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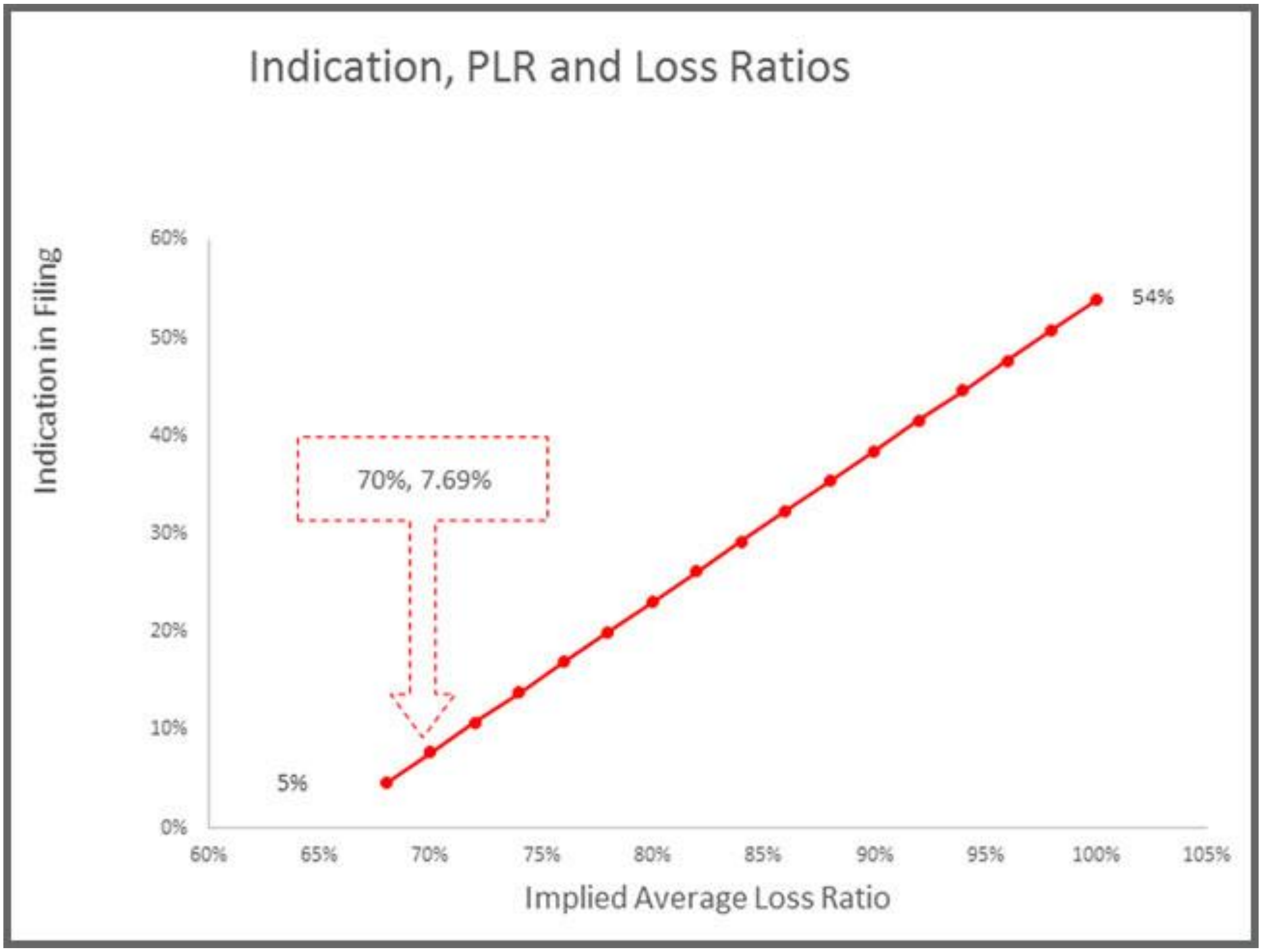
STUDENT OF THE INDUSTRY PARTING SHOT

What's in a Rate Indication?

By Paul Buse, President of Big I Advantage®

"XYZ insurer is increasing its rates, **the rate indication is 8%.**" What's a rate indication? What does that mean?

A rate indication is what an insurer thinks it needs to increase its rates by in order to achieve a target loss ratio or the "Permissible Loss Ratio" or "PLR." This math is important because in most situations we deal with as agents, our insurers cannot just charge any amount they want to. They have to seek approval of pricing changes from a state insurance regulator. In doing this, insurers go through an exercise of comparing what the loss ratio **should be** to what the loss ratio **is**.



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So how does our insurer arrive at a needed "rate indication" of 7.69%? First they estimated what they think the loss ratio on the book of business is now. They do this by looking at the past five years or so and adjusting the premiums and losses to current dollars and then averaging it. In this example, the insurer believes the average policy has a loss ratio of 70% at current prices. Getting to the "rate indication" this is a quick division (see below) and the insurer gets to 7.69% or about 8%.

$$Rate\ Indication = \frac{Average\ Loss\ Ratio}{Permissable\ Loss\ Ratio} - 1.0 = \frac{.70}{.65} - 1.0 = 7.69\%$$

Next time we'll look at the all-important PLR and what goes into that.