INSURANCE BROKERS
ASSOCIATION OF SASKATCHEWAN

BRIEFING NOTE: BEST TERMS PRICING

Over the past few weeks, IBAS fielded several inquiries related to *best terms pricing*. This briefing note has been prepared to respond to frequently asked questions and is 'up to date' as of December 11, 2020.

WHAT IS *BEST TERMS PRICING*?

Best terms pricing (BTP) is a method of pricing a *subscription* insurance policy, where there are multiple insurers covering varying portions of a particular risk. These carriers are paid uniformly based on the highest rate offered, regardless of the risk allocation.

For example: A three-story condominium requires a $5 million insurance policy. A *lead writer* indicates it will cover 45% of the policy at a quoted rate of 18 cents per $100 of coverage, and now the broker must fill the remaining 55%. A second carrier agrees to the *lead rate* at 35% and a third agrees to the lead rate at 15%, leaving 5% of the policy remaining. A fourth carrier agrees to take on the additional 5% but requires a rate of 30 cents. Under BTP, the lead writer will then be asked to match the higher rate of 30 cents, followed by the additional subscribers until the full 100% is subscribed at the same rate. If a carrier provided a *lower* rate than that of the lead, it would be asked to lead the policy and the same process would be executed. This is a common practice on subscription policies, including both within the strata market and on other commercial risks, such as those related to farming, manufacturing, and heavy industry.

WHY CAN'T INSURERS USE *SPLIT PRICING*?

In contrast to BTP, *split pricing* is the concept that each carrier charges their specific quoted rate for their respective percentage of the risk. Using the above example, the first three carriers would collect an 18-cent rate, while the fourth would collect a 30-cent rate on 5% of the policy. While — especially in a hard market — split pricing could ultimately lead to lower premiums, and there is no regulation currently *preventing* this approach, there are two main issues that are of concern.

The first is technology. In preparing this briefing note, IBAS reached out to eight insurance companies representing roughly 70% of the total non-auto property premiums in Saskatchewan. Only one of these companies has a system in place that would allow it to be the lead writer in a split pricing scenario and another does not participate in subscription risks. The remaining six indicated that manual workarounds *were* possible, although all said that it would require varying degrees of technology upgrades, ranging from 'moderate changes' to 'complete overhauls.' SGI CANADA, for instance, which is the lead writer on a large percentage of subscription policies in the province, could not retain that lead writer position in a split pricing scenario using their current platform.

The second issue is a mix between capacity and market dynamics. In Saskatchewan, a trio of insurers are responsible for close to three-fifths of the total non-auto property market capacity. The remaining 98 companies, meanwhile, write an average of only $4.5 million in property premiums annually. Due to this limited volume and, in some cases, to a lack of underwriting capability, many (particularly small) insurers rely on BTP as a substitute for more sophisticated rating practices. This injects additional capacity into the market leveraging the efforts of other insurance companies without requiring small-volume players to incur prohibitive underwriting costs.

WHAT IMPACT HAS BEST TERMS PRICING HAD ON THE CONSUMER?

There are many situations in which BTP does have upward pressures on premiums. IBAS has seen several policies where BTP has led to premiums between 15% and 25% higher than what would have been incurred if split pricing had been applied.

It is important to note, though, that BTP is significantly more impactful in a hard market than in soft or regular market conditions. In the latter, there is generally excess capacity and competition for most risks, even if a risk is on a subscription policy. This results in carriers meeting the rate set by the lead writer, or attempting to win that business and take over as the lead writer by offering a lower rate. But, in a hard market, brokers more often than not find themselves struggling to secure capacity to fill the subscription; and it is not uncommon to require four or more subscribers to some policies — either because of the unique challenges of that specific risk or the limitations of carriers' reinsurance treaties that prevent them from taking a larger share of the risk.

It is also key to recognize there are sound and ethical reasons why different insurance carriers would require different rates on the same risk. Publicly traded companies, for instance, have more stringent return on capital expectations than mutuals or government-owned insurers. Loss history, reinsurance, and access to underwriting data are other factors to keep in-mind.

WHAT ABOUT *WEIGHTED AVERAGE PRICING*?

IBAS has been informed that some regulators are exploring the concept of *weighted average pricing* as an alternative to BTP, whereby an average of bids — weighted for the percentage of risk each insurer is taking — would be calculated to arrive at a singular price for the entirety of the policy. While this approach *does* address technology limitations, it *does not* take into account many of the other factors at play.

For example, if the weighted average of a risk is 20 cents, but an insurer requires 25 cents to participate on that policy, it effectively takes capacity out from an already hard market. Additionally, it is reasonable to assume that carrier behaviour would simply evolve to meet those demands. If the lead writer is at, say, 20 cents, and another carrier *knows* they need 25 cents to participate, that carrier would simply be inclined to elevate its bid well beyond 25 cents so that the average would be increased to a level that would allow participation. Again, this would seldom take place in a soft or regular market.

Requiring a 'blind bid' (where insurers cannot see each other's bids, including that of the lead writer

— in other words: a 'blind tender' process) would likely compound and complicate adverse outcomes. It has been strongly suggested by insurers they believe this requirement would further limit participation and squeeze out capacity — at least on subscription policies, as all insurers would be required to fully evaluate and underwrite each risk, regardless of how small of percentage they aim to take.

WHAT IS IBAS RECOMMENDING TO GOVERNMENT?

IBAS fully understands and appreciates the impact that BTP may have on some insurance consumers in terms of elevated premiums. IBAS remains greatly concerned, however, of the unintended consequences that any regulatory changes may have leading to a loss of capacity in today's immensely hard market. It is IBAS's general position that:

- BTP is, at its root, an issue of market capacity that cannot be solved by a regulatory or price-control solution;
- Any decrease in market capacity in the immediate future will have a net negative impact on Saskatchewan consumers and the Saskatchewan economy;
- Insurance companies should be fully consulted prior to any decision around BTP regulatory measures;
- Should further regulatory measures be implemented, they must be executed with sufficient notice to allow insurance carriers and brokerages to adapt their operations accordingly;
- Any considered regulatory measures around BTP should only be directed at strata coverage and *not* more broadly towards commercial insurance;
- If insurers develop the technological capability to serve as a lead writer in a split pricing environment, that practice should be encouraged and supported; and
- Brokers must retain the ability to have open conversations with insurance companies in the placement of business — including dialogue related to rating, capacity, and the bid share of subscription policies.

I HAVE INPUT OR QUESTIONS — WHO DO I CONTACT?

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