

PROCEEDINGS

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PRESIDENTIAL ADDRESS BY THOMAS E. MURRIN

In this city on November 7, 1914, the Casualty Actuarial Society was founded by a group of 97 men who were active in actuarial and statistical work in the casualty insurance business. We now gather in a vastly different New York City to celebrate the Society's Golden Anniversary. It is indeed a pleasure to have with us practically all of our Past Presidents as well as four of the ten living charter members who attended that first meeting in 1914.

In addition to its significance to the Casualty Actuarial Society, this year is historical for other reasons. It would have been the 75th anniversary of the Actuarial Society of America if it had not merged with the American Institute of Actuaries to form the Society of Actuaries. Moreover, the formation of the American Academy of Actuaries was approved last May by the four national actuarial bodies – life, public practice, fraternal, and property-casualty. When granted by Congress, hopefully at the next session, a Federal Charter will formally give recognition to the actuarial profession and to carefully designed standards which must be met for a person to identify himself or herself as an actuary qualified in one or more fields of insurance. By the able, dedicated, and cooperative efforts of members of the various actuarial bodies, the American Academy of Actuaries is now on the threshold of reality.

It is customary at this point of the meeting for the president to address the membership and our distinguished guests. While an accident of time makes my term as President coincide with the Golden Anniversary of the Society, I deem it a particular privilege to have the honor of addressing you on this historic occasion.

There is no need for me to review in detail the history and accomplishments of the Casualty Actuarial Society. The accomplishments of the Society are contained in the *Proceedings* and in other works of its members; their careers, founded in actuarial science, have reflected advancement into such other positions as company executives and presidents, bureau mana-

gers, insurance commissioners, authors, and professors. The history of the Society has been covered more ably than any of my efforts might have done in two excellent papers prepared for this meeting. I recommend you read "Early Actuarial Studies in the Field of Property and Liability Insurance," by immediate past president L. H. Longley-Cook, dealing with the period prior to the formation of our Society, and "The First Fifty Years," by past president D. M. Pruitt.

My remarks will therefore emphasize more the present and future relation of our Society and its members to the broader picture of the insurance industry, with only a few brief references to the past to indicate how far the insurance industry and the actuarial profession have come in the last 50 years.

The founding of the Casualty Actuarial Society occurred at a time when there was a need for a concerted industry approach to a new problem. That problem, of course, was the rapid enactment of Workmen's Compensation laws around the country and the necessity of providing insurance to cover the benefits contemplated by those laws. In the five decades since 1914, the size and complexity of our industry and the country's economy have changed beyond the imagination of even the most foresighted individuals in 1914. From an underwriting point of view, there have been good years and bad years in this span and it is to the credit of actuaries that through the development of sound statistical plans and precise yet responsive ratemaking methods, compensation insurance has been able to keep pace with the economy and introduce indicated rate changes in a timely manner before rates became excessive or seriously inadequate.

At the time of the Society's founding, automobiles were beginning to appear on the scene to replace horse-drawn carriages. For many years, the premium developed from teams liability exceeded that produced by insuring automobiles, but the automobile industry and automobile insurance in turn have grown so rapidly that in 1963 the industry premium volume approximated \$7 billion. In this area too, actuaries have contributed much to the development and modernization of ratemaking methods and classification systems.

Property insurance premiums likewise grew during this half century as building, commercial, manufacturing, and industrial activities have expanded to meet the needs of the increased population. It was only during the last 15 years that actuaries became active in this field. Significantly, in recognition of multiple line developments, the scope of the Casualty Actu-

arial Society was broadened in 1950 to include property lines and the Society even considered a change in its name.

What is the condition of our industry today? We find it suffering serious underwriting losses in several major lines of business. These losses are usually attributed to inadequate rates. Underlying rate inadequacy are many factors. One often overlooked is that of excessive competition. Many colloquial adjectives have been used to describe the competition but their common denominator can perhaps best be described by the term "excessive." Competition is the essence of our private enterprise system, of which the insurance industry can proudly proclaim itself a vital part. We have always had competition, and if we do not have it, our business will no longer be a segment of the private enterprise system. Basically, competition is one of the many sciences of management and it is this "science of competition" I would like to explore with you today.

In glancing through a business publication recently, I read an article on current competitive problems which included the following statement, "The impact of an entirely new producer was reflected quickly in the price structure. Old established producers had to reduce prices to meet the competition provided by the new producer, who offered discounts to attract customers." Reading on, I noted another statement on competition in this article, "New producers continue to enter the market in spite of the decreased profit margins during recent years." And, still again on the same subject, "Often competition is intensified when a large company diversifies through the acquisition of another company. The large company is often able to offer technical, financial and management assistance which feeds the growth of a new subsidiary."

