1959 Presidential Address
On a dismal morning of the year 1374 in the German town of Aachen hundreds of men and women came together on the streets and, forming circles, hand in hand, danced hysterically for hours on hours till they fell exhausted and insensible on the cobblestones to be left where they fell or pushed aside to make way for others who were still bouncing and jiggling like puppets on a string. It was thought that these poor people were possessed of demons and prayers were said by the holy for their healing. This is the picture given of one incident in the dancing mania which afflicted Germany during the years following the Black Death.

The years of the Black Death had taken their frightful toll, wiping out half the population of Europe and then, at the very moment of release, when the grip of the plague was at last relaxing, the hysteria of the dancing mania took hold. It was born out of physical and spiritual exhaustion, out of an emotional desperation that had numbed the wits and depraved the reason. It was "catching," as any mass hysteria is "catching," propagated by the sight of the sufferers, like a demoniacal epidemic. Here was the origin of the name St. Vitus's Dance, for St. Vitus it was who had been granted specific powers for the healing of the mania.

We are, I suspect, witnessing in the automobile insurance business a parallel to the dancing mania of Germany in the Middle Ages. For several long years our business has had the insurance equivalent of the plague; many of us have been suffering severe underwriting losses in the private passenger lines; we have appealed to higher authority for rate relief over and over again and been rebuffed; and just as the picture begins to look clearer, just as the rate situation seems to be brightening, we begin whirling and jiggling, hopping and prancing
in a maniacal, competitive dance of policy forms and rating methods.

The picture, of course, was not really becoming clearer with the increased rates approved and the reduced commissions being allowed during the past year. One might almost imagine that these necessary corrective measures have aggravated the situation. The underlying disease, whatever it has been, is not cured. Quite recently the Bureau received considerable criticism to the effect that a major reason for the success of the direct writers in getting the preferred business is because the Bureau rates favored the youthful driver at the expense of Class 1 business. The Bureau vehemently denied such favoritism and implied that a company charging Bureau rates should be just as glad to write insurance on a car owned by a youth as on a car owned by a man of mature years; should be, in fact, happier to do so because, with the larger premium involved, there would be more dollars in the profit allowance. The trouble has been that, although the Bureau was undoubtedly right actuarially, the carriers have continued to show an irrational resistance to youthful drivers and have shown a keen preference for Class 1 business despite its smaller average premium. The direct writers have, in fact, been willing to make those premiums still smaller.

Every year a prominent analyst makes a careful study of the underwriting results of the big four direct writers: Allstate, the State Farm, the Nationwide, and the Farmers Exchange. His annual conclusion is that so long as these four carriers can continue to pay their producers less they can charge less for their wares. This gives them a competitive advantage and makes it possible for them to be very selective, resulting, of course, in lower loss ratios, which allows them to charge still less for their wares, and so on round and round. And to rub salt into the wounds, the salesmen, who get paid less in percentage, earn a good living on volume.

Some years ago a method of operation was devised within the American Agency System which was calculated to save the agent and his carrier before the big four got all the business. This is frequently referred to as the Safeco plan in recognition of the originating carrier. The agents have not generally relished this form of salvation, preferring, if possible, to live in original sin. The plan attempts to meet the big four competition by adapting their methods to independent agency operation. It involves a signed application, giving improved control over selection and classification assignment, and such money saving devices as a lower-than-normal commission rate and the requirement that the premium be paid in advance of effective date. In order to make the commission reduction more palatable the plan also includes automatic machine renewal and direct collection of the renewal premium by the carrier. One of the advertised inducements has been that the agent could take his smaller commissions and devote his energies to new production confident that the company machinery would keep the renewal certificates endlessly flowing to the assured with the cash flowing back, and the direct writers vanquished. It really has worked.
The lower rates produced the same sort of competitive leverage for the Safeco plan companies as it has for the direct writers. In the last two or three years there has been a great burgeoning of “economy plans” competing vigorously for the best of this low premium business that has theoretically less profit built into it than the big fat youthful driver business. There has been, however, no observable indication that the big four felt the slightest jolt from the growth of the Safeco plan. The two chief sufferers have been the so-called tariff or Bureau companies and the assigned risk plans, the former out of dearth of business and the latter out of surfeit.

