

REVIEWS OF PUBLICATIONS

CLARENCE A. KULP, Book Review Editor

Fundamentals of Fire and Casualty Insurance Strength. Roger Kenney. Kenney Insurance Studies, Dedham, 1949. Pp. 14, 246.

The author of this book is Roger Kenney, Insurance Editor of the *U. S. Investor*. His purpose in writing this book was to help the policy-buying public and investors to analyze the financial strength of fire and casualty insurance companies. With a background of war and inflation, and with rigid control of rates and policy forms now resting with the state as the indirect result of the recent trend in the insurance business away from "action in concert", the author feels that managements are faced with a heavy responsibility of marking out a course of individual action in an almost uncharted area of operation. It is the author's hope that this book will not only promote a better understanding of fire and casualty financial statements on the part of the public, but will promote a better appreciation of the skill required to operate a fire and casualty company successfully.

Even though the primary purpose of the book was to serve the policy-buying public and the investors and to present a very technical subject in language which the layman can understand, this book is a "must" for fire and casualty actuaries. An actuary is often charged with the task of explaining his company's financial statements in non-technical terms and of justifying loss reserve practices. It is the prime responsibility of actuaries to keep their companies financially sound. On the assumption that every actuary has or will read this important addition to the library of our business, this review will be limited to a discussion of his rules for measuring financial strength.

The Kenney theory of fire insurance strength is: "In its essence, the formula provides that other things being equal, the ratio of policyholders' surplus to the unearned premium reserve determines the relative strength of fire insurance companies." Taking the unearned premium reserve as the measure of the potential outstanding liability of the company in the form of risks accepted, Kenney concludes that the larger the cushion of safety (policyholders' surplus) against the unearned premium reserve the greater the strength of the organization. The author says that he likes to see a ratio of one to one between policyholders' surplus and the unearned premium reserve of a fire insurance company. However, unlike many other analysts and sponsors of financial formulae, this author "is not unmindful of the fact that there are conditions where a lower ratio may be approved. And one of these conditions is a persistently low loss and expense ratio over a period of years." In appraising this one-to-one ratio, the author also cautions that you must consider the liquidity of the company's assets. He also states that "it all comes down to the fact that to get the whole story of fire insurance strength, you really ought to have one eye on the operating account, as well as the balance sheet."

One chapter gives 6 rules for discerning how a fire insurance company laboring under a huge premium volume stands financially, and underwriting-wise: (1) look well to the investment exhibit; (2) if the company is owned by another, scrutinize the surplus of the parent company; (3) compare the loss ratio in the latest report with that of the preceding 4 or 5 years; (4) make inquiry as to the caliber and character of the management; (5) make judicious inquiry into the reinsurance arrangements of the company; (6) examine carefully the area of operation for concentration of writings in congested and hazardous areas.

In appraising the financial strength of a casualty company, the author makes some very significant statements. He warns that "you cannot legislate a casualty company into solvency or into good underwriting practice. Management still plays an all-important role in determining whether a casualty company will be a success, both from the policyholders' and the stockholders' point of view". Some years ago the author coined the slogan: "A casualty company is no stronger than its loss reserve policy". An important chapter in this book is entitled, *Loss Reserves—The Heart of a Casualty Statement*.

The author gives 7 rules for gauging the strength of a casualty company. Briefly, these are: (1) determine the adequacy of loss reserves, for Schedule P lines, with particular reference to Schedule P—Parts 5 and 5A; (2) examine carefully Schedule O to study the run-off of loss reserves on lines other than liability and workmen's compensation; (3) scrutinize the suit record of the company; (4) reconcile the reported underwriting results with the indicated savings or deficiencies in loss reserves; (5) measure the ratio of policyholders' surplus to premium volume in the light of underwriting results adjusted to the indicated equity or deficiency in the loss reserve; (6) examine the balance sheet for liquidity to ascertain if there is a "jingle" in the loss reserve; (7) study carefully the entire investment portfolio.

As a companion to the Kenney one-to-one theory for a fire insurance company, the author advocates a "2 for 1 casualty rule". Briefly, this rule is that a casualty company should have one dollar of policyholders' surplus for every two dollars of premium volume. The author is, however, very careful to qualify that rule with the statement that there are conditions where a somewhat higher premium volume can safely be written—such as a persistently low (and proven) loss ratio over a protracted period".

He also cautions that "practically every alternative measuring stick of casualty strength loses its value unless something is known about the underwriting habits of the management, particularly as regards premium volume".

These two Kenney rules—one-to-one fire and two-for-one casualty—have been the subject of much argument. The basis of the adverse criticism is not the rules as the author uses them, but with their use as automatic tests of financial strength without the important qualifications which permit of variations for such factors as good management, low loss ratio record, sound investment portfolio and adequate loss reserve practices.

N. E. MASTERTSON

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Inland Marine & Transportation Insurance. William H. Rodda. Prentice-Hall, Inc., New York City 11, New York. Pp. xvi, 539.

This book, the first to appear on the subject in 15 years, very ably fills the need for an up-to-date and easy-to-read treatise on inland marine insurance.

The rapid growth of the inland marine lines during the past 30 years has been nothing short of stupendous. This rapid expansion kept pace with the growth of the wealth of our country, as well as of our systems of transportation, particularly motor truck and the airplane. Growing pains have necessitated changes in policy conditions and rates. Governmental and self-regulation have become important factors. Both the fire and casualty fields have felt the development of these lines and it might be said that inland marine insurance has become a bridge between the two.

The author in an interesting manner touches on every phase of this subject, beginning with its colorful history and heritage from fire, casualty and ocean marine insurance, and ending with a chapter on governmental regulation. The intervening chapters describe the following: transportation policies, business covers other than transit, bailee and bailee customers' covers and personal covers. Mr. Rodda states, "The principal parts of the book are devoted to a comprehensive discussion of the problems facing the underwriter in providing inland marine coverage to policy holders." The text is based on the new inland marine forms which became mandatory on March 1, 1950.

The author has had 25 years experience in insurance engineering and rate-making and is Secretary-Treasurer of the Transportation Insurance Rating Bureau. He is also Chairman of the Truck Transportation Committee of The National Fire Protective Association. Out of many years experience he has written a book which can well serve as a modern text and reference volume on this important subject.

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PUBLICATIONS RECEIVED

Life Insurance Mathematics. Robert E. Larson and Edwin A. Gaumnitz. John Wiley and Sons, Inc., New York, 1951. VII, 184.

* Guest reviewer.