From these statements, I naturally concluded that the author was talking about the insurance business and that he was merely repeating things that we had all heard many times before. It wasn't until I reached the end of the article that I realized that the author had not been talking about the insurance business but rather in the first quotation was referring to the steel business, in the second quotation to the cement business and in the final quotation to the electronics industry. To describe how things are "rough all over" in terms of competition, a final paragraph described still another industry where competition is at an all time high – the toy industry. The competitive problems of the insurance industry are certainly not unique.

A review of the current competitive situation in our business is meaningful only if we review its historical background. For many years price

competition among major insurance writers in this country was minimal. The ability to sell casualty and fire insurance was based to a large extent on individual companies' proximity, reputation, financial standing, and ability to service risks. This situation existed both prior and subsequent to the Southeastern Underwriters decision. After World War II, however, a new type of insurer, the direct writer, emerged as a leading factor in the automobile insurance business. Placing great emphasis on a lower price and utilizing selective underwriting and mass marketing techniques, these companies were successful immediately. Their entrance into the field of insurance is particularly significant for it marked the beginning of a revolution within the industry and the first step in a transition from a seller's to a buyer's market. We all know the result.

Witnessing the rapid success and growth of the direct writers, stock and mutual companies alike responded somewhat belatedly at a critical time when inflation was absorbing the provision for contingencies and profit and was eating into surplus. In attempting to recapture much of the lost market and to prevent further inroads, these companies introduced new classification, marketing, and pricing techniques. This naturally led the direct writers to intensify their efforts. This action and reaction stage is where we find ourselves today. On an industrywide basis, it has resulted in a general underpricing at the worst possible time – when the overall economy is being influenced by an inflationary trend.

Compounding the interplay of competitive zeal and inflation that contributed to underwriting losses of such severe magnitude was the fact that this revolution in merchandising was being accompanied by the practical operation – despite the deemer provision – of the newly adopted prior-approval rating laws. The inevitable adjustment from the “good old days” in pricing, marketing, and classifications was affected and in many cases hindered by the application of these new ground rules. Pressures for their unduly literal interpretation also beset their administrators from various sources, some of which were difficult to understand logically.

Coincidental with the adoption and operational administration of the rating laws was the introduction of multiple line legislation over a period of several years. It was not long before the competition previously felt in automobile lines exploded in the dwelling business with the phenomenal growth of Homeowners contracts. Underwriting results became progressively worse as price competition intensified.

Lest you think I am going to lapse into a lament on our present predicament, relax. You have heard it before but more importantly, I think

we all have reason to be optimistic about the future of our industry and the influence of competition on it. My optimism is based upon a belief that the long term trend in the property and casualty business in this country is away from the type of competition that currently exists. I do not mean to imply that we will have a return to the "good old ways." These are gone forever and competition is here to stay. However, I believe it will be drastically different, characterized by maturity and a more scientific approach. There will be price differences but the ability to sell will not be based solely on price. Many of the factors, such as the costs of merchandising (including one stop shopping for all insurance needs), procedures that make it easy for the insured to budget his purchases, and a reputation for intelligent, fair and prompt claims handling will be necessary. Yes, you might even say "image" will be a factor.

Among the reasons why I believe price per se will not be the controlling factor is the fact that the current general market situation is vastly different from that which existed ten years ago – a fact that some may overlook in grappling with day-to-day problems. In the last ten years most companies have adopted modern merchandising techniques so successfully used in other industries. Where not too long ago many companies felt that prosperity was inevitable, all have since learned that aggressive salesmanship is essential for even a minimum of success. In addition, all companies now realize that to compete effectively it is necessary to operate at the lowest possible expense ratio and utilize the most simple and efficient accounting and processing procedures. In general, those differences which characterized the stock, mutual, and independent companies fifteen years ago have faded somewhat. Each segment has learned considerably from the other, even with the result that modifications in coverages, classification plans, rating plans, and marketing systems have been reciprocally adopted. In the process each has obtained a basic respect for the other. From this basic respect evolves the recognition that all segments of the industry are here to stay and compete and that there is sufficient room in our expanding economy for all to prosper. This reason for optimism can become a reality if based on the premise that competition must reflect sound pricing and merchandising methods in our business as in every other business.

An equally important cause for optimism is the fact that reliance on scientific analysis is expanding in the property and casualty insurance business. I think it is axiomatic that as the mathematical knowledge of the true cost of selling a particular type of insurance to an individual in a given class increases, competition based solely on price is correspondingly re-

duced. You will note that I say "reduced" and not "eliminated" because first, we will never know with certitude the true cost, and second, within any group there will always be risks a little better or worse than average. Accordingly, each company will need to underwrite its business. My point is, that through scientific statistical refinements and sound rating techniques, the experience of any one class will reflect a more homogeneous grouping than ever before. While underwriting will still be necessary, the amount of "skimmable cream" and possible price variation will have been reduced.

