TOWARDS STATISTICALLY BASED FIDELITY RATES

BY

ZENAS M. SYKES, JR.

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DISCUSSION BY J. W. WIEDER, JR.

Anyone who has tried to read the fidelity and surety manual and to rate fidelity and surety bonds from them finds a confusing maze of rules and tables that can be quite formidable to the greenhorn.

The author of this paper has done a commendable job in developing the readers interest by citing specific examples of how the present rating system applies.

The study of fidelity losses of one important insurance carrier effectively points up some of the deficiencies of the present rating system and some possible solutions. The loss study indicates, as the author points out, that:

1. Fidelity has a preponderance of low cost losses
2. The rates for low penalty bonds ought to be increased
3. The rates for high penalty bonds may be somewhat redundant.

Thus, this paper demonstrates what fidelity underwriters have generally believed to be true.

As new bond forms have been developed over the years, rates have been set for these forms on a judgment basis by analogy, using the rates for prior or existing forms. Essentially, this is what is causing the fidelity rate structure to become increasingly unsatisfactory and to be in need of drastic revision. As a result of the loss study the author has stated a five-point proposal for rating fidelity bonds, a proposal which can surely serve as a sound basis on which to build a rate structure.

There will obviously be many practical difficulties in actually devising a new rating method, and the author has anticipated these problems. Undoubtedly one of the most difficult areas will be to establish an adequate classification system and much thought will have to be given to this problem by fidelity underwriters.

Perhaps the most difficult area from an actuarial standpoint lies in the treatment of loss salvage in determining loss costs for ratemaking purposes. As the author has noted, the data available to him in making this study were too recent to contain reliable salvage information, and he was forced therefore to make the study on the basis of gross losses. Salvage in the fidelity lines is important for all penalties and types of bonds. Mr. Sykes properly notes that salvage collection may be made soon after loss payments or may be deferred as installments over a period of time. Whether the treatment of salvage in ratemaking partially by an average value approach, as he suggests, will be adequate is a question which requires further study.

Even the definition of what constitutes salvage presents some problems.

For example, there was recently one very large public official loss on which there appeared to be a substantial early salvage collected. However, at least a portion of what appeared to be salvage was actually nothing more than a revision in the estimate of incurred loss. As the investigation of the case proceeded, it developed that the actual monetary obligation of the fidelity carrier was not as great as was first thought, and the reduction in the incurred loss amount was reported as salvage collected.

Another example of the difficulty in defining salvage is found in the case of disappearance of securities. Frequently a fidelity carrier will be issued duplicates of the securities which are held by the carrier for a period of time until it seems evident that the original will not be recovered. When this becomes evident, the carrier disposes of the duplicates for whatever price they will bring, and thus recovers salvage on the loss. The question is how to treat these security holdings prior to the time they produce actual salvage.

Similarly, if money from an embezzlement has been invested in real estate, the fidelity carrier frequently will issue a mortgage on the real estate, and use the monthly mortgage payments as salvage on the original loss. Thus, the salvage is reported over a period of time when actually the value of it is pretty much known soon after the discovery of the loss.

In summary, this paper is a very valuable first step in taking a new approach to fidelity ratemaking. The author has well stated the problems which require further investigation and has made some sound and constructive proposals for basing fidelity rates on statistical information.

THE COMPENSATION EXPERIENCE RATING PLAN— A CURRENT REVIEW

BY

DUNBAR R. UHTHOFF

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DISCUSSION BY R. M. MARSHALL

Mr. Uhthoff's paper serves the admirable purpose of bringing into focus the underlying features of the Experience Rating Plan Manual—1940 for Workmen's Compensation and Employers' Liability Insurance and further enlarging some of these features so that they can be examined for possible defects. Mr. Uhthoff also sets forth some of the considerations of the Subcommittee of the National Council Actuarial Committee regarding remedies for the seeming defects. I feel that the Society is indebted to Mr. Uhthoff for his timely paper.

Having spent many of these "happy hours," referred to by Mr. Uhthoff with the Subcommittee in its consideration of the Plan, it is hoped a report on the conclusions of the Subcommittee and a few comments will be in order.

The main defects of the present Plan appear to be two in number: