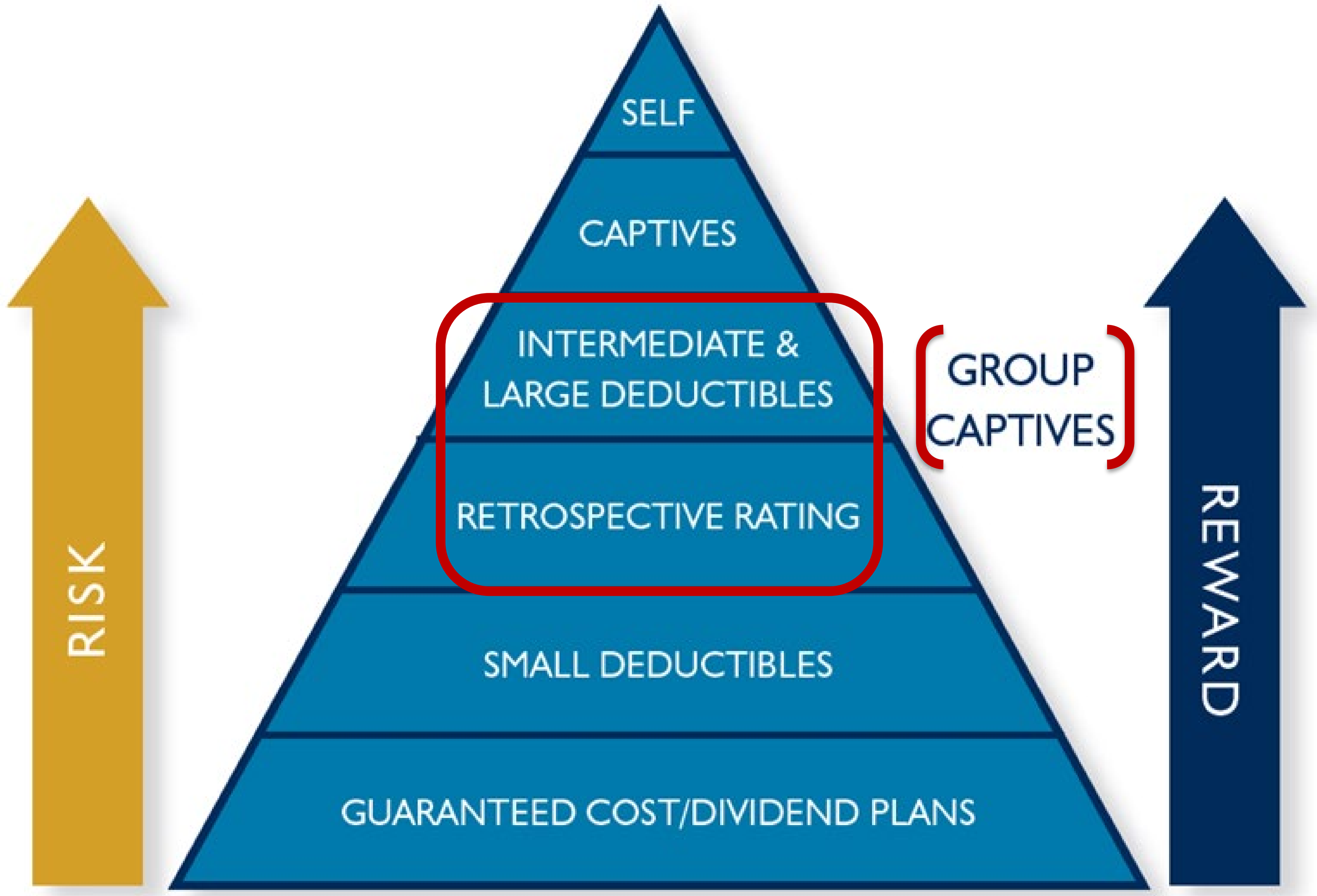
OceanusPartners
a ReSourcePro company

LOSS SENSITIVE RATING PLANS

Module 5

“How confident are you that you have the “Best Fit” risk financing plan?


SELF
CAPTIVES
INTERMEDIATE &
LARGE DEDUCTIBLES
RETROSPECTIVE RATING
SMALL DEDUCTIBLES
GUARANTEED COST/DIVIDEND PLANS
GROUP
CAPTIVES
RISK
REWARD

RETROSPECTIVE RATING PLANS

(RETRO)

WHAT IS A RETROSPECTIVE RATING PLAN?

- A rating plan that adjusts the premium based on the losses,

- Subject to a certain minimum and maximum,

WHAT IS A RETROSPECTIVE RATING PLAN?

The plan is based on a formula established by a contract.

RETROSPECTIVE RATING PLAN FORMULA

Basic Retrospective Rating Plan Formula

[Basic Premium + Converted Losses] × Tax Multiplier = Retro Premium

(Subject to Minimum and Maximum)

RETROSPECTIVE RATING PLAN FORMULA

Basic Premium

Basic Premium	=	Standard Premium	X	Basic Premium Factor
		After Experience Modification Factor/Before Stock Premium Discount		Developed by Insurance Company

RETROSPECTIVE RATING PLAN FORMULA

Converted Losses

Converted Losses	=	Losses	X	Loss Conversation Factor
		Incurred or Paid Depending on Plan		Developed by Insurance Company

SAMPLE RETRO QUOTE

Standard Premium	$500,000
Basic Premium Factor	.40
Maximum Premium Factor	1.25
Loss Conversion Factor	1.10
Tax Multiplier	1.06

RETROSPECTIVE RATING PLAN FORMULA

Basic Premium

$200,000	=	$500,000	X	.40
		After Experience Modification Factor/Before Stock Premium Discount		Developed by Insurance Company

RETROSPECTIVE RATING PLAN FORMULA

Basic Retrospective Rating Plan Formula

[$200,000 + Converted Losses] × 1.06 = Retro Premium

(Subject to Minimum and Maximum)

TYPES OF RETRO PLANS

Incurred Loss Retro

Paid Loss Retro

INCURRED LOSS RETRO

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INCURRED LOSS RETRO

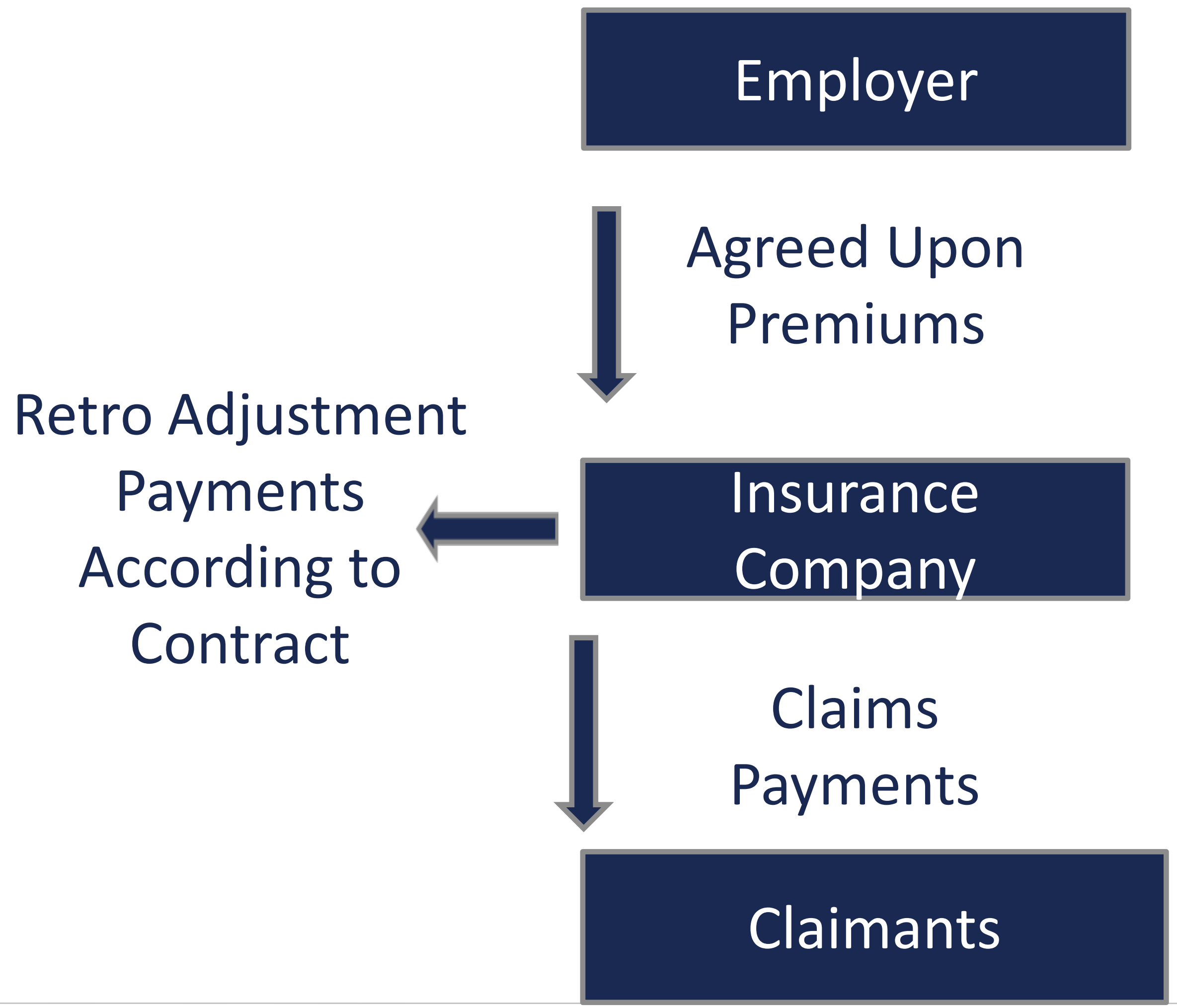
Funding is like Guaranteed Cost;

