DISCUSSION BY DALE R. COMEY

While the title of Roger Wade's paper, "Expense Analysis in Ratemaking and Pricing", may suggest a narrow discussion of various techniques for developing final premiums from pure premiums, Mr. Wade, explicitly or implicitly, covers a wide range of expense allocation problems with a very few words. Unfortunately, the paper begins with a brief description of the various techniques utilized in the last step of the expense allocation problem, namely the loading of the pure premium. The latter part of the paper presents a discussion of a technique, presumably used in other industries, concerning the problem of allocating (or not allocating) company overhead expenses to line of business. The entire subject of expense allocation, especially its impact on the price individual consumers pay for insurance, might have been put in better perspective had the order of the paper been reversed.

The last half of Mr. Wade's paper is devoted to a discussion of the so-called "contribution method" of analyzing pricing and marketing operations. The explicit suggestion is that this method may serve as a sound basis for line of business decision-making. The implicit suggestion is that the use of this method would generate a more correct basis for projecting line of business operating expense needs which, in turn, would have a significant impact on rate level projections. Although Mr. Wade illustrates the "contribution method" with an example on marketing strategy, it is difficult to understand how this method would be utilized in a long-term pricing environment. The "contribution method" assumes that certain costs may not be affected by the movement of other costs included in the final premium. However, very few "fixed costs" are fixed for very long and some procedure must be devised to move these "fixed costs" over time.

The allocation of company operating expenses to line of business is not, or should not be, performed in a haphazard fashion. The main question is whether the relationship of past expenses to past premium is a reasonable and equitable yardstick for estimating future expense needs as a function of future premiums. The answer to this question must encompass both the socio-economic and political environment in which insurance rates are established as well as the practical result, at the consumer level, of utilizing some other method of expense need projection. It is my belief that, with the exception of atypical variation in the overall line of business pure premium, the projection of future line of business operating expense needs on the basis of historical expense to premium relationships is a reasonable and equitable insurance pricing technique.

While I believe my conclusion with respect to overall line of business expensing for pricing purposes is practical and reasonable, the next step in the pricing procedure, namely allocating expenses by state, territory, classification, etc. presents (or may soon present) a substantial challenge. In the initial sections of his paper, Mr. Wade suggests that equity may be better served if some means other than a "constant percentage" approach is utilized in allocating company operating expenses in the determination of individual risk premiums. Mr. Wade mentions "expense constants" and "expense gradation" which are in use for several lines of insurance. He properly mentions that these techniques are used to adjust expenses on a "total premium basis" when the number of exposure units varies significantly from the average. He then goes on to suggest that, in addition to variation in exposure units per policy, perhaps some expense allocation recognition should be given when the pure premium varies significantly from the average.

While the concept that Roger Wade addresses is not new, as a practicing ratemaker, I have some anxiety concerning the timing of the resurrection of the idea. My anxiety is caused primarily because he is probably correct that some recognition is needed in this era of wide-ranging pure premiums and also because other people are extremely interested in the concept. At the June 1973 meeting of the N.A.I.C., the Rates and Rating Organizations (D1) Subcommittee of the Property and Liability Committee reported on its appointment of a task force to study automobile classifications and rating plans. One of the charges to this task force is to "examine the present system of expense distribution. . .".

Mr. Wade, therefore, has provided a timely paper for inclusion in our *Proceedings*. As the ratemakers in the property and casualty insurance business, we will be called upon to justify our present practices. We will also be called upon to evaluate concepts such as those outlined in Mr. Wade's paper. It is quite possible that some of the age-old support for present practices may no longer be justified. Roger Wade's paper deserves careful reading and the challenges he has presented warrant careful consideration.