



CARIBBEAN ACTUARIAL ASSOCIATION



Accredited as a Full Member  
of the International Actuarial Association

# **2011 Conference: *“Tailoring Actuarial Practice to Caribbean Reality”***

21<sup>st</sup> Annual CAA Conference

Hyatt Regency Hotel, Trinidad

November 30 - December 2, 2011



CARIBBEAN ACTUARIAL ASSOCIATION



Accredited as a Full Member  
of the International Actuarial Association

# Pricing group health business in a competitive environment

**Marcus Bosland FSA**

December 1, 2011

# Market for Group Health

- Organizational market
  - Sold to organizations (employers, labour unions, associations) by insurers, associations of underwriters, etc.
- Derived demand
- Demographics - Fewer in number, larger
  - Makes direct selling particularly effective
  - Permits close relationships between seller and buyer
- Use of professional advisors to assist purchases

# Generic pricing

---

- Set strategic pricing objective
- Estimate demand and price elasticity of demand
- Determine costs and their relationship to volume
- Examine competitors' pricing and costs
- Select pricing method
- Set a price
- Adapt to recognize variations

# Strategic pricing objectives

- Maximize sales growth – low price above costs
- Maintain quality or service differentiation – high price relative to competitors
- Maximize current profit – Set price to maximize profit
- Survival – reduce price even below total cost as long price covers variable price

# Demand and cost

- Demand and relationship to price
  - No such thing as the right price but rather the right prices
- Costs
  - Understand sources of economies of scale
  - Don't take it for granted that bigger = cheaper
  - Determine how to reflect economies in pricing
  - Understand variable costs

# Examine competitors pricing & costs

---

- Difficult to know what competitors strategy is, but sometimes they tell you
- Regardless of their overall strategy, their tactics will differ group by group

# Pricing methods

---

- Cost-oriented methods
  - Markup including target return
  - Competition-oriented methods
  - Customer-oriented methods
  - All of the above

# Industry dynamics

# Industry dynamics

---

- Bargaining power of consumers
  - Large customers have significant power
  - Modest switching cost
  - Price sensitivity
- The intensity of competitive rivalry
  - Pricing cycles (hard/soft)
  - Soft market – aggregate premium goals exceed market size

# Industry dynamics

---

- Large groups – small or non-existent priced margins
- Small groups – small priced margins
  
- But will they be realized?

# Insurance dynamics

---

- Year to year claim fluctuations can be large
- Small margins + beneficial claims experience = everyone's happy
- Small margins - adverse claims = fire the actuary!

# Who prices group plans?

---

- V.P. Health
- Group underwriters
- Account representative
- Actuary

# What makes these people tick?

- Socially acquired needs include the need for achievement
  - Taking moderate risks by pursuing goals that are difficult but not impossible
  - Need immediate feedback on performance and goal progress
  - Finding task activities and accomplishments to be intrinsically rewarding
  - Defining work in terms of approaching success instead of avoiding failure
  - Being totally task absorbed until the job is done

# Rogue traders

- “The traits banks tend to look for when hiring new traders are the very same ones likely to make them go rogue, industry insiders and psychologists say.”
- Compliance company Actimize conducted a survey of investment firms which found that 45 percent of respondents thought regulators, financial crime units and the media would not be notified of rogue trading if a trader was earning, rather than losing, large sums of money

# Part technical, part animal spirits?

“there is the instability due to the characteristic of human nature that a large proportion of our positive activities depend on spontaneous optimism rather than mathematical expectations ... Most, probably, of our decisions to do something positive, the full consequences of which will be drawn out over many days to come, can only be taken as the result of animal spirits - a spontaneous urge to action rather than inaction, and not as the outcome of a weighted average of quantitative benefits multiplied by quantitative probabilities.”

Keynes (1936) - The General Theory of Employment, Interest and Money

# High on sales?

---

- New sales and successfully hard-fought renewals feed our need for achievement
- Profit emerges over time and has less of a direct link to our day-to-day activities

# High on sales?

---

Insurers perusing more growth than exists then:

- The average insurer fails to meet their target
- Winner's curse.

