

LIABILITY AND WORKMEN'S COMPENSATION LOSS RESERVES.

BY

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The laws of the various states, relating to liability and workmen's compensation insurance, are crude in the extreme when viewed from a logical and scientific viewpoint. Even more crude are the plans advanced by some of our able actuaries. What we lack more than anything else is a standard, legalized, accident table by which we can measure the expected cost and determine the proper reserves regardless of the premiums collected.

It is almost an axiom that inadequate premiums will, under our present laws, produce inadequate reserves, this, of course, being due to the fact that the reserves are computed as a percentage of the premium.

It is possible under our present laws and methods of computation, for a company to be hopelessly insolvent, yet legally in good financial condition. It reminds one very much of the old fraternal laws, under which a fraternal was solvent, even when it was six months or more behind in the payment of losses.

It would seem to be high time for the various states to wake up to the fact that our reserve laws are inadequate and need immediate attention, otherwise we will certainly have some insolvent companies and some unpaid compensation claims. I can think of no greater calamity to stock insurance in general than the failure of some injured workingman to get his compensation. Such a situation is possible when we have the combination of an irresponsible employer and an insolvent insurance company with non-assessable stock.

An examination of the convention blank of the National Convention of Insurance Commissioners, is very interesting in this connection. I have in mind the following situation:

The earned premium for the year 1914 in this case contained over 50 per cent. of not-taken premiums, a similar situation obtained in the years 1910, 1911, 1912 and 1913. This will account for the

SCHEDULE "P"—SCHEDULE OF EXPERIENCE.

Year in Which Policies Were Issued.	Amount of Earned Premiums.	Amount of Loss Payments Including Loss Expenses.	Suits Pending Dec. 31 of Year of Statement Except Suits Not Dependent on Negligence.		Unpaid Death Claims Dec. 31 of Year of Statement, Without Proof of Negligence.		Unpaid Claims (Non-fatal) Dec. 31 of Year of Statement Without Proof of Negligence.		Sum of Items in Columns 2-3b-4b and 5b.	Loss Ratio Col. 6a Divided by Col. 1.
			No.	Amount Charged Against Suits at \$750.00 Each.	No.	Amount Necessary to Pay for Each Death.	No.	Present Value of Estimated Future Payments.		
(1)	(2)	(3a)	(3b)	(4a)	(4b)	(5a)	(5b)	(6a)	(6b)	
1st period:										
1905.....										
1906.....										
1907.....										
1908.....										
1909.....										
1st total										
2d period:										
1910.....	\$ 40,000	\$ 50,000							\$ 50,000	1.25
1911.....	110,000	130,000	3	\$ 2,250					132,250	1.20
1912.....	150,000	150,000	3	2,250	1	\$1,200			153,450	1.02
1913.....	160,000	180,000	20	15,000	1	2,000	10	\$4,000	211,000	1.32
1914.....	290,000	100,000	10	7,500	1	2,000	12	5,000	114,500	.39
Total...	\$750,000	\$610,000	36	\$27,000	3	\$5,200	22	\$9,000	\$661,200	

loss ratio in 1914 being so much lower than the ratios for prior years. When the year 1914 is straightened out and not-taken business is charged off, the ratio will be around 100.

Let us now turn to the matter of loss reserves. In the second part of Schedule "P" we find this interesting situation.

Years in Which Policies Were Issued.	53 % of Earned Premiums Stated in Col. (1), 2d Period.	Deduct Loss Payments and Expenses Stated in Col. (2), 2d Period.	Remainder.	Sum of Amounts Stated in Columns 3b-4b and 5b for Each Year of 2d Period.	Carry out for Years 1910-1911 1912, the Amount Stated in Col. C or D Whichever is Greater and for the Years 1913 and 1914, the Amount Stated in Col. C.
	(A)	(B)	(C)	(D)	(E)
1910.....	\$21,200	\$50,000	-\$28,800	—	—
1911.....	58,300	130,000	— 71,700	\$2,250	\$2,250
1912.....	79,500	150,000	— 70,500	3,450	3,450
1913.....	84,800	180,000	— 95,200	21,000	—
1914.....	153,700	100,000	53,700	14,500	53,700
Total...	\$397,500	\$610,000	\$53,700	\$41,200	\$59,400

In the first place it will be noticed that the losses shown in Col. (B) greatly exceed the 53 per cent. of earned premiums shown in Col. (A) for the years 1910, 1911, 1912 and 1913. The year 1914 will show the same situation as soon as the not-taken premiums are charged off. This of course shows that the company is being operated at a heavy loss. The absurdity of this system however is most thoroughly shown in the year 1913 wherein the loss payments exceeded the 53 per cent. of the earned premiums by \$95,206. with outstanding losses of \$21,000 but with no reserve required by the blank. It will also be noticed that under the working of this blank the higher the loss ratio the lower will be the reserves.

No sane person can successfully contend that this system of computing reserves is correct. It may produce adequate reserves for companies operating under adequate premiums, but what about the company that is charging inadequate premiums? Under this system the very company that needs the closest watching and should be compelled to carry heavy reserves is allowed to become hopelessly insolvent and yet show legal solvency.

The remedy for workmen's compensation business is the adoption of a standard accident table by the state. We have a mortality table for life insurance business, why not an accident table for workmen's compensation? There is now sufficient experience from which to derive such a table and although the same might not be perfect by any means, yet, the business could be placed on a sound basis and injured workmen would be sure of receiving their compensation in full.

While it may be true that it will be difficult to apply a standard table to liability business, yet, there is no reason why state officials should stand idly by and make no effort to change our laws so as to, at least, compel a company to carry a reserve for outstanding liabilities. As far as liability business is concerned, the great danger is with the young company having inexperienced underwriters and actuaries. It should not be a difficult matter to have our laws changed so as to compel all companies to carry adequate reserves as shown by reliable experience, such reserves to be independent of the premiums collected by the companies.

It is also merely the statement of a self-evident fact that unearned premium reserves based upon inadequate premiums will also be inadequate. This reserve should also be computed independently of the premiums collected, but with proper allowance for acquisition

cost. Otherwise, the companies should be compelled to collect adequate premiums.

It has been suggested that any legislative action should be along the line of compelling all companies to charge adequate premiums. As far as solvency is concerned, any such action would be futile unless it extended to every state in which a company operated and I am wondering how far New York could go in controlling rates charged in Michigan. There is no doubt, however, that the various states can regulate reserves and can exclude a company that does not carry reserves as required by the law of the state, neither should it be a difficult matter to have the laws changed so as to require adequate reserves. Serious opposition is to be anticipated, however, to any movement to regulate rates and to make the application extra-territorial. The American people, as we all know, are opposed to any action which will foster monopolies, and the regulation of rates would seem to many people to do this very thing.

Summing up the whole situation, it would hardly seem necessary, in view of the self-evident inadequacy of our reserve law, to be obliged to urge a change. Nevertheless, it may be necessary to have a few failures, to have a few workmen or widows fail to get their compensation, in order that the states may realize the gravity of the situation. It should be borne in mind that employer's liability insurance is becoming a thing of the past and in a few years will not be a matter for serious consideration. Our present efforts should, therefore, be directed to the matter of adequate reserves for workmen's compensation.