Employer pays insurance company approximately the same as a Guaranteed Cost monthly premium;

Adjustments (Return of Premium or Additional Premium Owed) are made according to the contract.

Usually, 6 months post policy period and annually, thereafter.

INCURRED LOSS RETRO MAP



PAID LOSS RETRO

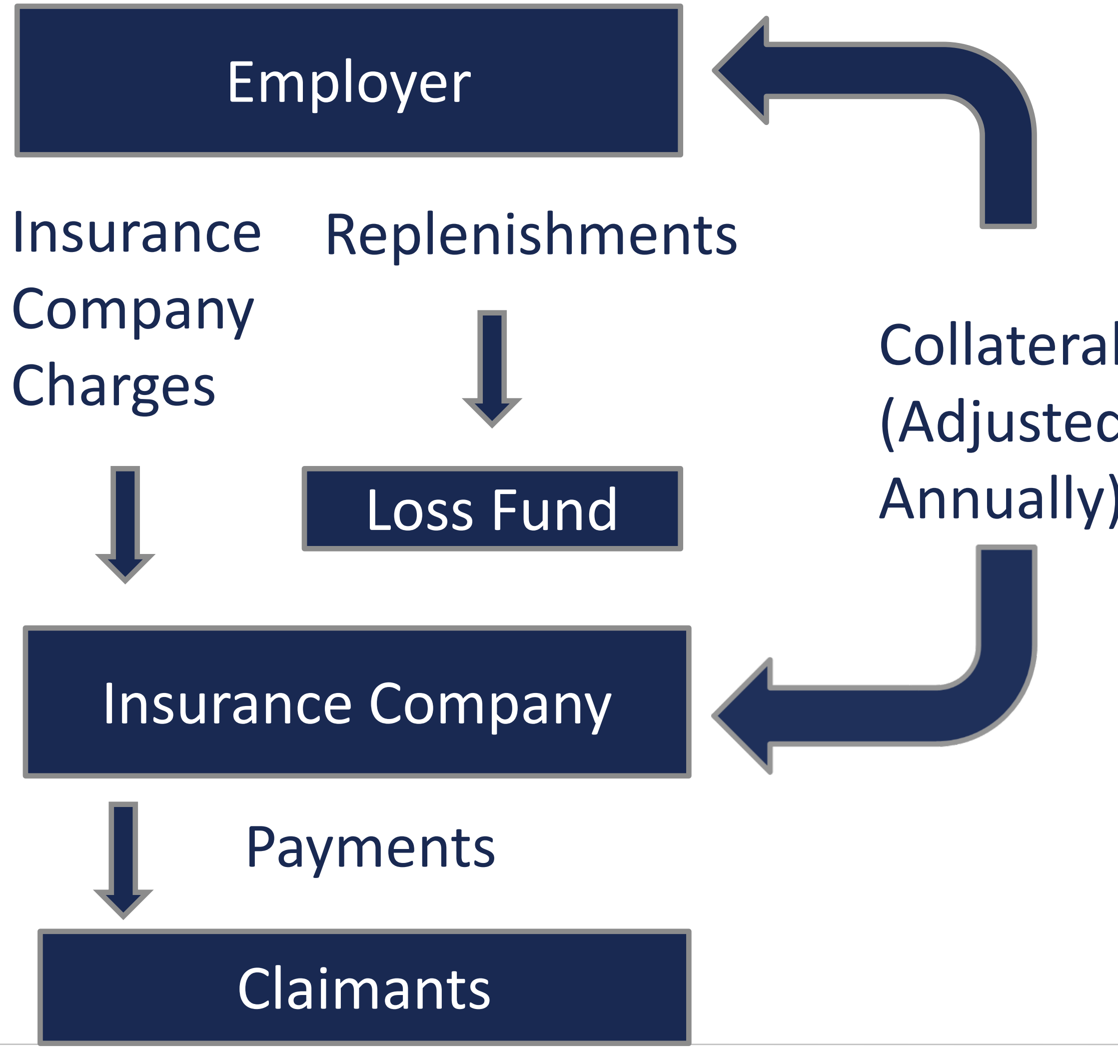
PAID LOSS RETRO

Employers pays a percentage of the Basic Premium on a monthly basis; (usually 1/12)

Employer pays converted loss amounts as claims occur;

Employers pays claims amounts until either claims are closed, or the Maximum Retro Premium is reached

PAID LOSS RETRO MAP



	Quote A	Quote B
Type of Plan	Paid	Incurred
Guaranteed Cost Premium	$448,810	$448,810
Standard Premium	$500,000	$500,000
Basic Premium Factor	.45	.40
Loss Conversion Factor	1.10	1.10
Tax Multiplier	1.06	1.06
Min. Premium Factor	0.477	.424
Max. Premium Factor	1.25	1.25
Minimum Premium	$238,500	$212,000
Maximum Premium	$625,000	$625,000
Losses Equal to Guaranteed Cost	$180,368	$203,096
Losses Equal to Maximum Premium	$331,475	$354,202
Maximum Risk Exposure	$176,190	$176,190

ASSESSING THE RETRO CONTRACT TO AVOID SURPRISES

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Premium calculations greater than the formula would indicate.

ASSESSING THE RETRO CONTRACT TO AVOID SURPRISES

Example: Basic Premium Factor of .40

But …

"Minimum premium is 60% of Standard Premium"

ASSESSING THE RETRO CONTRACT TO AVOID SURPRISES

Watch out for "Noogie Factors" added to losses

IBNR (Incurred But Not Reported)