# Turnaround study

# Case study - CHBL

---

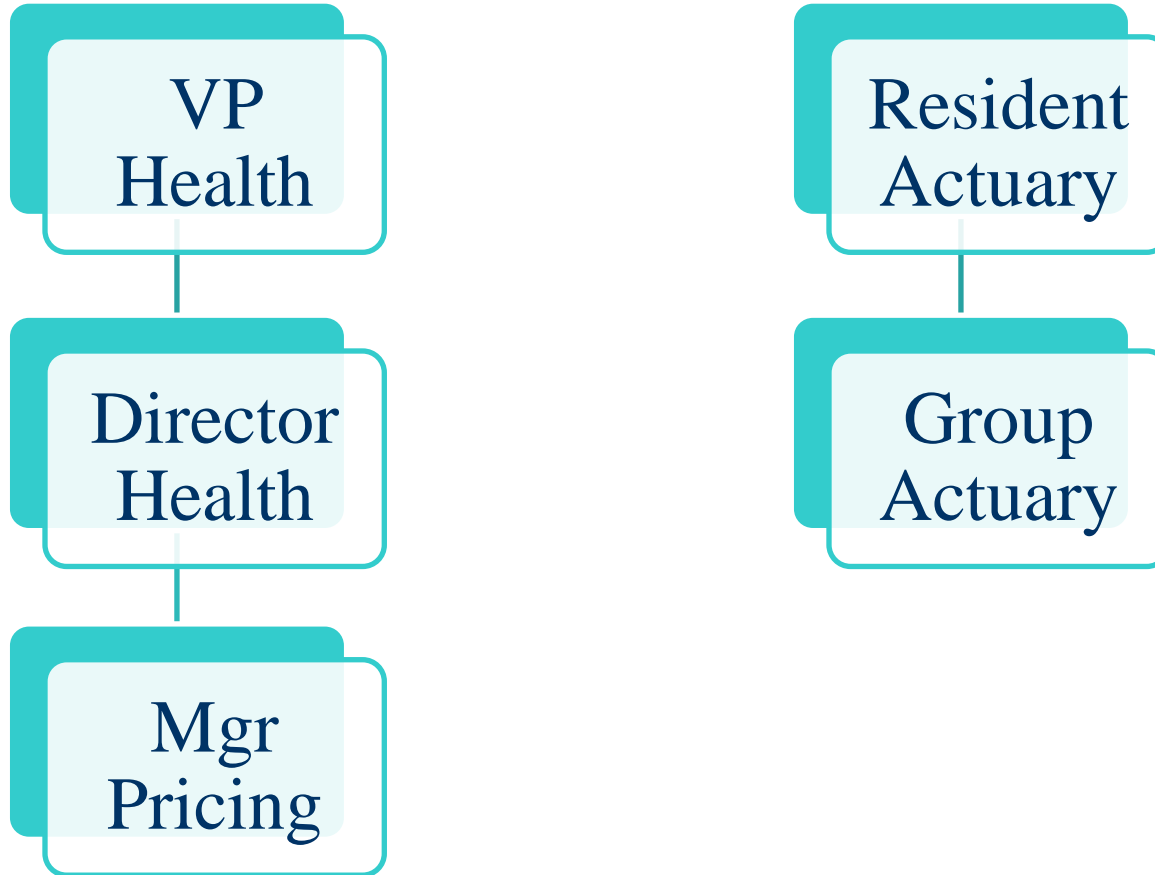
- I am pleased to confirm that Colina Holdings Bahamas Limited (CHBL) has had an exceptional year and has recorded its best ever financial results. (2006)

