 average loss figure. Current incurred losses exceed the year-to-date (YTD) goal of $2.15 million (established by dividing the annual goal of $4.3 million by twelve months to determine a monthly goal and multiplying the monthly goal by six), and the loss trend is moving upward.

Knowledge to Action

What does a high-level review of AmberRock's BOP results for the past six months appear to reveal?

a. A decline in new business written
b. A loss of more profitable business to competitors
c. An increase in loss frequency
d. An increase in loss severity

Feedback: c. The YTD goal for loss count, or number of losses, is 45 percent above the six-month goal, indicating a loss frequency problem. The average loss of $857 (calculated by dividing the loss count by the incurred losses for each month) is well below the established goal of $1,100 and is steadily decreasing, indicating that the rising loss ratio is being driven by loss frequency, not loss severity, with a significant increase in the number of smaller losses. If the opposite were true—if the loss ratio appeared driven by higher average losses—you could request or prepare a report with any shock losses backed out in order to get a better picture of loss trends.

Following an underwriting rule of thumb, you recognize that deteriorating results caused by a loss frequency problem can indicate a policy selection shortcoming (while unprofitable results caused by a loss severity problem would indicate pricing inadequacy). Therefore, an underwriting audit is also a logical step. However, an audit may not be effective until the source of the problem has been identified. For example, an analysis of losses may reveal a need to change underwriting guidelines. If so, an audit may not reveal any problems if underwriters are following existing, albeit outdated or flawed, underwriting guidelines.

Knowledge to Action

You have identified a loss frequency problem, but further analysis is needed to determine the cause. What is your probable next step in analyzing the book of business?

a. Examine market conditions where AmberRock writes business to determine whether goals are realistic
b. Analyze pricing for the purpose of recommending pricing adjustments as soon as possible because pricing changes may take a considerable amount of time to implement
c. Examine claim data for the past six months to look for patterns in losses
d. Conduct an underwriting audit to determine whether problems exist in risk selection practices