LDF (Loss Development Factors)

ASSESSING THE RETRO CONTRACT TO AVOID SURPRISES

Conversion to Incurred Loss Plan from Paid Loss Plan at a specified time.

Incurred Losses (Paid + Reserves) are converted to Paid.

ASSESSING THE RETRO CONTRACT TO AVOID SURPRISES

Basic Factor contingent on a Dividend being declared.

THE ADVANTAGES AND DISADVANTAGES OF RETRO PLANS

Advantages	Disadvantages
Net costs can be lower when losses are reduced	Adverse loss experience creates higher costs
Maintains insurance company services	Uncertainty regarding budgets and final premium – multiyear

THE ADVANTAGES AND DISADVANTAGES OF RETRO PLANS

Advantages	Disadvantages
Potential cash flow benefits	Collateral reduces liquid capital
Provides rating plan options and flexibility	Uncertainty regarding budgets and final premium – multiyear

INTERMEDIATE AND LARGE DEDUCTIBLE PLANS

LARGE ACCOUNT DEDUCTIBLES

Intermediate Deductibles	Large Deductibles
• $25,000 • $50,000 • $75,000	• $100,000 • $250,000 • $500,000

TYPES OF DEDUCTIBLES

Specific Deductible

- Deductible per claim

Aggregate Deductible

- Maximum claims losses per policy period

TYPICAL “RIGHT FIT” SIZE OF ACCOUNT (VARIABLES

Intermediate Deductibles

- $150,000 to $250,000 Premiums and Up

Large Deductibles

- > $500,000 Premiums

STRUCTURE OF INTERMEDIATE AND LARGE DEDUCTIBLE PLANS

Premiums + Claims* + Expenses + Assess-ments

=

Total Cost

*Potentially, Subject to Aggregate Stop Loss

Claims Administration Expenses

Unallocated Loss Adjustment Expenses + Allocated Loss Adjustment Expenses = Expenses

