

stock company can best serve his management by analyzing rate level indications and business distributions and advising accordingly.

It would seem that a more thorough investigation of this subject with emphasis both on state rating procedures and market penetration by the various types of carriers would be necessary in order to fully explore this problem and Mr. Longley-Cook is to be thanked for his paper which opens this area to investigation.

AUTHOR'S REVIEW OF DISCUSSIONS

I greatly appreciate Mr. DuRose's careful review of my paper on profit in fire bureau rates. This is an important subject and Mr. DuRose's comments call for a considered reply. My paper aimed to show that, if mutual and independent loss experience is included in the data used for making bureau rates for stock agency companies, the rates developed may not, in fact, be adequate for such companies and will certainly not provide the 5% profit in the Commissioner's formula.

Mr. DuRose argues that regardless of whether my contention is correct, fire insurance rating bureaus may be required by law to use all the experience of the companies for which they make rates, namely, all members and subscribers. It is unfortunately true that in the regulation of insurance there has been a tendency to seek to determine matters of ratemaking, not on the question of the adequacy of the rate for various companies which would seem to be the intent of the law, but on the literal interpretation of the wording of other sections of the law which were written many years ago without contemplating conditions as they exist today. This is, of course, very understandable because an insurance policy is a legal document and must be interpreted strictly with little regard to intent and it is not unreasonable for the same philosophy to carry over into the field of ratemaking.

A cobbler should stick to his last, and, not being a lawyer, I do not intend to try to argue the law. However, I must point out that if Mr. DuRose's argument is, in fact, the law, it is being otherwise interpreted in many states and in many lines of business; further, the difficulty could be overcome by having separate stock and mutual fire rating bureaus or by a proper interpretation of profit, which should consist of 5% *plus* the differential between the loss experience of stock member companies of the bureau and the loss experience used to make rates.

The reviewer makes the point that, "It is yet to be established that

member and subscribing companies of a fire insurance rating bureau would agree that they could survive the results of an intensely competitive market wherein a higher rate level were to be promulgated for stock insurers than the rate level promulgated for non-stock insurers by the same bureau." I did not contemplate two rate levels because the mutual companies anyway distribute their profits to their policyholders and are at liberty, and often do, deviate from the bureau rates. I have many times advocated that, at least for personal lines, competition should be allowed to look after the problem of adequate and non-excessive rates, and that insurance commissioners should concern themselves with discrimination and company solvency. The spread of the direct writer method of merchandising has introduced a variety of rates for nearly every class of personal lines business in the majority of states, and as is apparent from the recent Virginia automobile hearing, the stock agency companies are opposed to the use of all company experience for automobile insurance and do not object to independent filings even by bureau members. It would seem logical, therefore, for the fire rating bureau to promulgate rates at a level which provides the correct profit margin for the stock member companies and for mutual companies to use these rates or such lower rates as they may wish, by deviations or independent filings. Of course, if the stock member companies feel such rates would be uncompetitive, a lower profit margin could be adopted by the bureau for its filing.

Mr. DuRose suggests there is not sufficient data to justify my contention that stock agency companies are not capable of writing an average of fire insurance risks placed with all insurers. There is certainly ample evidence that this is true for private passenger automobile insurance and for homeowners business. For fire business alone it is, I believe, sufficient to note that for every year since 1944, the first year for which data is readily available, the nationwide fire loss ratio of mutual companies entered in New York has been consistently about ten percentage points more favorable than the loss ratio of stock companies. This provides very high credibility to my statement. I fully agree with the reviewer that there is a similar difference between Direct Writer experience and American Agency experience, at least for all personal lines.

It can be argued that this difference in experience could be due to difference in fire class of business written, since it is true even today that some classes are consistently more favorable than others. That this is to some extent true is probable but I have not had the opportunity to research this point although the necessary data are available. However, if any

difference in class distribution exists, it would be because the stock agency companies are not capable of writing an average of fire insurance business placed by all insurers. For stock companies this points to the desirability of introducing improved rating techniques. Mr. DuRose makes the point that any difference might be due to claim adjustment practices and procedures. This may be in part true but cannot, I believe, account for anything approaching ten percentage points.

I was, perhaps, remiss in not discussing the problem of conversion to common rate level in my paper. I did, in fact, include a short discussion in an early draft but to discuss all possible cases becomes complicated and seemed to distract from the point I was making, that if the data used for ratemaking has a different overall loss ratio from the data of those companies who are seeking to earn a profit for their stockholders, then the rate of profit assumed in the formula will, in fact, never be earned. Where a stock company deviates on the ground of expenses, if the company's *actual* expenses enter into the determination of the expense portion of the rate, then the company's *actual* premiums should enter into the determination of the loss portion of the rate; otherwise the standard profit margin will not be preserved. If, on the other hand, a budget expense provision is used, as is the custom for production expenses in most casualty lines of business, then the company's premiums should be restored to common rate level.

It seems to me that with divergent marketing techniques there are differences not only in expense but in loss experience and different kinds of companies must be granted different rate levels, if they so desire. Regulatory authorities should allow companies to operate at profit margins less than 5% for fire insurance if they wish for competitive reasons, but should not force margins of less than 5% on the companies by insisting on the use of all company statistics.