The life insurance business affords a good example. Scientifically compiled information in the form of standard mortality tables is the foundation of the proper pricing of life insurance contracts. Competition has certainly been keen but because the expectation of loss for different ages is fairly definitely predictable, competition based *solely on price* has been conducted within very narrow limits and other factors such as coverage innovations, service, reputation, and salesmanship play a major role in the company's ability to attract customers. Contrast this with our business where in the past several years varying discounts utilized by individual companies to attract customers have been based not on analysis of actual loss or expense savings – often this information has been unavailable – but rather on optimism and judgment colored by competitive pressure that "hopefully, with a little luck we will come out ahead." A quick look at the balance sheet for most companies will show that this has not happened. We may never be able to determine our expectation of loss for any particular group of risks as precisely as do life actuaries from mortality studies because there are many other factors – social, economic, and even psychological – which do not lend themselves to exact measurement in our business.

Nevertheless there are many indications that expectation of loss in the property and casualty fields will be measured more accurately than ever before. For example, the new classification plan for private passenger automobiles that was recently announced will enable actuaries and underwriters alike, with the aid of electronic processing equipment, to closely determine the true cost of selling insurance to various classes of insureds.

In the field of fire and allied lines, the traditional compilation of statistics apart from ratemaking requirements has made actuarial study difficult. Actuarial medicines – meaningful statistical plans and sound rating techniques – are necessary for the restoration of health to the fire insurance business. But the indispensable determination for a successful recovery will also require some hard thinking by many with respect to the traditions

and practices of the past. Some of the problems involved here are term business written at guaranteed rates, complicated by discounts for pre-payment and even installment payments, proper insurance to value, coinsurance, the use of deductibles, loss adjustment costs, and other expenses.

However, it is encouraging to note, that, more and more, actuarial science is coming to the fire insurance business. Another optimistic sign is the general recognition in the fire business that rate competition is only as sound as the rates themselves and that rates can only be sound if they are developed from a scientifically refined statistical plan designed for ratemaking requirements.

In this changing competitive scene, what can the actuary contribute? First of all, he must be responsive to the changing complexion of the industry. I believe that the actuary should not be concerned solely with statistics and ratemaking formulae but that he must continually broaden his horizons and utilize those economic, legal, and underwriting principles applicable to the industry as a whole which are an essential part of the Society's examinations. Conventional approaches to problems must be re-evaluated. The opportunity of utilizing modern statistical methods in our studies must not be overlooked because we now have the equipment to handle what otherwise would have been tedious mathematical computations. There is an obligation to develop suitable and proper ratemaking refinements heretofore considered impractical and to be optimistic that we can convince our associates in industry and regulatory officials in particular, of the soundness of such refinements.

For example, five full calendar years of classified industry experience are hardly necessary to develop fire or homeowners rates that meet statutory requirements. Yet the inclusion of such a requirement in many state laws suggests that modernization of these laws is needed in this age of computers in which valid results can be achieved by the use of tested and accepted statistical sampling procedures. Improvement in rating laws and their administration could result if these procedures were recognized together with the basic economic principle that competition determines the success of a product and its price in the market place.

Consider how sampling techniques in the recent election were able to accurately predict final results from fragmentary early returns in many of the election contests and how they could be used in fire and homeowner's ratemaking. The biggest challenge in the area of sampling, I believe, is in the commercial package field. In order to insure a profitable outlook for these policies and determine what I described previously as the expectation of loss for particular classes of insureds or coverage forms, it is vitally

necessary that we consider ways and means of sampling the early returns under a statistical plan less complex than that currently in effect. We should be optimistic enough to agree that this can be accomplished.

In addition to being responsive, the actuary must continue to develop his ability and desire to counsel other members of management. The simple fact that insurance is a business of numbers is often overlooked. We sell protection or indemnification in dollar amounts for which the consideration is also expressed in dollars. Marketing, underwriting, and claims are the indispensable components of property and casualty insurance but each of these involves numerically quantitative elements, in addition to other important factors. If our industry is to succeed and prosper, our associates in these three areas will need a much greater understanding of the significance of statistical data than was necessary in the past, when coverages and rating systems were more simple and the questions involved in agency evaluation, underwriting and rating policies, and claims management did not have to be made under the pressure of competitive conditions.

The property and casualty insurance industry has certainly changed in the last fifty years. Our charter members as well as our newest members undoubtedly would agree that we will continue to face changes, all basically generated by changes in the science of competition. Insurance has demonstrated itself to be vital to the American economy and actuaries have ably proven themselves to be vital to the insurance business. Future responsibilities will be heavier than those of the past and the challenge will be how to meet them successfully.

I am optimistic enough to believe that, despite the weight of the burdens, success will be achieved. Achievement, however, will require recognition that competition is a factor in pricing. Struthious reaction to the often struthious actions of others is folly. Competitive reaction must be the product of mature, scientific evaluation.