# Case study - CHBL

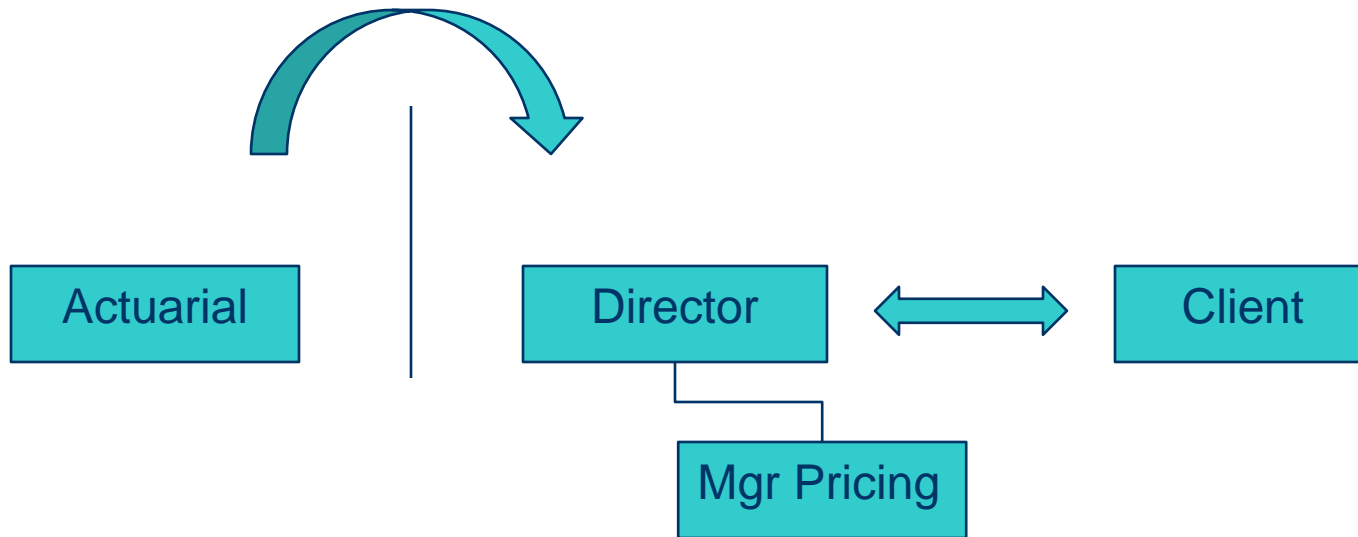
---

- The year 2007 has been a challenging year for the Company. The effects of increased medical claims experience had a significant impact on the operating results of the Company.
- Losses of over \$10 MM between group and individual medical

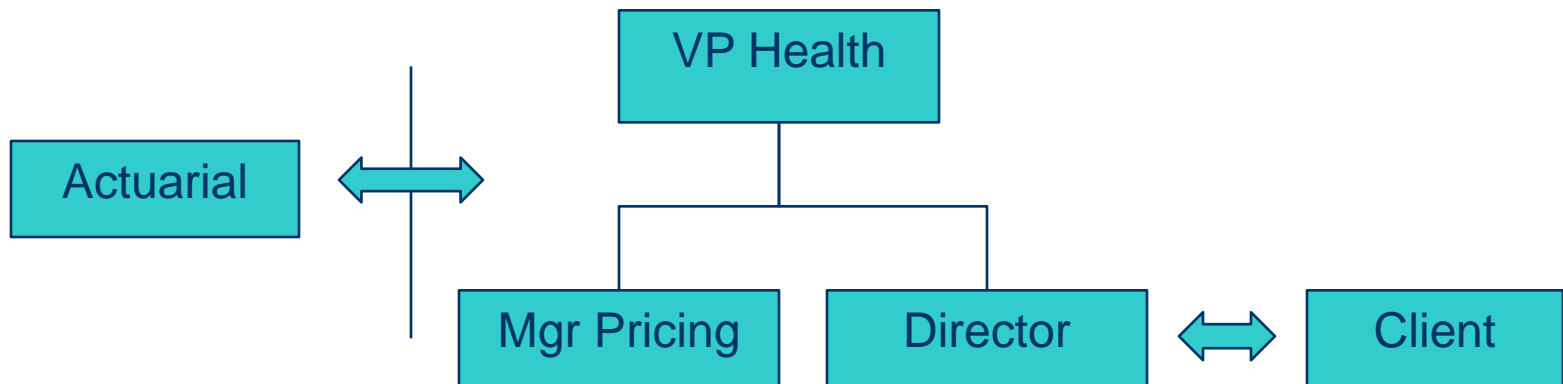
# Leadership



# 2007 group pricing governance



# 2008 group pricing governance



# Navigational tools

---

- Management info was not good enough
- Pricing tool not owned by Actuarial

# Strategic pricing strategy

- We will seek to increase prices so as to produce our targeted financial returns
- We will not accept expected losses beyond a particular threshold
- We expect that this will result in reduced business
- Communicate strategy as appropriate
  - Management
  - Board
  - Brokers

# Strategic pricing strategy

---

- Re-assess strategy
  - Internal metrics (loss ratios, persistency, new business)
  - External metrics

# Summary of turnaround strategy

---

- New leadership
- Develop and communicate clear strategy
- Improved financial reporting tools
  - More responsive IBNR method
  - Improved loss ratio reporting
- New group products
- Improved group pricing tools
- Improved group pricing governance

# Results

---

- Dramatic loss ratio improvement
  - Over 15% reduction in loss ratio between 2007 and 2009
- Loss of business
  - Lost approx. 20% of business
- Significant improvement in profit

# Critical success factors

---

- Sense of urgency
- Widely shared and accepted strategy
- Mutual trust between Actuarial and Group

Thank you

