

## DISCUSSIONS OF PAPER READ AT THE MAY 1951 MEETING

## RATE REGULATION AND THE CASUALTY ACTUARY

THOMAS O. CARLSON

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WRITTEN DISCUSSION BY H. J. GINSBURGH

In the course of his paper, Mr. Carlson has taken care to explain that his own experience and background might tend to produce some particular emphasis of viewpoint in his treatment of his subject. "At the same time" he writes "I have striven for an impartial understanding of the problems of all parties". And in this he has succeeded admirably, in a paper of great scope, presented in a manner to excite interest and to provoke thought. When I venture to raise an issue it is not because of Mr. Carlson's failure to recognize problems and to deal with them impartially. It is rather because of what he calls "a fundamental split in social philosophy". Perhaps a few sentences will help to explain what raises the issue.

It is obvious, or should be so, that the regulatory statutes are not meant to protect or benefit the insurance business, or any segment of it, for its own sake. The requirement for rate adequacy is designed for the ultimate protection of the policyholder, not for the immediate benefit of the stockholders. Even the specific provision for inclusion of profit as an element in insurance price fixing can be said to be a recognition of the necessity of maintaining and attracting insurance capacity to meet the needs of our economy. The basic criteria for rates set by the statute must therefore be interpreted and applied in the light of their ultimate effect on the policyholder. Certainly we must maintain the truth of this principle with respect to application of the criterion of rate adequacy, when regulatory authorities seem to be concerned only with the immediate impact on the insuring public. And we should stand by this principle in our view of that criterion which is a continuing one in the application of rates deemed neither excessive nor inadequate, namely the criterion that rates shall not be unfairly discriminatory.

The treatment of the concept of "flexibility", given considerable prominence in Mr. Carlson's paper, arouses some doubt as to whether the avoidance of unfair discrimination is to be given the same degree of actuarial consideration as the other two of the three basic rate-making criteria. Or is the actuary to turn his gaze aside and absolve himself from responsibility? One can only applaud Mr. Carlson's description of the role of actuarial science in its application to present problems in rate-making and his refutation of the idea of its "exactness". As he intimates, competent and responsible actuaries do not claim omniscience or clairvoyance, nor do they claim for their techniques the capability of exact prophecy. Surely there is such a thing as actuarial judgment, just as there is underwriting judgment. Flexibility in approach to the establishment of rating systems or even rating plans is necessary and entirely desirable. But once established, how flexible shall be the application of these systems and plans? This is the issue. Are plans designed to produce prospective rates from actual past experience to be used, or partially used, or not used at all, completely at option, as the competitive demands of the moment dictate? Will the actuary be able to demonstrate consistency in the principles and

practices applied, in order to prove the discrimination between risks to be fair? Or, losing faith in the ability of his techniques to produce a basis for consistency of appraisal, will he design his rating procedures so that in any given instance of application he may abdicate in favor of "underwriting judgment", relieving himself of responsibility in the meeting of the basic rating criteria of the regulatory statutes?

There can be little if any dispute with Mr. Carlson's statement that "all rate-making procedures represent some compromise between the practicable and the theoretical ideal". In a discussion which seems otherwise to hold the balance so well as his does, the frequent reference to "flexibility" seems to say: "This is all very well, but when we get down to actual operation let us throw the compromise overboard and embrace what seems to be purely practical." This may well be a mistaken inference. Its correction would be welcomed. In the whole rate-making procedure the introduction of flexibility at some points is necessary and desirable, but at others it may be taken to afford a means of negating the principles and aims of the regulatory statutes. For the latter impression to be given would be unfortunate for all, since, as Mr. Carlson points out: "Regulation is with us, to stay."

WRITTEN DISCUSSION JOHN A. RESONY

*"Tomorrow's fate, though thou be wise,  
Thou cans't not tell, nor yet surmise"*  
(Omar Khayyam)

The first two sections of Mr. Carlson's excellent paper give a concise review of the development of the regulation of casualty insurance rates. Of particular interest is the summarization of the various state laws pertaining to ratemaking. The lack of uniformity in the various laws is strikingly brought out in Appendix A wherein are listed some 150 deviations from the basic all-industry law. These sections are of considerable value to younger members and students of the Society.

As pointed out, in these and following sections of the paper two perplexing problems involved in the administration of these laws are: 1. the meanings of the three criteria for rates (i.e. adequate, not excessive, not unfairly discriminatory) and 2. the question of what supporting information is required to judge whether the rates filed meet these criteria. The problems are of course inseparably interrelated. Generally there are three types of situation to be met: 1. a bureau filing, 2. a bureau member or subscriber filing for a uniform deviation from bureau rates or an independent company filing a bureau manual and rates with or without a uniform change from bureau rates and 3. an independent company filing its own manual and rates. In a state where the bureau members and subscribers write the majority of the business the filing approved for the bureau sets the basic level of rates; the filers in groups (2) and (3) above more or less keying their filings to the bureau filings. Therefore it is essential that most careful consideration be given to the bureau filing both as respects overall rate level and the changes in rates for the various classes and territories involved. There is generally enough experience available, which when considered with other factors involved, enable one to feel with some confidence that at least for the major classes rates have been produced which are within a "zone of reasonableness". Perhaps it should be said they

appear reasonable at the time produced; more often than not the losses actually incurred on business written at the new rates will be quite different from the loss provisions in the rates. This is to be expected under any prospective system of ratemaking; it would be indeed remarkable if for any one state in any one policy year the experience in any line should develop by classification as "expected" in the rates. In any event if and when a bureau filing is approved by a supervisory official it is presumed to be within the "zone of reasonableness". As a practical matter it amounts to the upper limit of this zone.

