DISCUSSION BY NICHOLAS F. MILLER, JR.

Investment income has long been recognized by the insurance business when determining insurance premiums. In the property and liability segment of the business, investment income has been taken into account by depressing the underwriting profit and contingency factor built into premium levels.

The 5% (before taxes) provision for underwriting profit and contingencies in automobile liability rate levels is hardly excessive — if it were possible of attainment. And if it were possible of attainment and supplemented by income yields on invested assets, the resulting net earnings would be reasonable when compared with other industries — most certainly far from excessive by any standard of comparison.

An examination of the industry records of the past describes the underwriting and economic climate in which we operate:

> $1.8 billion underwriting loss in the last ten years, a ten year rate of loss over 4%;
>
> a rate of loss greater than 5% in each of four years — years in which the rating formula missed the objective by over 10%.

There is no substance to support a thesis that insurance companies' earnings need be scrutinized for excess profits.

The record does highlight the incongruity of rate regulatory systems which assume that the insurance business is a monopoly which has been required to accede to rate regulation as a consideration for its privileged franchise. Any efforts to establish excessive premium levels will be defeated by the competitive elements of our economy. There is, therefore, no need to develop a formula for taking investment income into account to assure that premiums are not excessive — competition will do the job.

In his paper Mr. Bailey expresses the thought that certain funds are "held in trust for policyholders." While it may be appropriate to interpret this expression in the layman's sense of integrity, confidence, or even hope, the relationship which exists between a policyholder and an insurer is a contractual one and not a fiducial one. Policyholders have no valid claim to investment income earned on unearned premium reserves, and we therefore do not need a formula to take it into account in determining premium levels.

While I cannot agree with the basic purposes for Mr. Bailey's undertaking the development of his paper, I do share his thought that preparation of his paper and our studies and discussions of it should increase our understanding of the characteristics of investment income.

Examining his method from a technical standpoint, some of us observed:

(1) It relates the investment income from an accumulation of years to earned premiums of a particular year. A company that is growing rapidly and building reserves rapidly would have a smaller accumulation of invested "policyholder funds" than would a comparatively stable company and as a result the rapidly growing company would have a smaller element of investment income in its rate making process. The justification for having a smaller amount is not apparent.

(2) The composition of invested assets is ignored. It averages investment income among all assets and between stockholders' and policyholders' interests. The result may be unfair to the shareholders as a company may feel that shareholders' funds may be invested in long-term obligations with the higher yields which normally accompany lack of liquidity.

(3) A company deciding to strengthen its loss reserves would give future policyholders the benefit of a larger investment income element in rate making, all other things being equal. On the other hand, by weakening reserves a company could get a larger allocation of investment income for shareholders.

(4) Another approach would be to measure from actual experience the dates at which funds are received from policyholders and disbursed as expenses and claims. Such a procedure would recognize the lag in premium collections, the payments of commissions and other costs arising when the policy is written, the impact of payroll audit and retrospectively rated business, the spread of certain costs through the term of the policy and the disbursement of losses and expenses over a period of years. These patterns of income and outgo can be expected to vary by line and by company.

There is no preferred way to estimate a segmentation of investment income between that which might be thought of as emanating from insurance-oriented funds and that which may be thought of as emanating from shareholders' funds. While we do not need such a segmentation for rate making purposes, from time to time it is helpful to have one for internal management purposes. The character of the particular purpose will influence the judgment used in the selection of alternatives to be incorporated into the method. I believe Mr. Bailey's paper will serve as a very helpful point of reference.

DISCUSSION BY RUTH SALZMANN

Mr. Bailey's provocative and interesting paper on underwriting profit from investments lends itself to five areas of discussion: