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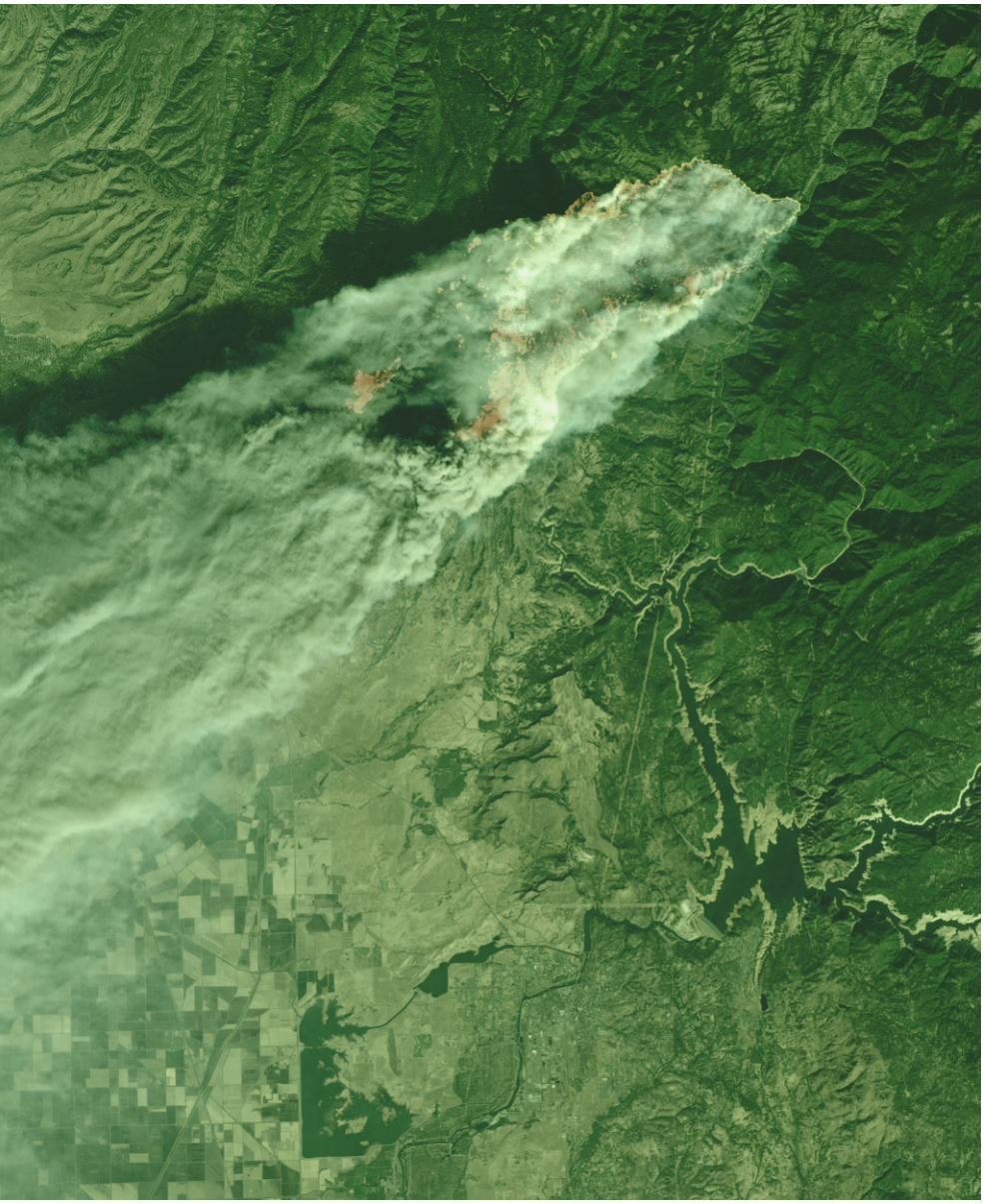
# ISSUES & ANSWERS:

# RISK AND RISK MODELING

Carriers discuss evolving risks while risk analytic providers and advisory firms explain the latest developments in risk modeling and analytics.



**Interviewed Inside:**

***Ben Williams***
*Willis Towers Watson*

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# Additional Uses for Loss Cost Models

Ben Williams, a director with Insurance Consulting and Technology for Willis Towers Watson, said insurers could use their loss cost models of expected claims to guide their underwriting or their client acquisition efforts. "We do see more sophisticated clients using their models for these more general purposes, while the majority of the market is still focused on rate segmentation," he said. The following Q&A is an excerpt from a recent interview.

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**How are most insurers using these models and how can they be using them?**

The pricing teams of most property & casualty insurers, particularly in personal lines, spend a lot of time developing sophisticated models of expected claim costs. The main reason is to understand how variables or rating factors impact expected claims. Once they have this information, they use it to inform the segmentation of their rates. They will compare the impact of, say, credit scores according to their predictive models against what their current rates are doing and make a selection. Then the combination of each of those selections is their proposed set of rates.

**What should insurers consider when using loss cost models for other purposes?**

They should consider the purpose of the model they're fitting. If the purpose of the model is only to inform rate segmentation, it may be fine to consider the variables or factors you can rate on. If you want the best possible estimate of claims, then you should include all information available to you. If the predictive models only include factors or variables that insurers can rate on, then they could give a biased or incomplete view of the expected claim costs.

**Is it a lot of work to fit constrained and unconstrained models?**

In a word, yes. Fitting unconstrained and constrained models does require more work than just fitting constrained models. If a pricing team has time constraints, then it makes sense just to focus on those constrained models. We advise our clients to begin with unconstrained models, that is, not being constrained by the variables they can use for rating. We do find there are benefits associated with starting with unconstrained models and then focusing on constrained. So when reducing the variables being considered, we do generally find that the additional work is worth the effort.

"Unconstrained models will give you the best estimate of claims associated with any combination of predictors or characteristics of the risk."

**Ben Williams**
Director, Insurance Consulting and Technology
Willis Towers Watson


Go the Issues & Answers section at *bestreview.com* to watch an interview with Ben Williams.

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