ULAE AND ALAE

ULAE

- Cost to the insurance company to manage claims department

ALAE

- Charges related to the adjustment of individual claims

UNALLOCATED FIXED FEE EXAMPLES*

Per Claim Fee

- $ 150 Medical Only*
- $1,500 Indemnity*

Loss Conversion Factor

- 1.07 X Claims' Cost*

RATING MODELS

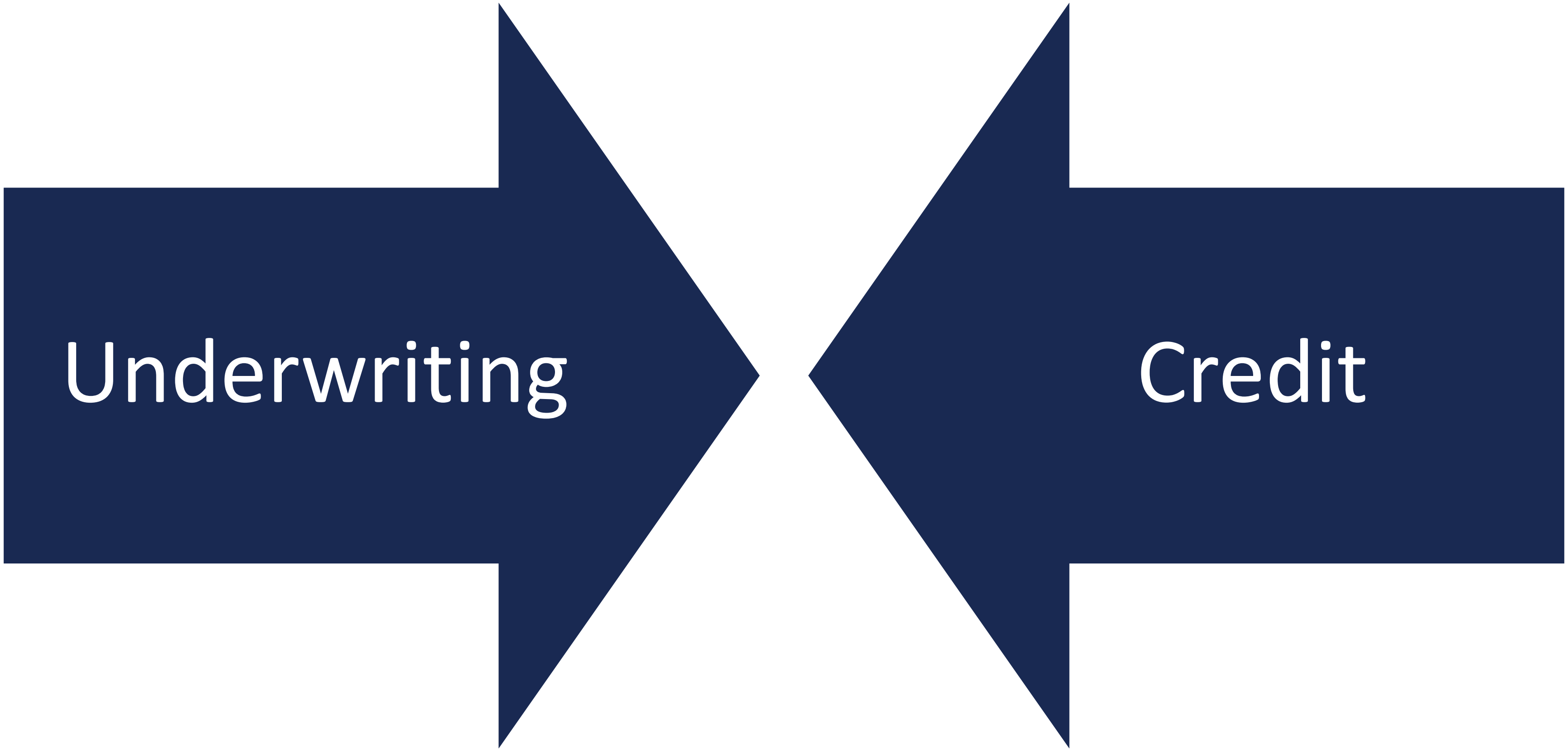
Credit off Standard Premium

- Traditional Premium Algorithm

Composite Rate/$100

- One Rate X Total Payroll

CARRIERS' RISKS



COLLATERAL PROVISIONS

Collateral is a

BIG DEAL

COLLATERAL PROVISIONS

How is it calculated?

What are the standards for adjustments in future years?

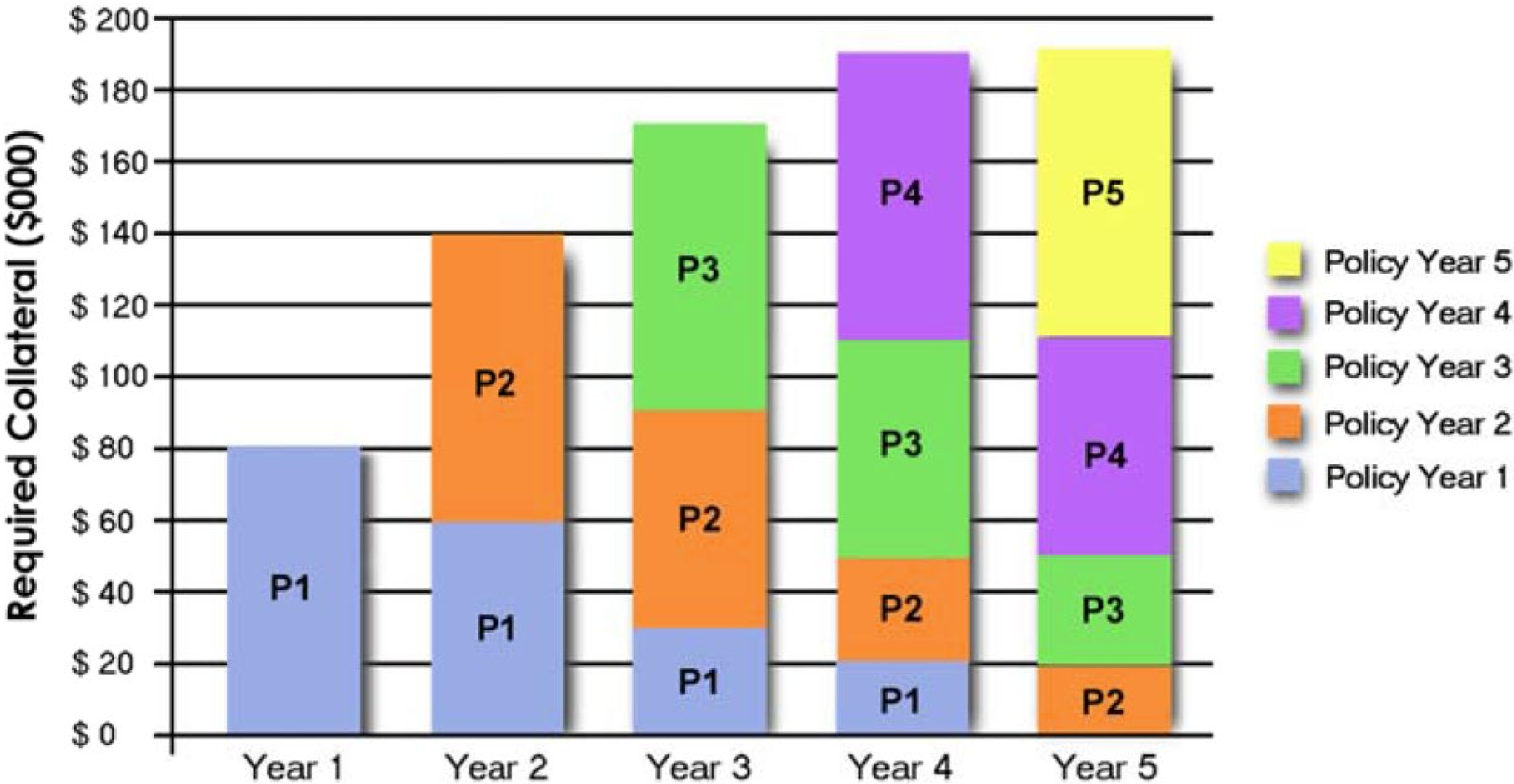
COMPUTING COLLATERAL REQUIREMENTS

$ The total ultimate losses for all past deductible years (if any) is calculated by the insurance company's actuaries.

+ The total of all claims paid to date is subtracted from ultimate losses.

An estimate of the losses for the new policy period is added.

HOW COLLATERAL BUILDS



RECAP AND Q & A