Once this limit is established the supervisory official is faced with the problems of determining whether deviations should be approved. There is little difficulty when the application for deviation is based upon difference in expense provisions. With uniform accounting and the filing of the Expense Exhibit in the Annual Statement fairly credible expense data is available as respects the deviating company which can be compared with the expense provisions in the rate. Also differences in company operating procedures such as acquisition procedures are known and in some cases the effect on expense ratios can be approximated. The difficult cases are deviations based on favorable underwriting results presumably due to selective underwriting. Our old friend credibility again must be considered. The problem is what credence can be given to the limited experience of one company in one state or even countrywide. The same problems as described above for companies filing deviations are met in the case of independent filing companies filing a bureau manual and rates with a uniform change from the bureau rates. Companies filing a manual of rules and rates involving different classification systems than the bureau present an even more difficult problem. The total company experience in the state is sometimes sufficient to judge overall changes in rate level, but when the experience is broken down to territory and classification it is seldom sufficient to have much credibility. Countrywide figures are of help in some cases.

It is my feeling that the most important provisions in the rate regulatory statutes are those with regard to supporting information for rate filings. The provisions read as follows:

"The information furnished in support of a filing may include 1. the experience or judgment of the insurer or rating organization making the filing, 2. its interpretation of any statistical data it relies upon, 3. the experience of other insurers or rating organizations, or 4. any other relevant factors."

Thus it is seen that anything that appears to be relevant may be submitted in support of a filing; any one of the items listed above may be submitted but not any particular one is required to be submitted. However no matter in what form a filing is substantiated, be it based on purely underwriting considerations or on a rigorous mathematical formula, the element of judgment exists. This is clearly so in the case of underwriting considerations; in the case of mathematical formulae it is implicit in the filing that it is the judgment of the filer that such formulae should be used. It would appear therefore that where the judgment of the supervisory authority differs with that of the filer this would be sufficient to controvert the filing providing the action

was neither arbitrary nor capricious. Thus although the supervisory official does not have the authority to make rates any filing which in *his judgment* does not meet the statutory requirements may be, indeed must be, disapproved.

By this I do not mean to imply that the element of judgment should be eliminated from rate filings, on the contrary I believe that one of the major faults of many rate filings has been slavish adherence to the policy year experience. It always seemed a bit ridiculous to me that rate level changes, rates, rating factors, etc. should be precisely calculated to three decimal places in accordance with an established ratemaking system when the ratemaking system itself doesn't justify any such treatment. Doing so implies an exactitude in the ratemaking which does not exist. This is especially apparent when developments subsequent to the experience period used indicate significant changes in experience.

It would appear that the following principles should be recognized:

1. It is not possible to produce rates which will be exactly appropriate for any future period.
2. Past experience is the most reasonable guide for ratemaking; the older the experience the less value it has for these purposes.
3. Trend factors based on calendar year figures or preferably average loss costs and claim frequencies per unit exposure are of value. The judgment element is of great importance in the use of such factors and the procedures used should not be formalized.
4. There is always possibility of honest differences of opinion in rate filings based to a great extent on judgment factors. Prior consultation with supervisory officials before use of such factors is advisable.

#### WRITTEN DISCUSSION BY DUDLEY M. PRUITT

We are indebted to Mr. Carlson for presenting us not only with a comprehensive record of the history of rate regulation in this country, but also with a very readable paper. There is probably no one in the industry so well qualified as he is by training and experience and by the native gift of understanding to report on and to discuss this confused and complex chapter in insurance history. We should be thankful that the job was done, and doubly thankful that Tom Carlson, and not some other, did it.

Much that he says is, of course, historical and not subject to dispute, but fortunately for our pleasure and to give the reviewer ammunition Mr. Carlson has indulged at times in comment and conjecture, delightfully expressed though frequently controversial, and has even at times conceded a bow to the opposition. One can hardly do credit in a brief review to the broad scope of this paper. I shall therefore devote most of my attention to underscoring, for emphasis, certain of the author's expressions of opinion with which I find myself in particular agreement and to registering protest against other expressions with which I find myself in violent disagreement. A certain charm about the paper comes from the happy selection of literary quotations at the chapter headings. Or, as Samuel Butler put it, the author

*"Cheer'd up himself with ends of verse  
And sayings of philosophers."*

The reader will pardon me if I proceed to use, or abuse, this technique, but not for the same reason. I find myself to be one of those who, for want of more original material,

*“. . . lard their lean books with the fat of others' works.”*

—Robert Burton

#### ACTUARIAL EXACTNESS

*“A Hair perhaps divides the False and True.”*

—Omar Khayyam

Worthy of emphatic underscoring is all that which Mr. Carlson has said about the phantom of “actuarial exactness.” We have, perhaps, done too thorough a job in convincing the layman that our profession is a science, which, of course, it is in the broadest sense of the term. Modern man, however, is conditioned to think of science as SCIENCE, worshipping the exactness of tolerances that makes it possible both to split an atom and then to weigh the resultant parts. It is our own fault if the public has the impression of us that we

*“. . . could distinguish and divide  
A hair 'twixt south and southwest side.”*

—Samuel Butler

Perhaps we should admit first to ourselves and then to our public, with appropriate advertising, that our profession is basically an art.

