

ABSTRACT OF THE DISCUSSION OF PAPERS READ  
AT THE PREVIOUS MEETING

A NEW EXPERIENCE EXHIBIT FOR CASUALTY INSURANCE  
COMPANIES

H. O. VAN TUYL

VOLUME X, PAGE 7.

WRITTEN DISCUSSION

MR. GEORGE D. MOORE:

Mr. Van Tuyl's paper is a fairly detailed and a very clear exposition of the information called for by the casualty experience exhibit blank. As no theories are advanced by Mr. Van Tuyl, it is hardly possible to criticize this paper. For this reason, all I can do is to call your attention to some of the difficulties casualty companies have encountered in determining the various items called for as well as some of the methods employed in distributing the disbursements to lines of business.

There are four classes of stock casualty companies whose methods and results are probably quite dissimilar, namely: first, specialty line companies writing only one or two of the major lines of insurance; second, multiple line companies on a general agency basis; third, multiple line companies on a branch office basis; fourth, multiple line companies on a general agency basis having also departmental offices organized along the lines of fire insurance companies.

Of course, companies coming under these various groups have entirely different accounting records, and from my knowledge of the companies' methods of operation, I will endeavor to set forth in as clear a manner as possible how, in a majority of instances, the results determined by the various classes of stock carriers were arrived at.

*Part 1 of the Underwriting Exhibit:*

I. Premiums: This disclosed the earned premiums by line of business for the country as a whole, and presented no particular problem to the companies.

II. The same might be said of "Losses".

III. Investigation and Adjustment of Claims: The fact that the unpaid expenses of investigation and adjustment of claims for

both December 31, 1922 and December 31, 1923 under the Automobile Liability, Liability other than Auto, and Workmen's Compensation lines were eliminated by most companies on account of their inclusion in the Schedule P reserves will have in the aggregate little effect on the results disclosed in this portion of the exhibit, as it is only the difference in the figures for both years which affects the result.

IV. Acquisition and Field Supervision Expenses: This section gave the companies considerable trouble, for when it came to the question of determining what items made up Acquisition and Field Supervision expenses other than commissions, and how the item itself was to be distributed to lines of business, considerable diversity of opinion existed. It was a mooted question whether the expenses, (home office rents, salaries, etc.) of the Agency Department should be charged to this item. In fact, probably 40% of the companies included it, and 60% of the companies excluded it. It seems to the writer that, in theory at least, the expenses of the Agency Department should have been included with the Acquisition Cost.

When it came to the question of the basis of distribution, a still greater diversity of opinion appeared to exist. About 45% of the companies probably reported this item distributed upon the basis of the entire company's premium volume; 40% of the companies evidently attempted an analysis of their branch office or general agency expense in order to allocate it to line of business where possible; 15% of the companies distributed this item partly on the total premium volume, and partly on some other basis. It is the opinion of the writer that a company under a branch office system should be allowed in all fairness to make an analysis of its branch office cost, and it is fair to assume that a portion of this branch office cost is in reality home office general expense. Such being the case, a company of this character should be allowed to deduct from the item appearing on line 30, page 3, of the Annual Statement "Salaries, Traveling and All Other Expenses of Branch Office Employees, etc.", that portion which in its investigation it finds is properly chargeable to the item of general expense.

Many of the above companies are compelling their branch offices to do a considerable amount of head office accounting and

statistical work, and it is manifestly not fair to charge all of this item against Acquisition cost.

In the case of a carrier organized on a departmental basis, *i. e.*, when a company maintains in various sections of the country offices organized and run on the same basis as the home office, it should be entitled to charge the entire cost of these departments against general expense.

V. General Administration Expenses: About half of the companies probably distributed the general expenses to line of business on the basis of premium volume alone, and the remaining half attempted some form of a distribution based on statistical investigation, and used it in distributing a portion of the expenses, the remainder being distributed on a premium volume basis.

The cost of payroll auditing included in various items in the Annual Statement was undoubtedly removed and distributed in this section to the lines of business requiring audit.

Not a few of the companies had difficulty in obtaining the correct total of General Administration Expenses, in that the item of investment expense in the Underwriting Exhibit of the Annual Statement had to be deducted in order to obtain this figure.

VI. Inspection and Bureau Expenses: That portion of the item referring to the expenses and maintenance of Bureaus, of course, was allocated in accordance with the direct Bureau charges, but there was quite a diversity of opinion on the question as to the method of distributing the cost of Inspections; about 40% of the carriers distributed this expense in accordance with the time expended in inspecting the various lines of business, and about 60% on the basis of the number of inspections made.

VII. Taxes: The Federal Income Tax was the one disturbing element in this section, some companies holding that this tax should be charged partly to Underwriting and partly to Investment income, but the greater majority holding that it should be distributed entirely to underwriting on the basis of premium volume. A few companies suggested that the item ought to be omitted entirely from this section as it had no bearing whatsoever on the Underwriting profit. Without this item, however, the exhibit, as the blank own stands, will not balance to the

gain from underwriting as shown on page 8, item 39, of the Annual Statement.

The taxes paid on premiums included in this item were distributed to lines of business in different ways, some carriers going so far as to take the specific items of taxes and distributing them in accordance with the basis for such taxes to the lines of insurance, while other companies simply distributed the total premium taxes paid in 1923 in accordance with the premiums written during 1922. This seemed to be the general practice, the companies distributing their outstanding premium taxes for 1922 and the paid taxes in 1923 on the basis of 1922 premium writings by lines, and the outstanding premium taxes for 1923 on the basis of 1923 premium writings by lines.

VIII. Other Underwriting Items: The amount to be entered on line 54 of the Exhibit consists of item 22, page 8, Annual Statement (with the exception of policy fees), but apparently a number of companies think that this amount should not have been called for, as the individual items concerned are not true underwriting items. However, with the present blank, it is necessary to insert this amount in order to arrive finally, on line 79, at the amount of Gain from Underwriting, as per item 39, page 8, Annual Statement. The apportionment of the amount with the exception of the change in overdue premiums is not easy, as it is difficult to determine to which lines such items as Agents' balances, bills receivable, etc., belong.

Some companies entered the amount in the total column, but did not distribute it to line of business. This course, however, throws the exhibit entirely out of balance. A premium volume pro rating was probably used by those companies that completed this line, and it seems to be the best that could be adopted under the circumstances. The remainder of the section presented no difficulties.

IX. Ratio of losses and expenses to Earned Premiums: The ratios disclosed in this exhibit should be fairly indicative with the exception of those for Acquisition and Field Supervision expenses incurred on those lines of insurance where policies are written for a longer term than one year, such as Burglary, Fidelity, Surety, Steam Boiler, Engine and Fly Wheel. This is especially true if the volume from year to year has fluctuated considerably

as these expenses have been incurred on three year premiums, and are referable in the exhibit to the earned premiums for the calendar year 1923.

Wherever a distribution of any of the above items was made on premium volume with the exception of taxes, I believe the correct method is the use of the net *direct* written premiums as all expenses other than taxes should be referable to this item.

*Part 2 of the Exhibit. Acquisition and Field Supervision Cost by Lines of Insurance:* This provided some interesting problems for most of the carriers, as it referred entirely to the net premiums written on direct business, and as this was the first year that the exhibit was filed, some carriers had of necessity to make an estimate of some of the items.

*Part 3 of the Exhibit. Loss Ratio Experience of Policies in New York:* Mr. Van Tuyl in his paper outlines a method of arriving at the earned premiums by lines of business for policies written in the State of New York, and I trust that this method will continue to be satisfactory to the Department. He states, and quite correctly, that the earned actual pro rata premium reserve at the end of each year by lines for business written in New York would involve an unreasonable amount of labor. Some companies have followed the method outlined by him, while others have assumed that the earned premiums in a given state for any line of business in a given year are the average of the writings for the given year, and the preceding year.

*Part 4. Workmen's Compensation Loss Experience by Policy Years:* This exhibit, of course, speaks for itself.

While I do not wish to minimize the results achieved by an intricate cost analysis (and the making up of schedules of this character easily leads to the conclusion that some analysis of this character must be made), nevertheless it is itself a costly proposition, and if apparently correct results are achieved without too extended a system, then I believe that short cut methods should be used. Any system of cost accounting providing figures of this character must be subject to constant correction, and any change in the company's office procedure might very easily disturb a considerable part of the system. It was, therefore, my aim in making up schedules for the companies which I represent

to as far as possible determine broad pro rating methods, and the results which we have achieved have proved quite satisfactory.

In fact our main basis of pro rating was an analysis of the home office salaries which could have been supplemented by a similar analysis of rents had there not been so many changes affected during 1923 that it was impractical. This analysis was accomplished by furnishing each department head with a sheet showing headings of "Underwriting", "Claim" and "Inspection" by lines of business; the salaries for a given month were then distributed on this basis. This distribution of home office salaries as regards the underwriting by lines of business was then assumed to have been the proper distribution for apportionment of a part of the expenses during 1923, and this apportionment weighted 50% together with the net direct premiums written also weighted 50% was used in distributing a large proportion of our expense. The cost of payroll auditing was distributed by our company on the basis of an analysis of one month's auditing of the various policies subject thereto, and 50% weight was given to the number of audits made for the various lines of business, and 50% to the total of the additional premiums plus the refund premiums for the entire year by lines of business. The cost of inspections was determined from an analysis of the inspectors' reports which contained the number of inspections made by lines of business together with the salaries and traveling expenses assignable to those lines. With the number of these inspections having a weight of 50% and these costs having a weight of 50%, the remaining cost of inspections, including home office supervision, rents, etc., was distributed.

When the combined results are finally tabulated, I feel that a fairly good picture of conditions as they existed in 1923 will be disclosed. I also commend the wisdom of making this exhibit supplementary to and not a part of the Annual Statement blank.

MR. R. A. WHEELER:

The new experience exhibit for casualty insurance companies drafted by the New York Insurance Department marks an important advance in state supervision of rate making for it will give the Insurance Department all the information necessary to test the adequacy and reasonableness of rate levels for the various

casualty lines of insurance and also information as to the relationship of nation-wide rate levels in these lines of insurance as compared with rate levels for New York State. It further gives the necessary information for the determination of the expense loading included in the rates.

The exhibit has been very carefully drafted with a view both to the purpose to be served and the practicability of obtaining the information desired. It will probably be possible to obtain a certain amount of uniformity in methods used for the allocation of expenses after the exhibit has been in actual operation for a few years although this will be difficult of actual accomplishment on account of the difference in organization of the individual companies.

From the point of view of the purpose which the exhibit will serve I would suggest that a test as to the adequacy or excessiveness of company reserve estimates in the form of a review of reserves be included in future exhibits so that some check may be made upon the accuracy of results of previous years.

It might be pointed out that the incurred loss ratio on compensation insurance as computed in this exhibit is not a true calendar year loss ratio in view of the manner in which compensation premiums are collected, the advance premium on one year's policies being considered as earned in the year in which the policies are issued and audits received on the same policies during the subsequent year being considered as earned in the subsequent year. Where there are rapidly changing industrial conditions this introduces a very considerable error in the true loss ratio of the companies for calendar year periods. This criticism, of course, also applies to a certain extent to manufacturers' and contractors' public and automobile commercial policies but the inclusion of these figures on all lines of insurance is necessary to balance with the financial statement.

In addition to this insurance exhibit the New York Department has made a call for classification experience on automobile, manufacturers' and contractors' public liability insurance which will not only supply the necessary information for making individual rates but, being compulsory upon the part of all companies, will give the rate making organizations themselves the advantage of a larger volume of experience upon which rates can be based. This additional call very well supplements the casualty experi-

ence exhibit in giving the department information not only as to rate levels but also as to the basis of the rates for individual classifications within each line of insurance.

This exhibit is a step in the right direction and deserves the whole-hearted co-operation of all carriers. The companies may experience some difficulties in making a separation of expenses but these difficulties are not insurmountable and the information called for is no more or less than information which every company should have as a basis for analyzing its own business.

### MISCELLANEOUS PROPERTY DAMAGE INSURANCE

S. D. PINNEY

VOLUME X, PAGE 33.

WRITTEN DISCUSSION

MR. MILTON ACKER:

Mr. Pinney has explained the fundamental principles underlying the miscellaneous forms of property damage insurance which have been developing during the past two years. These forms of coverage will undoubtedly increase in importance as the insuring public comes to realize their place in the plan of complete insurance protection against loss by reason of legal liability for injury to the persons and property of others. Property damage insurance logically supplements public liability insurance for the reasons (1) that both involve the legal responsibility of the policyholder and (2) that in general both arise out of the same sort of occurrences.

The use of the term "property damage" insurance is inconsistent with the terms already in use for other forms of insurance which cover the legal liability of the policyholder. This point was emphasized recently by Vice President Cowles of the Travelers Insurance Company who suggested that the proper name should be "property liability" rather than "property damage," inasmuch as the legal liability of the policyholder for damage to the property of others is covered in the same manner that "public liability" covers the legal liability of the policyholder for bodily injuries to members of the public, and "employers' liability" covers the legal liability of the policyholder for bodily



injuries suffered by his employees. The term "property damage" should logically be applied to insurance which protects against loss because of damage to the property of the policyholder, but the latter form is now generally known as "collision" insurance and change in nomenclature would undoubtedly result in confusion. However, the term "property damage" in its present interpretation should be changed to read "property damage liability", and undoubtedly the latter term will be adopted in the future.

Mr. Pinney has stated that the miscellaneous forms of property damage insurance known as Manufacturers' and Contractors', Owners', Landlords' and Tenants', Residence, Farm and Private Estate, Theatre, and Owners' or Contractors' Protective Property Damage insurance, provide indemnity against loss by reason of the policyholder's legal liability for damage to or destruction of the property of others, but exclude coverage for damage to property which is owned, leased, occupied, used by, or in the care, custody or control of the policyholder or any of his employees. This coverage is similar to that afforded by Aircraft, Automobile, and Teams Property Damage insurance. This condition should be contrasted with that which obtains in other forms of property damage insurance which indemnify the policyholder for loss or damage to his own property in addition to covering his legal liability because of injury to the property of others—I refer to Steam Boiler, Engine, Flywheel and Electrical Machinery, Sprinkler Leakage, and Water Damage insurance. In the latter forms, indemnification for loss or damage to the property of the policyholder is the primary consideration, coverage for legal liability being of secondary importance.

Elevator Property Damage insurance includes coverage for loss or damage for which the policyholder is legally liable, to property in the care, custody or control of the policyholder or of any of his employees but excludes coverage for loss or damage to property owned, leased, occupied or used by the policyholder or to any of his employees. Elevator Collision insurance provides indemnity for loss or damage to the property excluded under property damage insurance in much the same manner that Automobile Collision takes care of coverage which is excluded from Automobile Property Damage insurance. The Elevator Collision policy excludes (a) loss from collision due directly or indirectly

to fire, (b) loss resulting from collision due directly to the breaking, burning out, or disrupting of any electrical machine which is not located within the car of the elevator, and (c) damage to any electrical machine by reason of the breaking, burning out, or disruption thereof. Exclusion (a) is inserted to avoid conflict with fire insurance whereas exclusions (b) and (c) are inserted to avoid overlapping the coverage afforded by the Electrical Machinery policy.

The property damage contract covers liability for damage to the property of others and does not insure the property of the policyholder. But this exclusion is difficult to define. Property which is leased, occupied or used by the policyholder is not necessarily held by legal ownership, nor does property which is in the care, custody or control of the policyholder always belong to him. The element of possession does exist in these cases and recognition of proper underwriting principles, therefore, demands the exclusion of property which is in the possession of the policyholder and for which he is held responsible. The result otherwise would be a considerable variation in the property damage hazards of individual risks. The introduction in the policy coverage, of leased or occupied property, or property in the control of the policyholder in risks which are otherwise on a parity from the exposure standpoint, would require the same premium charge for these risks in spite of a considerable difference in the hazards assumed under the property damage contract.

A clear understanding of the exclusions just mentioned is important, and in this connection it might be well to refer in particular to the case of contracting risks. If a general contractor erects a building, performing certain operations himself and subcontracting the remaining operations to others, question arises as to the scope of the general contractor's property damage contract. The element of possession determines this. If the general contractor damages any of his own materials, or any of his own work, finished or unfinished, there could be no recovery for property damage, because all of this property is either owned by or in the control of the general contractor. If, however, he caused damage to the material or to the finished or unfinished work of a subcontractor, before the work is turned over to the general contractor, the property damage would be covered,—the property is not considered as being in the care or control of the policy-

holder until he actually secures possession of it. But once the work of the subcontractor has been completed and accepted by the general contractor, it comes under the latter's control and if damaged by him, no recovery is possible. Similarly, coverage for the subcontractor applies to all property damage caused during the course of his work, excepting only damage to his own material and work still in his charge or control. The same line of reasoning may be applied to a contractor who performs special jobs on or in completed buildings—possession on his part includes his own material and the material in place at the point where the work is to be performed. This is property in the care, custody or control of the policyholder, and damage to it is not covered by the property damage contract.

In line with the thought that property damage insurance and public liability insurance provide practically complete coverage necessary to protect the policyholder for full legal liability in respect to personal injuries or damage to property of others, it is reasonable from an underwriting standpoint, to require that the two forms of insurance should go hand in hand and that property damage should not be written unless concurrent public liability is written. It frequently develops that the same accident is productive of both public liability and property damage claims, and with concurrent insurance written in the same company, the investigation and settlement of such claims can be administered much more expeditiously and satisfactorily than would be the case if the insurance were divided between two companies. Steam Boiler insurance provides a precedent for this treatment because the steam boiler policy covers the legal liability of the policyholder for personal injury as well as for damage to the property of others. The same is true also of Engine, Flywheel and Electrical Machinery insurance.

In the development of rates for the miscellaneous forms of property damage insurance, Mr. Pinney has pointed out that it was necessary to pay particular attention to the various sources of property damage claims. Experience will undoubtedly prove that many causes of loss exist of which underwriters are unaware at the present time or to which they attach little importance. Even at this early date, it is apparent that property damage insurance must be underwritten with extreme caution, and unless careful investigation is made before individual risks are

accepted, unless due consideration is given to causes of property damage losses in certain industries, the experience on this line of insurance will be disastrous.

At present the property damage contract affords full coverage up to a limit of \$1000 with the option of securing coverage for higher limits upon payment of an additional premium. Mr. Pinney has explained that no attempt has been made as yet to provide deductible average coverage. Indications point to the possible necessity of introducing the deductible coverage in much the same manner and for the same reasons that we have this coverage in connection with Automobile Collision insurance. Property damage claims will unquestionably involve smaller average losses per claim than public liability claims, but the frequency of accidents will be considerably higher for property damage, and the tendency at the outset, as is usually the case in the development of a new line of insurance, will be for those risks in most need of the protection to secure coverage. The burden will be shifted to the insurance company and the introduction of a deductible coverage which would require the policyholder to assume all losses up to a stated amount, would have a salutary effect upon the business for it would introduce an incentive for policyholders to exercise a more careful supervision over their operations and so to conduct the work as to reduce the frequency and severity of accidents.