

DISCUSSIONS
OF PAPERS READ AT THE NOVEMBER 1951 MEETING

THE NATIONAL DEFENSE PROJECTS RATING PLAN

WILLIAM LESLIE, JR.

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WRITTEN DISCUSSION BY CHARLES J. HAUGH

In setting forth the details of the National Defense Projects Rating Plan and its evolution, Mr. Leslie has made a very valuable contribution to the *Proceedings*. In attempting to discuss a paper of this nature one finds himself limited to calling attention to omissions, misstatements of fact, or, as a last resort, to quibbling. I find myself unable to call attention to any serious omissions or misstatements of fact. Therefore, I must quibble.

As Mr. Leslie states, this plan in essence is simply a revival of the Comprehensive Insurance Rating Plan which was in effect during World War II, but revised to correct defects and annoyances which were inherent in that plan. This present plan is a substantial improvement over its predecessor. The use of composite rates on a payroll basis for determination of the standard premium for automobile and general liability insurance; the inclusion in the fixed charge of a provision for profit and contingencies; and the treatment of the catastrophe hazard on risks involving manufacturing or handling of explosives are among the more important revisions which bring about substantial improvement in the plan.

Mr. Leslie has thoughtfully incorporated two statements with which one can disagree. I have no thought of injecting lexicography into this discussion, but I cannot refrain from expressing my unhappiness over his use of the word "wholesaling" in his statement to the effect that "the new plan, like its predecessor, provides for the wholesaling of automobile liability, general liability and workmen's compensation insurance. . . ." These coverages are combined in a retrospectively rated package, but I question the "wholesaling". Since the plan provides for the employment of an advisor regardless of the type of carrier involved, the advisor's fee is not a part of the insurance premium, but is treated separately. Aside from that, the charge and rating values are quite in accord with those developed generally on retrospective rating plans. This constitutes my first quibble.

Beginning on page 181, Mr. Leslie shows a series of calculations developing an indicated ratio of unallocated claim expenses to losses of .135. Actually in the table on page 181 on which there is developed the ratio of unallocated claim expense to losses, the permissible loss ratios used for lines other than compensation are not the permissible loss ratios for losses alone, but are the permissible loss ratios for losses plus allocated loss expense. Since the factor to be used is applicable to losses exclusive of allocated loss expense, this calculation to test the adequacy of the 1.12 factor should be based upon a permissible loss ratio exclusive of allocated claim expense. However, at this point I must confess to being engaged in my second quibble, for these liability lines constitute a minor part of the total hazard and the resulting effect is insignificant. However, as I indicated at the outset, a discussion of a paper is of no

value if it does not afford an opportunity to call attention to any slip which shows, however slightly.

Up to the present time the volume of business subject to the plan is relatively small. However, it is important that the plan be available, not merely for the relatively small volume of business currently written under it, but for use in the event conditions arise necessitating a rapid expansion of its use.

THE MAKING OF WORKMEN'S COMPENSATION RATES—
1951 PENNSYLVANIA REVISION

GEORGE B. ELLIOTT

Volume XXXVIII—Page 141

WRITTEN DISCUSSION BY A. Z. SKELDING

Mr. Elliott has noted that the Pennsylvania ratemaking structure differs considerably from that used in many other jurisdictions. Had I Tom Carlson's erudition, or if a copy of "Bartlett's Familiar Quotations" had been on the shelf of our local library where it should have been perhaps I could inject here a more elegant quotation than the homely adage which now occurs to me, namely, "There's more than one way to skin a cat."

I take it that this is neither the time nor place to attempt to argue the relative advantages of one system as against the other. It may be of interest, however, to point out some of the principal differences between the ratemaking procedure of the National Council and of the system described by Mr. Elliott.

It appears to me that, perhaps, the most important difference is the use of wage factors, or payroll modifiers, in the Pennsylvania system which includes, not only a modification of payrolls on the basis of known changes in average weekly wages by broad industry groups during the five year experience period, but a projection to the midpoint of the period during which the new rates are to be effective.

Back in the early 1920's, the ratemaking procedure of the National Council also provided for the use of a wage factor. Without going into detail I merely mention that this program did not work at all satisfactorily. Finally, as noted in the report made to the NAIC by the late Clarence W. Hobbs at the September 1925 session of the NAIC, it was recommended "that the troublesome wage factor be eliminated."

Nevertheless, during the recent war period it became evident, because of skyrocketing payrolls coupled with the influence of other factors, some of which worked in a contrary direction, that some modification of the then current ratemaking program was desirable.

I do not want to take the time to expound at length upon the studies made by the staff of the National Council, its Committees, and Committees of the NAIC in investigating this problem. Those who are interested in the details will find a complete exposition in the reports of the Workmen's Compensation Committee in the Proceedings of the NAIC, beginning with the 1943 session and continuing almost to the present time.

Suffice it to say, that as a result of those studies the carriers reported to the NAIC, prior to the December 1947 session "Subject to approval and endorsement by the NAIC," the carriers will introduce into the compensation rate-making structure a rate level adjustment factor giving overall recognition, state by state, to the aggregate effect of factors which produce underwriting results either better or worse than those contemplated by the rating structure. Such factor would be based on underwriting results in the individual state within a specified period of the recent past and would be limited in its effect to a moderate percentage of decrease or increase in the rate level otherwise determined. The present procedure of the National Council provides that the latest available 12 months of calendar year experience, which depending upon the time element may terminate either December 31 or June 30, shall be used in determining the rate level adjustment factor and such factor shall be limited to a maximum of 1.10 and a minimum of .900.

