Rate Regulation.

BY

ALBERT W. WHITNEY.

That there must be some sort of regulation of competition in insurance, either by organization among the carriers or by the state, is too well established now to need demonstration. The more pertinent question at this stage of our development is: what shall be the nature of this regulation?

The object to be secured is obvious: right rates. A "right rate" implies that the hazard of a risk can be correctly determined; but this determination would be an extremely difficult one to make even were no elements involved other than a pure scientific desire for correctness. When however the problem is complicated by the desire for profit and by the presence of competition, the difficulties become much greater.

The rates, as a whole, may be in error, either by being too high or by being too low. The natural result of unrestrained competition is the use of rates that are too low; this could hardly be so were it not for the fundamental difficulty of knowing exactly what the rate ought to be, for no one with full knowledge of the facts would use rates that were insufficient. But competition, acting in the presence not only of uncertainty as to the proper rate for the class but uncertainty with regard to the degree of hazard in the individual risk, has the inevitable tendency to drive the rates too low.

Where competition is restrained there is in theory the possibility of rates being too high. In practice this is a remote contingency; as too high rates must almost inevitably produce a condition which leads to their readjustment. This is particularly so in the case of workmen's compensation insurance, owing to its quasi-public character. The early history of rates in New Jersey and Massachusetts bears this out. The most important problem of rate regulation in the case of workmen's compensation is therefore the securing of adequacy.

The acknowledged necessity for regulation of some kind, taken in

conjunction with the acknowledged duty of the state to safeguard the solvency of the companies in the interests of the public, indicates the necessity for some form of state control.

The first state to pass a law regarding the regulation of compensation rates was Massachusetts. This law provided for approval as to adequacy; it was copied substantially in New York and other states. More recently a number of states have enacted laws providing for the approval of reasonableness as well.

In the effort to determine what constitutes a proper form of state regulation, we may with advantage analyze the similar procedure in the case of life insurance, recognized to be the most thoroughly developed form of insurance.

The only control of the general level of rates in the case of life insurance is through the reserves. This is in practice an effective control. The reserves are prescribed by the laws of the various states which specify the table of mortality and the rate of interest to be used in their calculation. Control through reserves is effective in securing a scale of minimum adequate rates; there is no control of the reasonableness of life insurance rates; this is left to competition.

Theoretically there might be a control of compensation rates through reserves and, as a matter of history, it is interesting to know that in the first year of compensation in California a bill providing for this kind of control passed the legislature but failed of signature by the governor. In practice, however, a control of the rates themselves is doubtless to be preferred.

If the analogy with life insurance is to be followed out, we should admit the propriety of a control of minimum adequate rates by the state, while the question of reasonableness is left to be controlled through competition.

An "adequate" rate law may be interpreted in two ways. The approval may be based strictly on adequacy or on minimum adequacy. The Massachusetts law when first applied was interpreted in the former sense. A company filed its rates; if they were deemed to be adequate they were approved without raising the question of whether possibly they might be more than adequate. But with the growing consciousness of the rating problem as a single problem with its objective "right rates," and in line with the practice of the stock companies of filing one set of rates for all, the adequate rate law has come to be interpreted in all states as calling for the approval

of minimum adequate rates. That is to say, in practice, the approval that the state official is called upon to make is the approval of one standardized set of rates and this is understood to be the minimum scale of rates that he deems to be adequate and that will therefore meet with his approval.

Any rates approved by the state as minimum adequate rates competition will cause to be the going rates, provided they are not so low as to be absolutely unreasonable; this has been demonstrated by experience.

It appears therefore that a control of the adequacy of rates is also in actual practice a control of their "reasonableness" as well both in theory and in actual practice.

Since therefore specific control of reasonableness is unnecessary, the preferable procedure is control of adequacy alone. It is simpler, and there is not the same temptation to abuse that there is in the case of a specific control of reasonableness. There is the danger, and experience shows it to be a real one, that political pressure will cause rates to be fixed by officials at too low a level, and this is particularly true if specific control of reasonableness is provided.

It is not an imaginary situation in the case of a rate revision to find all the reductions approved by a state official and all the increases disapproved. It is obvious that such action as this by an official can not be the basis for any fundamentally sincere treatment of the rating problem. The inequity as between states is apparent. No fault is to be found with the principle of state control; that is as it should be, but the danger of its possible abuse should be reduced as much as possible.

In this connection, an observation should be made; namely, that a law providing for approval of rates indicates that the initiative is to lie with the insurance carriers themselves. This is a very different thing from state rate making.

This consideration brings me to the real thesis of this paper, namely, that the hope for a well-balanced rating system, free from arbitrary action by any particular state, lies in the establishment of a standardized rating procedure of sufficiently great repute to command universal respect.

Here again we may observe the situation in life insurance. In life insurance there is complete control of minimum adequate rates on the part of each individual state, and yet there is not arbitrary action. Why? Because a standardized rate-making procedure has

been built up of so great repute that no state would undertake to set it aside. When it becomes advisable to devise a new mortality table, no state takes arbitrary action, but the procedure is most careful and well-considered, a matter for the Convention of Insurance Commissioners and the companies, through the actuarial societies, to consider together.

A similar procedure should be our goal in the compensation field. Already wonders have been accomplished in the short space of time since the inception of compensation in this country. The getting together, in the so-called Conference of 1915, and the so-called augmented Standing Committee of 1917, of all the various forces directly interested in compensation rates, stock companies, mutuals, state funds, insurance departments and industrial commissions, was most significant. This good work must go on; it is a work on which all should unite. This Society, through its papers and discussions and committees, has already been a potent force. The time should not be far distant when the standardization of rates shall have been as fully accomplished in the compensation field as in the field of life insurance.