#### REPORTED STATISTICS OF INDEPENDENTS

*“Many shall run to and fro, and knowledge shall be increased.”*

—The Book of Daniel

Mr. Carlson discusses at some length the question of whether or not independent carriers should be required to maintain statistics in as complete detail as do Bureau companies even beyond their need for such data as information supporting rate filings. His conclusion that they should is based primarily on the claim that to do otherwise “would void that objective of the regulating laws which would permit establishment of rates upon a broad spread of experience,” because carriers might find it too burdensome to act in concert and might become independent in self defense. Clearly here he is not thinking of the use of the independents' experience in aiding the common establishment of rates; as a matter of fact in the concluding section of his paper he brings out very strongly the arguments against any such practice. It must follow, therefore, that he is thinking of the maintenance of statistics by independent carriers not so much as a useful pursuit *per se* but rather as a kind of sporting handicap designed to keep the overburdened Bureau carriers in the game.

*“Like Aesop's fox, when he had lost his tail, would  
have all his fellow foxes cut off theirs.”*

—Robert Burton

In his own words, however, this objective of the regulatory laws would *permit*, not *require*, establishment of rates upon a broad spread of experience. It hardly follows that any situation which might make this permissive feature burdensome would *void* its permissiveness. Mr. Carlson also chooses to ignore the fact that this "burden" of rate making in concert voluntarily assumed by the Bureau carriers is accompanied by the privilege of reducing competition. Among the independents there is something less than complete accord with the doctrine that the non-independents are being actuated by motives solely of sweetness and light. Before the current developments in regulation these Bureau carriers bore the unequal burden, one cannot say without murmuring, but certainly without withdrawing *en masse* from the Bureau.

#### THE INDEPENDENTS AND THOSE BUREAU COAT TAILS

*"A dwarf sees further than the giant when he  
has the giant's shoulders to mount on."*

—Coleridge

Mr. Carlson has credited some maverick spokesmen for the independent carriers with the admission that they are riding on the coat-tails of the rating organizations. He fails to bring out the very essential service the independents render both the insuring public and these same rating organizations. The metaphor of the coat-tails might well be abandoned in favor of the simile of the pilot fish.

*"The pilot fish is a small cigar-shaped fish with zebra stripes,  
which swims rapidly in a shoal ahead of the shark's snout.  
It received its name because it was thought that it piloted its  
half-blind friend the shark about in the sea."*

—Thor Heyerdahl, —*Kon-Tiki*

A very strong case can and should be made for the service the independents perform in experimenting in new forms of coverage and in new techniques. Such experimentation, possible to a footloose independent is frequently out of the question for rating organizations because of their size and the essential rigidity of their natures. It cannot be denied that many valuable advances in the industry have been piloted originally by independent carriers.

A second and not inconsequential service rendered by the independents to the rating organizations is in providing the legally essential element of free competition. As was noted earlier the privilege of acting in concert is essentially the privilege of reducing competition. It is also an elementary thesis of the American economy that the natural regulation through competition is to be preferred to state regulation, but that to the degree in which natural competition is reduced state regulation must fill the vacuum. Had there been an adequate degree of independent competition in the area involved in the S.E.U.A. case, it is possible that the case might never have developed and the current intensified era of rate regulation never moved in upon us. If, as is *not* admitted, the independents really are riding on the coat-tails of the rating organizations, they should be more than welcome, for they are providing comfort and protection to the wearer of the coat.

We cannot, of course, accept the base canard implied in the passage in *Kon-Tiki* which follows the one quoted above. This goes thus:

*"In reality, it (the pilot fish) simply goes along with the shark, and, if it acts independently, it is only because it catches sight of food within its own range of vision."*

#### STATISTICAL COMBINABILITY

*"Fillet of a fenny snake,  
In the cauldron boil and bake,  
Eye of newt and toe of frog,  
Wool of bat and tongue of dog,  
Adder's fork and blind worm's sting,  
Lizard's leg and howlet's wing."*

—Shakespeare

Greater emphasis should be placed upon the inappropriateness of combining the experience of all carriers. Mr. Carlson has pointed out that "it is not reasonable to combine the experience when classification, territory, or coverage definitions differ from company to company." Further than that, formal definitions may even be identical, but the resultant combination still produce an unholy witches' brew. Classification definitions must naturally comprehend very wide bands of accident proneness among insureds. Frequently no refinement in words can actually be found to break such broad bands into narrower ones. Yet carriers do, through varying methods of operation and varying sources of production, narrow these bands. The process is some times known as "skimming the cream." Cream and milk and even water may be homogenized together to be sure, but the resultant fluid is poor stuff to put in your coffee.

This demand for combination reflects the views of many insurance department officials who seek, not unnaturally, yardsticks for their guidance in approval of rate filings, and harbor the forlorn hope that, through the combining of all statistics of all carriers, statewide pure premium tables may be constructed as the guide for *all* rate filings, to be used in much the same way that the mortality table is used in life insurance rate making. The Industry should lose no opportunity to impress upon supervisory officials that this is indeed a forlorn hope.

#### SUPPORTING INFORMATION

*"And if you take one from three hundred and sixty-five,  
what remains?"  
'Three hundred and sixty-four, of course.'  
Humpty Dumpty looked doubtful. 'I'd rather see that  
done on paper', he said."*

—Lewis Carroll

In this reviewer's opinion Mr. Carlson, although treating with the question of supporting information in some detail, has not brought out with the emphasis it deserves the wasted effort and the actuarial non sequiturs demanded of the carriers in the supplying of information in support of rate filings. Inde-

pendent carriers, naturally, suffer in this regard to a greater extent than rating organizations, because in most cases the experience of an individual independent carrier is far too thin alone for the establishment of a rate. There is a tendency, on the part of regulatory officials, to expect the data of the single carrier in the single state to support any rate filing regardless of its nature. Frequently the conclusion must be drawn that the demands of the officials are not dictated so much by a wish for the truth as by the very human desire to have a file—some file—in “support” of an official approval. Thus a premium is placed on prolixity, and actuarial truth is buried under a ton of paper.

#### RETROSPECTIVE RATING PLAN D

*“The question is not yet settled, whether madness is or is not the loftiest intelligence—whether much that is glorious—whether all that is profound—does not spring from disease of thought—from moods of mind exalted at the expense of the general intellect.”*

—E. A. Poe

Perhaps there has never been another act that has so thoroughly confirmed the long standing popular impression of an actuary as the introduction of Plan D. We will all agree with Mr. Carlson that “this reaction is the result of mental lassitude on the part of individuals who have not even tried to understand what is fundamentally a plan far less formidable than it appears.” But that is precisely the point. The public has always suspected us of making the simple complicated. Now they know it. It hardly helps matters to reply that the public is mentally lazy. Before the introduction of Plan D signs were springing up that the casualty actuary was, if not understood, at least beginning to be tolerated; some were being installed as vice-presidents of their companies; one was even made the president of his local school board. But now we are back where we began. Plato put the public attitude neatly when he said,

*“I have hardly ever known a mathematician who was capable of reasoning.”*

#### GENERAL COMMENTS

*“He knew what’s what, and that’s as high  
As metaphysic wit can fly.”*

—Samuel Butler

There are many other points worthy of comment in this paper, so many in fact that I can only mention a few.

As one who made the circuit with the Industry Committee on Allocated Loss Expense I express my warm appreciation for the very adequate and fair treatment Mr. Carlson has given that subject.

There are several excellent passages regarding the need for the maintenance of flexibility in the rate making procedure and the value of informed judgment. I found myself voicing a resounding Methodist “Amen” to such expressions. We who play with formulas have been imprisoned by formulas, and too often we do not realize how much of our freedom we have lost. We find ourselves uncomfortable, even apologetic, when it is proposed that a subject be exposed



to the free light and air of informed judgment. Let us make no more apologies, let us boldly admit that judgment is one of man's great geniuses and that flexibility is judgment's handmaiden. Will someone please write a paper on this?

Mr. Carlson's final look into the future at the end of the paper is both splendidly enlightened and prophetic. All students of the business should read it carefully and take note. We have been fortunate indeed that the "accident" of his employment, as the author puts it, has provided the industry in these recent crucial years of regulation with so worthy a protagonist. May we pray that no second accident cheat us of his services in the still more crucial years to come.

Happily there is a passage in the world's literature which in its prophetic vision seems to give assurance that the National Bureau will be blessed with its Actuary for yet some years to come—a picture not yet quite achieved, yet so like to the present that the breath of life is in it, a picture drawn a hundred years ago.

*"Then the magician solemnly 'gan to frown,  
So that his frost-white eye brows, beetling low,  
Shaded his deep green eyes, and wrinkles brown,  
Plaited upon his furnace-scorched brow."*

—John Keats

WRITTEN DISCUSSION\* BY R. W. GRIFFITH

It is indeed a privilege to have the opportunity to present before the Society a critique of Mr. Carlson's very capable and admirable paper entitled, "Rate Regulation and the Casualty Actuary." There can be no question but that he has presented a substantially exhaustive and authoritative review of the history and background of the regulation of casualty rates. I consider it a splendid opportunity to present before this group of men who are instrumental in making rate regulation work, a few of the viewpoints and problems of independent carriers.

In his opening statements, Mr. Carlson emphasizes that his remarks are restricted to the liability, burglary and boiler lines in the casualty field, with emphasis on the viewpoint of a rating organization representative. My comments on Mr. Carlson's very fine paper will be confined to the major line of insurance written by member companies of the National Association of Independent Insurers: i.e., automobile liability and physical damage. The concentration of writings of these companies is in the midwest. As of the end of 1950, they totalled some 167 companies with most of them having relatively small volumes of premiums. As a matter of fact, 66 of these companies had countrywide casualty premiums in 1950 of less than one-half million dollars, and 93 of the companies had countrywide premiums of less than a million dollars. Only 19 of the member companies had countrywide, casualty premiums in excess of five million dollars a year.

It is important to recognize that the advent of rate regulation, countrywide, in one form or another has had a much greater impact on the independent carriers than on the organization companies. Mr. Carlson has touched on this

\*By invitation

in his comments on the viewpoints of some independent carriers during the formative stages of all-industry legislation, and in his comments on statistical plans. It must be remembered that the great bulk of the independent companies are relatively small; that never before did they have to consider more than ordinary logic and competition in the establishment of rate levels; that statistical data to support rate levels was practically non-existent; that even the most simple rate-making principles were unknown; and that only a few had progressed far enough to have a Casualty Actuary either in name or in function. It is amazing that they have progressed as far as they have in the few short years since the enactment of rate regulatory laws.

If we have *any* quarrel with Mr. Carlson's presentation, it lies largely within his discussion of supporting information for rate filings and his interpretation of the regulatory provisions calling for annual reporting of statistical data to supervisory officials. Let me say at the outset that we are duly appreciative of the laudatory comments which Mr. Carlson makes in connection with his discussion of the N.A.I.I. Statistical Plans. The Automobile Plan was designed to fit the needs of the majority of member companies who in the main were writing full coverage automobile insurance. This factor is the one largely responsible for the development of a statistical plan that would accommodate both liability and physical damage coverages. I might add that we are much encouraged by the present cooperative effort among the rating organizations handling auto liability and physical damage coverages. We hope that these efforts will be successful in the not-too-distant future in the ironing out of existent differences in rules, territorial definitions and coding. I say this because these differences are troublesome to those independent companies who use rating bureau manuals, and in some cases, bureau coding. I would assume that these same differences present problems to any full coverage automobile insurer, whether organization or independent.

#### SUPPORTING INFORMATION

The subject of supporting information for rate filings has been a troublesome one for independent carriers. It is readily acknowledged that the great percentage of independent carriers, numerically, do file rating bureau manuals with perhaps a provision for writing at 10 or 15% off manual. This is a hold-over from the pre-regulation days when for years these companies had been using bureau manuals with a small deviation and produced reasonable underwriting gains consistently. Since their volumes of business within the individual states had little or no credibility, they were in no position to support a bureau rate level with their own limited statistics. It was quite logical that they continue to write insurance on the same basis as in the past and to support their rate filings of bureau manuals with the supporting data that had been filed by the rating organizations. This is the primary reason for the so-called "Moser Amendment" which provided in part that, "the experience of other insurers or rating organizations" may be used in support of a filing. I know of no single independent company predicating its filings on bureau manuals, however, that produces more premium within an individual state than that produced by an automobile rating organization within the same state.

It is, however, quite true that the independent companies as a group do have more premium volume in a number of states than do the bureau com-

panies. As consolidated statistics of the independent carriers becomes available for two or more policy years, we anticipate that there will be an increasing tendency to use such statistical data for at least partial supporting information on rate filings.

Mr. Carlson is of course right when he says that no cut and dried generalizations should prevail in any consideration of the subject of supporting information. Supervisory authorities have exhibited considerable interest in the types of supporting information used by both rating organizations and independent carriers. In the great majority of cases, the experience data of a single independent company within a state is insufficient for rate determination. It will probably also be admitted by both regulatory officials and industry representatives that it is both permissible and logical to use statistical data submitted in support of bureau filings to support the filings of most individual independent carriers. The difficulty arises because the supervisory authority has no easy way to determine the premium volume of an independent company within the state for the coverages, classifications or lines involved in the rate filing. The annual statement or the insurance expense exhibit on file with the insurance department is frequently not readily available for the rate analyst's use and often does not contain a sufficient breakdown of state-wide premiums. It would be the better part of wisdom for the independent carrier to indicate in the filing letter its premium volume for the coverages, classifications or lines involved. Such a simple statement would immediately indicate the lack of credibility of the filing company's own experience. And in the great majority of cases it would completely satisfy the regulatory official. As to the reasonableness of using the rating bureau statistics for supporting purposes the controversy hence condenses down to the question of furnishing simple and readily available information to the supervisory official. In my conversations with the state rating authorities on the subject, they have readily agreed that all they need or want in most cases is a simple statement of this nature. Speaking as a representative of one of the larger independent companies in the automobile field, I will have to agree that it is better to submit supporting information in excess rather than in deficiency. As the independent carriers gather more experience in the making of rate filings, most of them will tend to supply sufficient information and hence eliminate many of the regulatory problems which have existed in the last few years.

#### STATISTICAL PLANS

For some time, there have been differences of opinion between independent carriers and organization companies as to the interpretation of that feature of the rate regulatory laws calling for the annual submission of statistical data. It is the viewpoint of the independent group that the filing of statistics for annual review purposes, and the filing of statistics in support of rate filings are two separate and distinct subjects. They are so treated in the regulatory acts. The development of the N.A.I.I. Statistical Plans was predicated on this viewpoint. We are firmly convinced that the reporting of annual statistics is designed to enable regulatory authorities to determine in a broad, general way whether or not the rates charged by carriers within the state seem to be fairly reasonable. I would assume from a study of the tabulated informa-

tion furnished state authorities by rating organizations, in accordance with the provision for reporting annual statistics, that the rating bureaus agree with this concept. The information furnished by rating organizations is usually a tabulation of premiums and losses by class and territory. It represents raw data with no calculated information on claim frequency, claim cost, pure premium or loss ratio. It contains no development for the two or more years usually used in the determination of rate levels. The data could hardly be considered as a submission of statistical information in support of current rate levels. Judging from the type of data thus submitted for annual review purposes, it would seem that the rating organizations concur in the philosophy that the submission of annual statistical data need not and should not be in the complete detail necessary for rate-making purposes.

Any discussion of the filing of annual statistics inevitably includes the question as to whether or not statistics for all companies within the state are to be reported in such a manner as to be readily combinable. Except on a broad, general basis, such combination would seem to be impractical, if not impossible. The substantial differences in classification plans, rating territories and methods of operation preclude the combining of loss experience for all companies in classification and territory detail. Even where such combination is possible, (monopolistic-rate states) I wonder if it does not work to the disadvantage of organization companies. A situation of this type arose in the state of Virginia a few years ago. The statistical data of the rating bureaus for auto bodily injury and property damage was not acceptable to the Bureau of Insurance because it did not include the experience figures of several large independent writers. When the experience of the independent companies was collected and combined with that of the rating organizations, the indicated rate level was reduced approximately 6%. No doubt the rate level that was thus established worked some hardship on the organization companies whose own experience indicated the need for a higher rate level. There is no reason to believe that similar results would not be forthcoming in any other state where regulatory authorities insisted on the experience of all companies in determining the proper rate level. Although I am not familiar with all of the reasons, it would seem that situations such as that just referred to is one of the main reasons why the rating organizations did not oppose approval of the N.A.I.I. Statistical Plans.

Mr. Carlson raises several questions in connection with the N.A.I.I. Statistical Plans. He makes a point that they do not appear to be designed to furnish complete rating information. Lest there be any question on this point, let me say that these plans were not designed as rate-making statistical plans nor is it contemplated that they ever will be rate-making statistical plans. They were designed solely to satisfy the obligation of the companies to report statistical data, annually, to regulatory authorities in accordance with the rating acts. The fact that the N.A.I.I. Statistical Plans were not designed for the development of statistics in complete, rate-making detail does not preclude their use in the rating process. A reasonable and adequate rate structure can be developed from the detail obtained under the N.A.I.I. Automobile Statistical Plan. The pure premium developed for private passenger classifications are quite adequate for the establishment of classification differ-

entials. Similarly, the pure premiums developed by territory will permit the establishment of territorial differentials. It is obviously true that the type of statistical data available makes for some limitation in the selection of rating methods. Basic limits premiums are not available but basic limits pure premiums can be readily secured. Credibility based on number of claims could not be used thus limiting credibility procedures to an exposure or premium basis. Classification detail for vehicles other than private passenger as well as some lack of uniformity in classification and territorial definitions among reporting carriers provides some further limitations. In his discussion of the Statistical Plans in use by organization companies, Mr. Carlson explains the "new approach" which is embodied in their automobile statistical plan which became effective January 1, 1951. This step must be accepted as a very forward looking program designed to materially reduce the internal statistical load for member and subscriber companies. Certainly the independent companies applaud this forward step toward simplicity in statistical plans. We are learning that too much statistical detail can sometimes be embarrassing when it comes to "selling" a rate revision program. It leads to the thought that perhaps the long-time views of independent carriers on simplicity in statistical plans may have some merit.

In summing up the history of the controversy of reported statistics versus supporting information, Mr. Carlson intimates that perhaps the views expressed by independent carriers are largely a matter of principle to highlight a policy of non-uniformity rather than a matter of deep-seated adherence to the details of such non-conforming practices. Many examples can be quoted which would indicate that this viewpoint of the independent carriers is far from being simply a matter of principle. Two outstanding examples involve the pioneering done by independent companies in the field of a special classification for farm vehicles and the development of the 80% collision coverage. It has not been until recent years that the organization companies have recognized the validity of a special classification for farm passenger cars. Those of us who have specialized in the field know as a matter of long experience that the farm passenger car pure premium differential ranges from 10% to 35% on bodily injury and property damage and from 20% to 40% on automobile physical damage coverages. The development of the 80% collision coverage goes back to the early twenties. For some independent companies, a substantial portion of their collision premiums comes from the 80% coverage. Where this is true, the rate levels for the coverage are relatively low, averaging out at about the rate level of the \$25 deductible collision coverage. Probably as the result of the competition produced by the introduction of this coverage, the organization companies made it available to their members and subscribers. Their loss experience on the coverage, however, must have been substantially unfavorable since the rate levels which they use today for the 80% coverage range from 70% to 100% higher than the rates used by those companies who have more or less specialized in the coverage. These are only two out of many examples that might be quoted to prove that there is a basic logic back of the necessity for non-uniformity and non-conformity by independent carriers. No—the stand against uniformity is much more than a matter of theory. The principle of non-uniformity has been instrumental in developing classifications and coverages beneficial to the insuring public.

## MANUAL RATE-MAKING PROCEDURES

Mr. Carlson is to be complimented on his very creditable job of outlining the manual rate-making procedures in simple and substantially non-technical terms. Particularly in the field of credibility procedures there has been considerable misunderstanding at the insurance department level. It seems to me that this discussion adds materially to the written subject matter and should be of assistance to all rate filers who must "sell" their rate revision programs to supervisory officials. It also seems to me that considerable benefit would be derived from making Mr. Carlson's paper available to all supervisory officials—particularly that portion of it dealing with rate-making procedures.

The historical development of the profit and contingency factor in casualty rates could perhaps be supplemented by decisive arguments in favor of a profit factor consistent with generally recognized profit elements in most industry outside the insurance field. The announced program of the National Bureau of a 5% profit and contingency factor is no more than reasonable in relation to the factor used for lines of insurance other than casualty, and in relation to what is considered a reasonable profit outside the insurance industry. If for no other reason, casualty insurance rating programs should contain a sufficient contingency factor to protect the financial structure of insurance companies against the vagaries of unknown future conditions. To be able to come within 5% of a rate level needed to produce reasonable underwriting results is no mean accomplishment. This is particularly true in the insurance business where it is often difficult to judge the effect of outside influences that materially effect the level of both claim frequency and claim cost. Those responsible for the promulgation of automobile liability rates in the last six years cannot be very proud of the underwriting results produced by the rate levels in use. It seems only reasonable that the rate makers should have allowed themselves greater leeway for contingency factors.

In summing up his discussion of rate-making procedures, Mr. Carlson comments on the necessity for judgment and flexibility. Here again, the independent carriers as a group must say a fervent "Amen." First and foremost: they stand for complete recognition of flexibility in the rate-making process and the exercise of sound judgment in the development of their rating programs.

## CONCLUSION

In spite of the few conflicts of opinion as between organization and independent carriers upon which I have commented, it seems to me that the areas of disagreement are but a small part of the over-all problem of learning to live under a system of relatively strict rate regulation. There are some of us who now think we may have jumped too quickly when we agreed to some of the limiting provisions within the all-industry bill. At least there have been a few states which have taken a substantially different approach to rate regulation that may some day point the way to modification of some of the more onerous provisions in the all-industry bill. It will be interesting to watch the development in such states as California, Missouri and Idaho and to evaluate the results of regulation under the types of laws in force in those states.

When you stop to think about it, there has been a continuously progressive tendency to recognize in both organization and independent circles the neces-

sity for cooperation and collaboration in the solution of ever mounting regulatory problems which have their effect on all of us. As Mr. Carlson has so aptly said, "Regulation is with us, to stay, and only a proper appreciation of its impact on all parties can produce reconciliation of conflicting interests that will make it work for the good of all." To this end, Mr. Carlson's paper has contributed substantially.

## AUTHOR'S REVIEW OF DISCUSSIONS

BY THOMAS O. CARLSON

The critics have been kinder than I anticipated a couple of weeks ago when I penned these lines which would serve as an introduction to my review of the discussions:

In this opus long in process  
I have thrust the old proboscis  
Into regions that a wiser man would shun.  
Lured by flickers of illusion  
Into fens of fell confusion,  
I'm astounded that the goal was ever won.

Worse than Perils of Paulina  
Is the critical arena  
Where I probably will be reduced to pap.  
But when epitaphs are written  
And the laurels tossed as fitten  
Let it not be said I ever shirked a scrap.

The comments of the four reviewers are to be highly commended for their constructive suggestions and for the extent to which they have rounded out the presentation of viewpoints that I was not in a position to represent with completeness.

Mr. Ginsburgh has presented a position which I shall designate as somewhat to the right of mine, using the term "rightism" as analogous to conservatism. His remarks represent fairly the basic differences in thinking that lie between the organized stock and the organized mutual companies. At the same time I cannot disagree fundamentally with his expression of caution as respects the utilization of such flexibility as we are able to preserve. I stated the case for flexibility forcibly because there have been such strong movements toward the restriction of such freedom of action as is now permitted. We all recognize that the flexibility presently available is a privilege the continuation of which is contingent upon the avoidance of its abuse.

As respects Mr. Ginsburgh's remarks on the basic criteria for judging rates, I still maintain that company solvency is of paramount importance in any case where doubt, or a legitimate field of argument, exists.

Mr. Resony, as expected, has concentrated on the particular problem of approval of other filings, once the filing of the central rating bureau has been acted upon. I think he has introduced a slight confusion in his reference to a

bureau filing as the upper limit of what we have discussed as the "zone of reasonableness". It may be, for all practical purposes, the upper limit of the filings to be expected by the hangers-on, but it is by no means necessarily the upper limit of the "zone of reasonableness".

This entire problem of independent filings, upon which Mr. Pruitt and Mr. Griffith also expound at length, reminds me of the school marm's question: "If there were twelve sheep in a field and one of them jumped over the fence, how many would be left?" A little boy answered: "None." The school marm observed: "Johnny, you don't know arithmetic;" to which Johnny's immediate comeback was: "No, ma'am, but I do know sheep."

I must express appreciation, in passing, for his plug for the "fairly credible" expense data produced by uniform accounting. Perhaps some one will some day produce a balance-scale on which we can properly weigh the conflicting expert testimony on that score.

Mr. Resony makes a legitimate point in stating that the final determination depends on the judgment of the supervisory official. That judgment is, of course, subject to review on hearing and in the courts. He also feels the "supporting information" provisions are the most important in the law. In that connection, I was surprised the other day, in talking to a Commissioner, to find he had overlooked the provision that he can call for supporting information, and by implication may of course indicate what he considers would be relevant to support of the filing.

With Mr. Resony's conclusions in summary I cannot quarrel, except for the fourth, suggesting review of all judgment factors with supervisory officials prior to the formal submission of a revision. Consider for example a boiler and machinery revision, which includes countrywide schedules of rates. How could a rating organization practicably consult in advance with supervisory officials in all jurisdictions as respects the judgment factors entering into the determination of the rates? As a matter of fact, the latitude of the officials in the handling of such a revision is going to be a good indicator of the possibility of the future success of regulation on the state level.

We are fortunate to add to this discussion the viewpoint of the N.A.I.I. carriers or, as I like to call them, the organized independents. Mr. Griffith is a competent spokesman and has directed his comments, as expected, to the two controversial items of statistics and supporting information, although his statement, near the close, on the profit and contingency factor is worthy of attention from all of us.

There are instances in which the writings of a single independent carrier predicating its rates on bureau filings approximate the combined writings of the bureau companies in the state. I do not feel that Mr. Griffith's suggestions answer the problem of the supervisory official in the state where the independents write the great bulk of the business—but indeed no one has yet satisfactorily solved that problem.

On the matter of statistical plans, we remain in fundamental disagreement in principle. Mr. Griffith's statement is, and I quote: "We are firmly convinced that the reporting of annual statistics is designed to enable regulatory authorities to determine in a broad, general way whether or not the rates charged by carriers within the state seem to be fairly reasonable." I ask you to compare that with the phraseology in the regulatory laws to the effect that such statis-



tics shall be in such form and detail as necessary to aid the commissioner in determining whether rating systems comply with the standards set forth in the law. To me, the comparison of the statements is sufficient to show a serious disparity in objective.

As respects the side-remark on the inadequacy of statistics furnished by rating organizations: (1) Mr. Griffith has clearly not seen all the data we furnish; and (2) the statistics are there and the law states they are to enable the commissioner to analyze; the burden of actuarial analysis is not put upon the statistical agent, but rather only the burden of compiling adequate data. I suggest the possibility that the supervisory officials delight in playing the organized carriers against the independent carriers in this connection, possibly with the objective of obtaining ultimately a uniform statistical system which will be simpler for them to administer.

For the record, since Mr. Griffith has conjectured as to the rating organizations' lack of opposition (why does he not acknowledge their assistance?) to the N.A.I.I. plans, let me say, and with authority, that it was solely because such a course was in accord with the principles underlying the Model Bill.

I do not want to engage in a dog-fight on rate-making principles, but as respects the statement that "a reasonable and adequate rate structure can be developed from the detail obtained under the N.A.I.I. Automobile Statistical Plan", I can only comment that in the first state I know of where the issue has been clearly posed, namely in Texas, the supervisory officials distinctly disagree with that thesis.

No one will quarrel with Mr. Griffith's conclusions on trends in thought throughout the industry, and his high-lighting of them is timely.

I am always genuinely fascinated and entertained with Mr. Pruitt's facility in speaking and in writing. His quotations would indicate that my isolated moles (or beauty-spots) have induced in him a sympathetic outbreak of freckles. The freckles are far more becoming, and beyond competition; or, as the shop-owner's sign puts it, he "defies computation."

Certainly he has avoided the dangerous pitfall of the profuse quoter into which tumbled the young Texas lawyer who in his first pleading wove in Shakespeare, Milton's *Areopagitica*, Locke on Human Understanding and many another imposing literary classic; the friendly judge at the close congratulated the quote-happy lawyer and added: "We have greatly enjoyed the points you have made and if we ever have a case before us in which they are involved, we shall certainly bear them in mind."

I shall comment only on Mr. Pruitt's criticisms.

In the matter of statistics reported by independents, I am surprised to find him taking a quotation out of context and performing a Don Quixote act with it. The quotation referred specifically to the *extreme* situation where a double standard is pressed providing for rigid regulation of rating organizations and virtually no regulation of independents.

As respects the coat-tails, Mr. Pruitt is the first spokesman for the independents whom I have heard disavow that metaphor. What he says on their behalf is true, although it is no less true that rating organizations have also contributed their share of new forms and techniques. I refer once again to my story of the sheep, and am content to rest my case with the second half of his quotation from Kon-Tiki on pilot fish.

In reference to supporting information, I particularly appreciate the phrase, "a premium is placed on prolixity," as an alliterative statement of fact that officials would do well to bear in mind.

Since Mr. Pruitt is so critical of making the simple complicated in Plan D, we all look for a paper from him restoring simplicity to its proper place therein.

In closing let me sprout two more moles, both originating in that modern master of phrasing, Christopher Morley. The first explains my approach which has resulted in such a wide area of agreement on the part of my reviewers:

"Most of all, men, I adore  
Who tells me what I knew before  
And with such tact that we agree—  
Not I with him, but he with me!"

The second describes the reaction of all of us whenever we come face to face with this morass of regulatory problems. Thus spake the Old Mandarin:

"Once, in a fluoroscopic clinic,  
I saw the workings of my entrails  
Reflected on a screen.  
Grievously I thought:  
My mind, too, churns like that."