I suppose Pennsylvania and Delaware have had a longer continuing use of a wage factor in their ratemaking structure than any other states. I also suppose Texas, which promulgated such factor, beginning in 1943, is about the next in longevity although, in promulgating revised rates to become effective December 1, 1952, the Texas Board of Insurance Commissioners, the rate regulating authority for that state, has discarded its previous "wage trend formula" for the current rate level adjustment factor program of the National Council. It appears that the primary reason for this action, after some 9 years of adherence to a wage trend factor, is that the Board is convinced that, under current conditions, the wage factor fails to give proper recognition to all of the elements, subsequent to the policy year rate level period, affecting compensation costs, and a much more satisfactory recognition of all of those elements is made through the use of the latest calendar year data without the intricacies of further projection.

At this point it is, perhaps, desirable that I pause a moment to explain that I have not forgotten my previous statement that I believe this is neither the time nor the place, in an objective discussion of Mr. Elliott's paper, to argue the relative advantages of one system against the other. I have been trying to adhere to a factual presentation. We like our system and Pennsylvania presumably likes its system. All of which may be merely another way of saying "What's one man's meat or drink may be another man's poison."

There are other differences, some of detail, and some of principle. Merely for the purposes of information, without any attempt to comment thereon, it may be helpful to list a few of them.

- (1) Pennsylvania uses five policy years, or 60 months of issue. Most states, although not all, use 24 months of issue.
- (2) Pennsylvania excludes the experience of minimum premium risks and experience of rated risks with more than 75% credibility. Most other states do not make these exclusions, although I believe New York now excludes the experience of self-rated risks.
- (3) Pennsylvania formula rates, in general, between the five year experience and the 15 year experience. Most states, although not all, formula rate between the two year experience and previous experience as reflected by the current rate.

- (4) Pennsylvania assigns credibility on the basis of the average annual number of temporary total cases. The Council procedure uses expected losses, based on the two year payrolls and present rates, for this purpose.

There is also considerable difference in the Pennsylvania system of adjusting reported experience to current levels. I do not propose to comment on those details except to remark that the relatively small number of classifications in Pennsylvania compared to the almost 700 classes, not all of which develop exposure, in other jurisdictions may, perhaps, have something to do with the different method of treatment. The great number of classifications in the National Council Manual, to say nothing of the great number of exception classifications and special classifications in a number of states, many with extremely small exposure, is the bane of the ratemaker's existence.

I was interested in the example on page 155 of the derivation of the 1951 rate for classification 225, Rubber Goods and Fire Manufacturing, and the subsequent remark of Mr. Elliott that for the larger classes it makes very little difference in the final rate whether such rate is based on the five year experience or the combination of the five year and fifteen year period. The same observation could be made of procedures in effect in other jurisdictions. This leads one to wonder regarding the wisdom of the enormous detail and refinements we go through to come up with a rate which differs only slightly from the current rate or from that produced by one of the intermediate steps. On the other hand, I suppose this is a case of hindsight (after the answer has been ground out) being better than foresight (before we know the answer) and there is, of course, much to be said for following a uniform procedure, without discrimination, letting the chips fall where they may.

Reference is made to a change to be made in the use of the experience period for the 1952 revision, that is, to get away from the use of what we have previously known as policy year experience, so that the latest policy of the experience period will expire exactly 12 months prior to the effective date of the 1952 rates. This involves, instead of a January 1st starting date, the use of the experience of policies issued to become effective between July 1st of a given year and June 30th of the following year. The National Council has embarked on a similar program, except that it provides that the latest policy in the experience period shall have expired 14 months prior to the effective date of the new rates.

The trouble is that, for one reason or another, action on proposed rates is sometimes delayed and new rates become effective quite a bit later than was expected at the time of filing. In most cases this automatically establishes a new anniversary date for the next revision, or if the old anniversary date is maintained, means two revisions in less than a year. Either result gives rise to difficulties. With the new anniversary date we widen, beyond 14 months, the lag in experience because it is a practical impossibility, for the coming revision, to go back and retabulate the classification experience for the earlier years on a different experience period so as to maintain not more than a 14 month lag. The difficulty of two revisions in a 12 month period is obvious if rates are going up—as they are in most cases today.

In conclusion, may I express the thought that Mr. Elliott has performed a real service for many of us in his lucid description of the Pennsylvania rate-

making procedure. Many of us are reasonably familiar with the broad aspects of the compensation ratemaking procedure in other states and to some of us most of the details are also known. The Pennsylvania method did not seem to be so well known except among the people who actually worked personally with it through membership on Committees of the Pennsylvania Bureau. I am sure that those members of the Society who are interested in the problems of workmen's compensation ratemaking will welcome Mr. Elliott's careful and detailed explanation of the Pennsylvania system. It is going to be helpful to have that system set down in writing for ready reference in the *Proceedings* of the Society and, to drag in another quotation that, I believe, I read some place, but I don't know where, "with such lustre that he who runs may read."