

DISCUSSION BY ORVAL E. DAHME

Upon first reading Mr. Wade's paper, "Expense Analysis in Rate-making and Pricing," I was not overly impressed with its content. I felt the paper to be mainly of referential value. The "constant percentage loading" and "use of expense constant" approaches to ratemaking are not unfamiliar to the actuary. Discussion concerning the "full absorption basis" and the "contribution method" seems to be an oversimplified polarization of the expense allocation problem. Though informative, the paper really did not offer anything new or beyond the awareness of the practicing actuary. In fact, in discussing the contribution method, Mr. Wade poses a situation of potentially damaging consequences—at least, to certain segments of the insurance industry.

While not disputing the three types of expenses differentiated by the contribution method of expense allocation: constant per premium dollar, constant per exposure unit and fixed expenses, and how they logically fit into the ratemaking process, I question the propriety of suggesting the insurance industry arbitrarily utilize the method in the manner suggested by Mr. Wade. Even if market and company expense data were available for determining the best mix of insurance writings for the expenditures being experienced, the insurance climate today, especially in the automobile liability field, is such that control of what, where, and how much insurance coverage a company writes is less in the hands of the company itself than under the dictates of the social and regulatory arena. We are called upon to provide for the complete insurance needs of society, but it is society, with the help of regulatory authorities, that is more and more setting the quotas and standards under which we operate.

So much for my initial reaction to Mr. Wade's paper. Not wanting to do Mr. Wade an injustice, I read his paper many additional times and studied what he was saying. It is a good thing I did. Although my initial observations about the paper did not change, I began to realize that Mr. Wade, either by accident or by design, had subtly thrown us a challenge.

The paper made obvious the unfavorable position a company can find itself in when the ratemaking expense formulae do not approximate the actual expense allocation methods followed by the company. It exemplified the importance of accurately formulating company expensing methods in the ratemaking procedures so that predicted results of revisions in rates closely resemble the reported experience that develops from such changes.

What was not so obvious, however, was the subtle questioning of whether companies using their same old traditional methods are allocating expenses in the best manner and whether advantages would accrue to the company that was able to refine its procedures beyond those of its competitors.

The extent to which a company accurately allocates its expenses through successively smaller breakdowns by line of business, kind of business, region, state, territory, coverage, etc. is based on practical considerations of the cost of a finer, accurate breakdown compared with the benefits derived therefrom. Modern computing systems have made it less expensive and easier to accomplish the detailed allocation, but the impetus for doing so has yet to produce tangible results.

Mr. Wade's paper seems to be offering us actuaries a challenge. We must be aware of the shortcomings of our companies' expense allocation practices. We should be the ones to determine the benefits to be gained by narrowing the difference between actual and practiced expensing. We can be the ones to convince our companies of the need for change in this area if such be our conclusion. Our companies are already adhering to the standards set forth for preparing the expense exhibit of the annual statement. They have no reason to go beyond those standards unless we convince them it is to their advantage to do so.

Mr. Wade's paper was refreshingly readable. Though seemingly lacking in technical development, the expense allocation methods practiced by the industry are so varied as to make the reason for such omission obvious. It should be welcomed by the Society for its informative value and as an inducement to others to submit similar type papers. In the challenge Mr. Wade presents to us as actuaries, his paper can be a noteworthy contribution to this Society—much will depend on how we respond to it.

AUTHOR'S REVIEW OF DISCUSSIONS

Rather than attempt to respond to individual points of criticism concerning the paper, although the temptation to do so is sometimes very great, a few basic points concerning the author's motivation for writing a paper on the topic of expense analysis and for selecting the particular format utilized in the paper is perhaps in order.