Shakespeare once wrote, “The smallest worm will turn, being trodden on,” and in this case the victim of the treading was hardly a small worm. Every indication today points to the certainty that the Bureau companies have had enough. They are doing something about it besides cutting commissions.

The new merit rating plan jointly sponsored by the National Bureau and the N.A.U.A. has now been introduced into several states. It is an attempt to meet what a Bureau spokesman described as “a public demand of long standing for a safe driver insurance plan which will produce a substantial difference in the price paid by insureds who are not accident prone vs. those who are. . . . The plan is designed to produce more competitive rates for the better classes of risks so that bureau companies will not be faced with an ever worsening cross-section of business.”

With this move on the part of the bureaus the Black Death was ended and the dancing mania began. Every day has brought its new manifestations. When the Travelers withdrew from the National Bureau the insurance world was as shocked as the average American would be if ex-President Truman were to withdraw from the Democratic Party. Several other outstanding company groups also withdrew in order to be free to try out their own individual steps. The independents, with their various “economy” plans, found overnight their happiness gone, their complacency shattered, and were seized with an acute realization that new ideas were needed fast. The automobile insurance industry is in a competitive struggle of titans. I see no reason why Senators Kefauver and O’Mahoney need fear for the freedom of the automobile insurance enterprise at the moment. For the past several months the insurance page of the Journal of Commerce has carried daily stories of new plans and projects. I quote a few headlines:

“NBCU FIRMS TO PUSH NEW AUTO PLANS”
“TRAVELERS LAUNCHES NEW AUTO PLAN IN NEBRASKA”
“AMERICAN CASUALTY HAS NEW AUTO COVER PROGRAM”
“ST. PAUL VETOES NBCU AUTO PLAN”
“MICH. STUDIES MERIT RATING”
And about the same day that three major plans were announced on one page, there was also displayed a large want ad by one of America's larger fire and casualty fleets, appealing persuasively for an actuary of mature experience and judgment capable of assuming the duties of vice president.

I wish I had space here to deal also with that other dementia that has seized our industry, the rate and coverage evolution taking place in the homeowners' business. Where are those wise men who promoted the multiple line approach on the theory that when the casualty lines went bad the property lines would save us by being good, and vice versa? Suffice it to say that many of the points discussed here in connection with automobile apply equally to homeowners'.

There has been considerable favorable comment in the local press as the merit plans have been introduced in various states. It is a very popular concept that "good drivers" should not have to share in the losses caused by the "poor drivers who have the accidents." The lower rate for the better record seems reasonable and just to most people. A fairly representative reaction as expressed by an insurance commissioner was to the effect that merit rating supplies what our young people have wanted for a long time—to be treated as individuals and not as a group of helter-skelter irresponsible undesirables. In fact there has been so much demand for the new plan that the Bureau has been constrained to ask for time. The plan is frankly experimental and needs maturing.

There are also those who take a very dim view of all automobile merit rating plans. At one time the Bureau was not nearly so sanguine about the practice as it seems to be today. In Best's Insurance News of January, 1952, a paper entitled "Merit Auto Rating" appeared, sponsored by the National Bureau of Casualty Underwriters and the Mutual Insurance Rating Bureau in collaboration. This paper cites twenty "administrative and rating difficulties to be encountered" in any program of merit rating for private passenger automobiles in 1952 and closes with the profoundly actuarial statement that "the extremely small exposure in a single private passenger car risk does not lend itself to self-analysis in terms of rate making as the element of chance overshadows a credibility expectancy." Perhaps it is unfortunate that the paper has this year been republished as a part of the Readings in Property and Casualty Insurance, edited by H. Wayne Snider, for it would seem that most of the twenty difficulties to be encountered in 1952 are still difficulties in 1959 with a few more added by the processes of time and the specific characteristics of the current plans.
A serious current criticism of the new plans is that they are far too difficult to administer, depending as they do on information that must be obtained from state motor-vehicle departments and that this difficulty brings the plans into direct conflict with the rapidly developing mechanization of automobile risk rating and policy issuance. This may turn out to be a decisive factor.

Another and widely held criticism attacks the plan at its actuarial foundations. This stands on the principle that insurance is a pooling of potential losses, that there must, of course, be some separation of risks into reasonable rating classifications, which are usually interpreted to mean the present classifications by use, and that any attempt to separate those who have accidents from those who do not breaks down the pooling principle and thus does violence to the "mathematical science of insurance." This has been a rather common charge and one that has the surface look of truth. It has, however, serious actuarial blemishes.

While insurance is certainly based on the principles of pooling, it has none of the elements of charity and very little in common with Marxism. The maxim, "From each according to his abilities, to each according to his needs," is from Karl Marx and not from Lloyds of London. The mathematical science underlying the insurance business, it has always seemed to me, is the science of finding mathematical measures of hazard, of determining the bounds of reasonable probability of an occurrence, including, to the extent practicable, a quantitative differentiation of such circumstances as who, where, and when. You have all heard the story of the horse-and-rabbit stew—"one rabbit, one horse." Such a stew has none of the elements of mathematical averaging. Surely, if you are certain to have no loss and I am certain to have a loss I can hardly expect you to pool your insurance with me on an equal, or in fact on any, basis. The impossibility of effecting a workable private flood insurance program is a clear illustration of this principle. And certainly if it can be demonstrated that you are less apt to have a loss than I, you would be the giver of pure charity and I would be the taker if we pooled our hazards on a fifty-fifty basis. As much as is possible the predisposition to loss is a proper subject for fair discrimination; only the operations of chance are the proper subject for averaging.

We are apt to cry discrimination rather readily in the insurance business, saying quite properly that it is unfair to discriminate between risks of essentially the same hazard. But over two thousand years ago Plato pointed out the other side of discrimination very clearly when he said that the greater injustice is to treat unequal causes equally. A single automobile liability rate for the entire state of Massachusetts, as has been at times politically proposed, would be unfairly discriminatory in the extreme. There is no need to labor this point further. I think we will all agree, when we look at the subject objectively, that insurance rates should be related as nearly as is feasible to the hazard of the risk, and that a proliferation of classi-
Classifications which actually do measure hazard, though it may complicate the business of insurance, does no more violence to its mathematical principles than does the betting on different odds do violence to the mathematics of gambling. In fact the pari mutuel is the very essence of mathematics.

Classifications can, however, complicate the business, and I suspect that most of the noncompetitive complaint within the industry about the merit plan is based on this problem of administration. There is always the compromise between the proper and the feasible. One of my friends, an eminent psychologist, has assured me that he could quite certainly discover the accident-prone and rather accurately measure the degree of proneness if he were permitted to examine personally all my company's applicants for automobile insurance. I believe he is essentially correct; but it is not out of perversity that the insurance carriers have failed to replace their underwriters and actuaries with psychologists; there would seem to be no feasible way to bring together car drivers and psychologists. This does, however, suggest the possibility of the carriers' employing a reasonable number of these learned men to help devise some less exact and possibly less drastic method of discovering the accident-prone. Perhaps with every application for insurance we should also demand a signed interpretation of one of Rorschach's ink blots.

What the Industry so desperately seeks is a simply-manipulated device for determining and mathematically evaluating the risk of accident inherent in a motor vehicle owner or operator. That this has not yet been found I believe even the promoters of the various merit rate plans will agree. That it ever can be found is extremely doubtful. It seems to me clear that in this area, as in so many others, simplicity and accuracy are mutually antagonistic. To the degree that we require a mathematical and clearly defined accuracy we must perforce sacrifice simplicity and ease of operation. There is no harder task than to make the intangible tangible.

Here I believe is the crux of the problem. Our statutes say, quite properly, that rates shall not be excessive, inadequate or unfairly discriminatory. In the abstract these three principles are ideal; in their specific administration, however, we find them far too broad and indeterminate. It is a bit like legislating that men shall not be niggardly, over-generous, or unfairly prejudiced. How can anyone know truly that a given rate for a given risk is neither excessive, nor inadequate, nor unfairly discriminatory? We are justly proud that ours is a government of laws and not of men, but an excess of zeal for legal safeguards beyond the needs of the circumstance can destroy the effectiveness of such natural safeguards as judgment and self-discipline.

Because we are so firmly committed to the regulation of rates rather than the supervision of their administration, we find ourselves taking an unrealistic and essentially Procrustean approach to rating philosophy. We imagine that all risks can be fitted into a limited num-
ber of specific classifications, subject to exact definition, and that by
the mere fact of fitting risks to a definition which describes their
tangible attributes we can make them homogeneous. This is at times
in direct conflict with the clear evidence of experience and judgment.
I recommend to all insurance men a rereading of that immortal classic
"Pigs is Pigs," by Ellis Parker Butler. There is something profoundly
prophetic about Mr. Flannery's position:

"Pigs is pigs. Guinea-pigs or dago pigs or Irish pigs is all
the same to the Interurban Express Company an' to Mike Flannery. Th' nationality of the pig creates no differentiality in the
rate."

Of course this has worked badly. Procrustes found that all men did
not, after all, fit his standard-sized bed, and was forced to resort to
stretching some and lopping others. I have a theory, which I shall
call the Procrustean Law of Classification Stability, that classifications
tend to produce their expected experience; in other words, the
experience of any class accommodates itself to the pure premium for
that class. While this may be partly due to the effect of underwriting
selection as it adjusts to the adequacy of the rate, there also seems to
be a tendency in our business, which will probably be honestly denied
by all concerned, to let the risk's inherent hazard, arrived at intangi-
ibly, determine the assigned classification. Since the results are rela-
tively reasonable and uniform, I must conclude that this reprehensible
practice does in fact produce a less unfair discrimination as to risks
of the same hazard than could prevail by a careful adherence to the
definitions.

Our classifications are broad bands of hazard; each one with a wide
spectrum of good and bad risks. They overlap to the point where the
best of the worst classification produces a lower loss cost than the
worst of the best classification. Under our present rating concept the
only discrimination allowed a carrier between the best and the worst
within the same rate group, or even between the better and the worse,
is by selection. If accepted they must be charged the same rate. Under
discrimination by selection the risk, which because of the intangibles
should fall into a worse classification than is indicated by the tangi-
bles, has difficulty obtaining any insurance at all and will finally have
to pay a higher rate either from a non-preferred risk carrier or
through the assigned risk plan. That this selection is valid is vouched
for by the experience of the so-called "clean" risks in the assigned risk
plans, which has been found to be as bad as or even at times worse
than the surcharged business at the same rate level. In the main it is
pure underwriting selection on the basis of intangibles that places a
risk without accident or conviction record in the assigned risk plan.
(Incidentally this clean assigned risk experience could cast some doubt
on the complete validity of the various merit plans currently compet-
ing in the market place.)

I can see no fundamental reason why discrimination by selection
ST. VITUS'S DANCE

should be considered socially preferable to discrimination by rate. Both can be fair and both can be unfair. Discrimination by rate has the one advantage that it keeps the market open, and, in general because of competition, causes each risk to pay a premium fairly commensurate with its hazard. Discrimination by selection, besides being a thoroughly annoying practice to the public, is the basic cause of the assigned risk program, that great Procrustean leveler where all risks are treated in a most unfairly nondiscriminating manner.

Because our present regulatory system has grown up gradually and because we have all breathed this atmosphere from our beginnings in the business, we accept it as appropriate and inevitable. Our friends in Great Britain, however, have grown up in a somewhat more liberal insurance rating atmosphere. Apparently they place more trust than we do in competition and sane judgment. The following rather amusing letter was published in the Manchester (England) Guardian Weekly for July 30, 1959:

"Your article on car insurance contains one statement which calls for correction. Your correspondent says that insurance companies accept possession of a valid driving license as the only qualification necessary for the granting of 3rd party insurance.

"As an actor I have found that this is not so. Although I have had a clear driving license for 5 years I have on several occasions found that my proposal for 3rd party insurance has been refused outright because of my occupation. I finally obtained 3rd party only, passenger liability excluded, and the premium 'loaded.' Comprehensive, I was told, was out of the question except for a fantastic premium.

"Even worse, in my opinion, is the state of affairs described to me by an actor who owns a self-drive car hire firm. In the first place insurance cover for his business was difficult enough to get because he was connected with the 'entertainment industry,' but further, he was required not to hire his cars to, among others, actors, publicans, jockeys, pilots, ice cream vendors, and log merchants!

"And most absurd of all are the car dealers who are keen to sell you their cars and who are also insurance agents. They find it necessary to suggest as I have had done to me, that if I describe myself as, perhaps, an 'interpreter' (dramatically, I suppose) or 'Commercial Artist' all will be well. No doubt it would be until the first court case, when such falsification might leave the customer uninsured and criminally guilty and the agent untouched. "Surely, if the law requires us to have 3rd party insurance it should be available to all on equal terms with our fellow-motorists."

"Yours &c
"Paul Whitsun-Jones
"12 Flask Walk
"London NW 3"
In this country, though his premium would not be arbitrarily "loaded", Mr. Whitsun-Jones would be in the assigned risk plan and even more unhappy. I quote this letter merely to show that automobile insurance can be operated on a different plan from ours. It is my impression that, in spite of Mr. Whitsun-Jones's dissatisfaction, there is more justice and less turmoil in British insurance than in ours.

I believe the insuring public would be better served, the premiums charged would be more equitable (by which I mean more nearly commensurate with the inherent hazard involved), and there would be a much more open and healthy competitive atmosphere in the private passenger automobile insurance market if carriers were permitted the exercise of some judgment in individual risk rate determination within the framework of over-all state supervision of rating administration.

There remains still the fear that unregulated rates in the face of keen competition will be inadequate rates from the point of view of company solvency, thus endangering the very security of our system. Under today's operating procedures, however, the safety of a carrier is irretrievably given over to the judgment of its underwriting organization through the authority to accept and reject. A company can sink into insolvency with tragic speed through bad risk selection even with every rate charged strictly according to manual. Why should we expect our staffs, which we trust to exercise adequate restraint in risk selection, to cast that restraint to the winds if given some limited discretion in rate assignment?

Some will accuse me at this point of selling my actuarial profession down the river. I plead "not guilty." It has always seemed to me that when the law is too pervasive the atmosphere breeds shysterism. The present regulatory climate makes actuarial shysterism a distinct, though, I hope, as yet an unrealized, possibility. When the rating laws or their administration in any state is unrealistic or pettifogging the temptation is very strong for the actuary to forget his professional obligation which is to seek the best estimate of a future rate and instead, to become the protagonist who uses his skill to argue his client's cause regardless of merit. In the three-cornered contest produced by current conditions, with the carriers, the agents, and the insurance departments all employing actuaries to interpret and promote their parochial points of view, the temptation has at times become well-nigh irresistible.

There would be adequate place for the actuary in a freer rating climate. The freedom I suggest does exist in the life insurance business where the actuary seems to do very well, and, although the actuarial problems in life insurance differ materially from those in fire and casualty insurance, there is a common need in both fields for rational analysis and the tempering of what is competitively wished for by what has a reasonable hope for success. The actuary can and does supply technical skill and logical perspective to the solution of
problems involving insurance rating and risk evaluation. These attributes grow in usefulness as the carriers gain in freedom.

But let us never make the basic mistake of considering the actuary a brake on competition. The current automobile situation clearly demonstrates that competition is alive in our business and that the actuary should be in the thick of it. With his analytical training, his interest in discovering relationships, and his familiarity with the substantive data of the business, he is uniquely placed for the exercise of creative imagination. He should be the source of new ideas and of new approaches to old ones. Such talents are much in demand in a free competitive system and the freer the system the greater should be the demand. In the current automobile dancing mania the Bureau actuaries have come in for a great deal of criticism from both the fearful and the offended. Some day in the future we shall all know just how good or bad this latest creation of theirs has turned out to be. Certainly I am no prophet. But one thing I know: their action has been in the best actuarial tradition; it has been logically developed, honestly presented, and saturated with the competitive spirit. I salute them for it.
New Papers Submitted
To The Forum