Letter To Mr. Feldblum
From Mr. Fisher

Dated 4/21/87

April 21, 1987

Mr. Sholom Feldblum

Dear Mr. Feldblum:

Mr. Ferguson asked me to take a look at your note of 4/10/87.

Your method is interesting and different, but it doesn't accomplish a true sharing of inflation between primary company and reinsurer.

The average effect of inflation on the loss used in your example is 64.8%.

Year	Nominal Dollars	Inflation Factor	Real Dollars
1975	$ 10	1.10	9.1
1976	15	1.21	12.4
1980	150	1.77	84.7
TOTAL	175	1.648	106.2

The comparison below shows that your approach results in an inequitable sharing of inflation.

Feldblum

	Nominal Dollars	Real Dollars	Inflation Effect
Primary	$ 75.5	$ 50	+51.0%
Reinsurer	99.5	56.2	+77.1
Total	$175.0	$106.2	+64.8

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	Nominal Dollars	Real Dollars	Inflation Effect
Primary	$ 82.4	$ 50	+64.8%
Reinsurer	92.6	56.2	+64.8
Total	$175.0	$106.2	+64.8

Interestingly enough, your point, I think, (page 2, first paragraph, last sentence) is that it is not equitable to share inflation equally. But are you confusing the leveraged effect of inflation with the leveraged effect of investment income?

Yes, the reinsurer holds his portion of the loss longer than the primary company - but the paper makes no presumption of total return pricing.

Sincerely,

Russell S. Fisher

cc: R.E. Ferguson