ABSTRACT OF THE DISCUSSION OF PAPERS READ AT THE PREVIOUS MEETING

SPECIAL FUNDS UNDER THE NEW YORK WORKMEN'S COMPENSATION LAW

GRADY H. HIPP

VOLUME XXIV, PAGE 247

WRITTEN DISCUSSION

MR. GEORGE D. MOORE:

It is evident from Mr. Hipp's paper that a very satisfactory piece of work was performed in making the valuation of these three Funds. Considering, however, the extremely meager data that was available due to the limited number of cases handled it is to be expected that the results are to be considered somewhat conjectural. There is, nevertheless, indicated quite an unhealthy deficit in the Second Injury Fund as well as the Reopened Case Fund, especially the latter.

One peculiarity in the data that is worth some consideration is that the amount of receipts in the nature of awards during 1937 does not seem to check with the facts. From the 1937 report of the Industrial Commission the following receipts are to be noted:

Receipts	Awards 1937
Second Injury Fund	$84,100
Reopened Case Fund	45,600
Vocational Rehabilitation Fund	84,000

It is evident from the above that there were at least 168 case awards to be accounted for during the year and if so it would seem as though the distribution should have been as follows:

	Cost to Carrier	Theoretical Receipts
Second Injury Fund	$500	$84,000
Reopened Case Fund	300	50,400
Vocational Rehabilitation Fund	500	84,000

It is quite possible that the awards to these Funds during 1937 are not in accordance with the above due to the wide variation in

date of death. In some cases death may have occurred prior to the latest requirement of payment into the Reopened Case Fund. This seems to be borne out by information recently furnished by Mr. M. T. Howard, Director of Finance Bureau, as follows:

Awards Made Amounts	Number Paid in During 1937 Year	Distribution		
		Second Injury Fund	Reopened Case Fund	Vocational Rehabilitation Fund
$100	1	$ 100	....	....
$500 & $500........	16	8,000	....	$ 8,000
$500 & $300 & $500.	152	76,000	$45,600	76,000
Totals...........	169	$84,100	$45,600	$84,000

However, the far greater problem of how to keep these Funds solvent is yet to be attempted. The first action taken by the Conference Committee which has now been carried into effect is to provide for the adequate defence of claims against the first two Funds. No actuarial computation can be made at this time of the effects of the much needed work and only time will tell just what the actual results will be. This should be checked continuously each year and a new valuation attempted. It is probable in the meanwhile that the combined income as compared with disbursements under these two Funds might not be far apart during 1938 if they are properly watched. This is shown by past performances:

	1935	1936	1937
Receipts*	167,996.64	169,575.24	180,364.68
Disbursements†	167,966.50	197,401.09	182,708.18
Excess	30.14	− 27,825.85	− 2,343.50

* Excludes proceeds of Securities sold or reduced.
† Excludes amount paid for Securities.

If after a year or two under this administration it is still determined that a continual deficit is to be realized then more drastic steps will be necessary. One possible solution to overcome this difficulty might be to consider extending assessments now payable into the Security Funds upon their completion, for such a term of years as will rehabilitate the two apparently unbalanced Funds.

The Mutual Security Fund is already completed and at the

present rate of contributions the Stock Fund will have arrived at the maximum required by law in a few more years. When this is accomplished then a careful revaluation of the deficient funds should be made and arrangements for a new requirement set up providing for a series of contributions from all the interests involved to gradually re-establish the solvency of the combined Funds. Any amounts that can legally be diverted from the Vocational Rehabilitation Fund will, of course, reduce the amount required. This method would seem to be the only practical course to pursue in order not to increase the rate of contributions from all sources at this time and still take care of the future.

MISS EMMA C. MAYCRINK:

When I was asked to write a discussion of Mr. Hipp's paper dealing with the Special Funds under the Workmen's Compensation Law, I declined because it seemed to me that Mr. Hipp had written an informative paper which indicated that, while there was much to be done, there was little that could be added to his outline of the present status of the funds. However, after the persuasive insistence of our president, I consented, still doubting that there was anything to be added to Mr. Hipp's excellent presentation of the known facts.

I found the text for a discussion in the statement of the purpose of the paper, which I will quote . . . "to summarize pertinent information with respect to the various funds (other than the Workmen's Compensation Security Funds) and to provoke comment on possible solutions of the problems involved." This is a challenge which no one can well refuse.

The first comment, or rather question, which suggests itself, is, why information as to the present status of the Workmen's Compensation Security Funds was not also included in the paper. Was it because there could be no question of a deficit in these funds? It certainly could not be because the funds were less worthy of interest for there is a limit to the payment to be made for both the stock and mutual companies. The references to sections of the compensation law governing these funds as given in Mr. Hipp's paper are to Article 5 (Sections 60 to 73 inclusive). It should be noted that the sections have been re-numbered and Article 5 now comprehends Section 75 to 88.

The following report of these funds which is taken from Volume II of the Superintendent's Annual Report for the year ended December 31, 1937 is included in this discussion for the information of the companies who may be interested. (This report had not been issued when Mr. Hipp's paper was written.)

	Stock Fund	Mutual Fund
Balance as of June 30, 1936	$552,878.98	$243,480.18
Paid into the funds by companies writing compensation policies during the fiscal year ended June 30, 1937	318,971.52	161,305.84
Interest credited (net)	8,344.46	3,978.06
Expenses paid	797.63	341.79
Totals of funds June 30, 1937	879,397.33	408,422.29
Cash in banks	416,178.58	204,000.41
Bonds (at cost)	463,218.75	204,421.88
	$879,397.33	$408,422.29

It would appear from the number of independent funds that the legislators have followed the sage counsel of a wealthy industrialist who warned against putting all of the eggs in one basket. The problem then becomes one of watching the baskets. The carriers and other contributors to the funds certainly have an equity in them, although relieved of responsibility for their safety and conservation. It may be said that the companies have only a very remote control.

Under the Workmen's Compensation Law contributions to all of the funds are compulsory at least upon the stock and mutual carriers. The custodian in all cases is the Commissioner of Taxation and Finance. The administration of all funds, except those required under Article 5 of the Workmen's Compensation Law, is chiefly in the hands of the Industrial Commissioner or his deputies, except that in the case of the Aggregate Trust Fund section 27 is administered by the State Insurance Fund as a fund separate and apart from its own funds and subject at all times to the rulings of the Industrial Board. Mr. Hipp cites a decision of the courts in which the State Fund is held to be "custodian" with its only duty "to pay over from the funds in its hands the awards directed by the board to be paid." With all due respect to the court, this decision is an understatement of the State Fund's duties.

There appears still to be some ambiguity in the terms as stated in the law where it provides for allowances to the State Fund for its "administration" of the Aggregate Trust Fund. The Commissioner of Taxation and Finance is "Custodian" under the law (now Section 91) of all moneys for the State Insurance Fund and as all moneys paid in are paid into the office of the Department of Taxation and Finance, the Commissioner of that department in practice is "Custodian" of the Aggregate Trust Fund. The clearest statement of the State Fund's part in carrying out the provisions of Section 27 is the statement in the rules drawn up by the Industrial Commissioners in 1920 from which I quote "Such fund (Aggregate Trust Fund) shall be under the direction of the Manager of the State Fund." The confusion of terminology should be corrected, if and when Section 27 of the law is amended, and explicit provisions as to duties and responsibilities should be given. Investments are limited to the kinds of investments required under the Banking Law for Savings Banks for all funds except those under Article 5 which requires "stocks and bonds of the United States or this state." The investments for the Aggregate Trust Fund are subject to prior approval of the Superintendent of Insurance. It is evident that not only are the funds in separate baskets but that several state departments have a part in their safekeeping.

The law does not require published reports of any of these funds and in no case is an examination or audit required. The annual report of the Industrial Commissioner includes a statement of income and disbursements covering the special disability (second injury fund), the vocational fund and the reopened case fund. It also includes a statement with the balance as of the end of the calendar year of the special disability and the reopened case fund. Reports of the Aggregate Trust Fund have been included each year in the reports of the Industrial Commissioner.

Mr. Hipp has given a summary of the financial status of the funds (page 249 of the *Proceedings*). He does not there state the source of these figures. However, in the following pages he has set up statements of assets and liabilities for each fund and has shown the source from which the figures were taken. The assets of the Second Injury and the Reopened Case Funds are as shown in the report of the Industrial Commissioner and the liabilities are

those shown in the report of the examination made by the Insurance Department examiner, Mr. John D. Byrne, to the Industrial Commissioner. The statement of the Vocational Rehabilitation Fund was taken from a report of an assistant state accounts auditor to the State Comptroller. The report of the Aggregate Trust Fund in its entirety is similar to the annual report made by the State Fund to the Industrial Commissioner and to the Insurance Department. In connection with each regular examination of the State Insurance Fund the assets of the Aggregate Trust Fund have been verified and a statement of this Fund's condition as shown by the books and records in the State Fund's office has been included in the examiner's reports. At the request of the former Industrial Commissioner an examination of the Aggregate Trust Fund as of June 30, 1938 is now in process.

It is obvious that reports of the various funds should be more readily obtainable, not only in order that the contributors to the funds may follow developments but so that administrators succeeding other administrators in office may be able to know whether there are deficits, whether re-allocations of contributions should be made and in general, whether recommendations for amendments to the law should be made to the Legislature.

The carriers interested are now aware of the deficits in three of the funds and that some action should be taken. Through their committees and the Compensation Insurance Rating Board further studies are being made towards this end.

In addition to the questions Mr. Hipp has propounded, is it not pertinent to ask that consideration be given to requiring more complete reports of these funds annually, that regular periodic examinations be made by the Insurance Department and that the reports of such examinations be included in the reports of the Superintendent to the Legislature.

THE RETROSPECTIVE RATING PLAN FOR WORKMEN'S COMPENSATION RISKS

SYDNEY D. PINNEY

VOLUME XXIV, PAGE 291

WRITTEN DISCUSSION

MR. H. J. GINSBURGH:

Mr. Pinney's paper is a very comprehensive treatment of a relatively new method of applying an old principle. The Retrospective Rating Plan of which Mr. Pinney writes is a legitimatized form of "stop-loss" coverage (long the object of recrimination, argument, envy and despair from our primary carriers' viewpoint) with the addition of "service" and with rates based at least upon some experience. The foundling has been legally adopted, clothed in seemly raiment, and given a name. This is said in no spirit of criticism, but merely as a statement of fact. There is nothing inherently wrong in adopting weapons of one's opponents. Since the paper is as much an apologia as an exposition, it would be difficult to discuss it without entering into arguments pro and con. These, however, are recorded in great detail in the records of various rate-making organizations and elsewhere. It is therefore perhaps unnecessary to enter into them here.

The Retrospective Rating Plan is a plan of "cost-plus" insurance. Of course this latter term is self-contradictory, as is the term "self-insurance." Insurance should mean the spreading of losses over the entire field of exposure. It is true that the Retrospective Rating Plan does set some limit to those risk losses on which insurance is not operative. This limit is set arbitrarily, but once set the charge for imposing it is based on a distribution of the varying amounts of total losses arising out of different blocks of exposure of the same size. Such distributions suggest the measurement, from experience, of probability of departure from normal loss ratios for risks of various sizes, and then the determination of the credibility of observed departures from normal in connection with equitable distribution of total insurance costs for all risks among the individual risks. Why could not the retrospective idea, foreshadowed in those early discussions which Mr. Pinney has quoted, be applied through the medium of a secondary and retrospective experience rating procedure? The

standard Experience Rating Plan could be applied prospectively at the beginning of the policy period to determine the initial or tentative rate. A secondary and much simplified experience rating procedure could then be applied, after the close of the policy period, to the actual experience of the policy under review in order to determine the final rate. Obviously, change in benefit levels and experience levels which must be recognized in prospective rating would not be present to complicate this secondary experience rating procedure. By such a process the credibility of exposure of an individual risk could be given recognition. This briefly made suggestion of a retrospectively applied experience rating procedure, involving the recognition of credibility of experience, is made with the thought that the possibility may not have been thoroughly explored. It would appear to have been in the minds of those whose comments Mr. Pinney quoted at the beginning of his paper.

In his description of the procedure followed in providing for expenses in the Retrospective Rating Plan, Mr. Pinney has not, it seems to me, brought out clearly the fundamental considerations underlying the treatment of various elements of expense provision in the Plan. When he writes "Certain expenses are logically assessed on the basis of the size of the risk, etc.,"—what he might have said more exactly is that such expenses are assessed on the basis of expected losses or probability of loss; for this is the underlying principle. In the Retrospective Rating Plan it would appear that, in general, provision is made for Home Office Administration, Inspection and Audit on the basis of probability of loss or in proportion to expected losses, while provision is made for Claim Adjustment in proportion to actual incurred losses. Both bases should produce the same result, as to total amount realized, over a sufficient period of time for the same risk or over a sufficiently large number of different risks at the same time. Acquisition is treated in an entirely different and arbitrary manner. In justifying the treatment of acquisition expense, recourse is had not only to a conception of the Plan as one of partial self-insurance, but also to an analogy drawn between the Plan and deductible and ex-medical insurance. With respect to the latter, Mr. Pinney writes: "In each instance acquisition cost is not loaded on the losses which are assessed directly against the assured." His

discussion of expense provision is then concluded in the next sentence which states, rather broadly and inconsistently after the immediately preceding argument, "The loading for taxes follows the usual procedure of applying such loading to each element of the final risk premium." It can readily be understood that in so comprehensive a review some points may be passed over without complete analysis for the sake of coherent unity. Yet it could be wished that the treatment of expense provisions in the Plan had been analyzed somewhat more deeply so that a consistent pattern might more readily be seen.

The picture of the background of the Retrospective Rating Plan which Mr. Pinney has drawn, and the structure of the Plan itself, indicate that the Plan may most logically be considered from the public viewpoint as one of partial self-insurance. Mr. Pinney has given an excellent presentation of a profoundly interesting development in the field of workmen's compensation insurance as written by the primary carriers.

AUTHOR'S REVIEW OF DISCUSSION

MR. SYDNEY D. PINNEY:

In Mr. Ginsburgh's critical discussion of this paper he somewhat facetiously refers to the Retrospective Rating Plan as the "foundling which has been legally adopted, clothed in seemly raiment, and given a name." Without admitting the validity of such an analogy the observation might be made that the "foundling" in this case is rather unique in that there seems to be no dearth of those claiming parentage. Furthermore, from present indications, it would appear that the infant has been given a promising start in life as measured by developments to date.

According to figures released by the National Council on Compensation Insurance, the New York Rating Board and the Massachusetts Bureau, approximately $4,000,000 of Compensation premiums were written under the Retrospective Rating Plan in 1938. The first tabulated results of the application of the Plan have been distributed by the Massachusetts Bureau, covering retrospective ratings promulgated for the period ending December 31, 1938. A summary of these results is shown below.

MASSACHUSETTS RETROSPECTIVE RATINGS
PROMULGATED THROUGH DECEMBER 31, 1938

Premium Group	No. of Policies	Audited Standard Premium	Retrospective Premium	Ratio (4)÷(3)	Average Modification
(1)	(2)	(3)	(4)	(5)	(6)
Minimum	29	$289,548	$194,135	.670	33.0% Credit
Above Minimum, but less than Standard.	16	487,856	358,881	.736	26.4% "
Above Standard, but less than Maximum	5	55,594	65,119	1.171	17.1% Charge
Maximum	1	29,054	40,530	1.395	39.5% "
Total—All Ratings	51	$862,052	$658,665	.764	23.6% Credit

Subsequent to the writing of the paper, the Plan has been approved for application in California, Michigan and Texas on an intrastate basis, and in Louisiana and New Hampshire on an interstate basis.

It has been suggested by Mr. Ginsburgh that the fundamental considerations underlying the treatment of various elements of expense provision in the Plan might have been more clearly outlined. This criticism deserves consideration since, as pointed out in the paper, the attention of the assured is focused not only on the cost of accidents but also on the underlying expense provisions in the retrospective premium. Of primary importance, the one fundamental which must be kept in mind is that the Plan has been designed principally for individual risks of substantial size. Also of importance is the fundamental that, since the Plan must be available to all insurance carriers, the expense provisions must be established on a basis which will, on the average, meet the requirements of all classes of carriers. A consideration of the practical application of the Plan to the risks for which it was designed indicates that there must be a realistic approach to the matter of expense loading. To simply provide that expenses shall be assessed on the basis of expected losses or probability of loss will not suffice. Even as the Plan seeks to reflect, within the limits of sound underwriting, the individual risk loss experience, so should it also reflect, insofar as possible, the individual risk expense requirements. Bearing in mind the fundamental that the Plan must be made available to all classes of carriers, it is obvious that the provisions for expenses must be established on the basis of average requirements. However, these average requirements

should take into consideration the type of risks falling within the scope of the Plan.

The provision for acquisition expense is based directly upon the scale of acquisition allowances to producers established for such risks. Mr. Ginsburgh states that acquisition is treated in an arbitrary manner. The point might well be made that any scale of commissions to agents is arbitrary, although in the final analysis it represents a compromise between what the agent believes his services to be worth and what the assured is willing to pay. Under the Plan acquisition allowance is determined by applying the standard acquisition provision to the minimum retrospective premium. If this basis does not produce an equitable result both from the standpoint of the producer and the assured, it will require future modification. At the outset, however, it appears to meet such requirements and, being thus established, may be incorporated in the determination of the retrospective premium without difficulty.

Claim adjustment expense is more properly related to incurred losses than to any other base. Consequently, in the Plan provision is made for such expense as a percentage of the losses actually incurred by the risk within the minimum and maximum loss limitations.

Other company expenses,—home office administration, inspection and payroll audit,—have, in most instances, been expressed as a fixed percentage of the standard premium, using for this purpose the same percentage as that incorporated in the standard expense loading for the individual state. It is felt that, although such expenses should be expressed as a percentage of the standard premium, consideration should be given to the average requirements by size of risk. In other words, consideration should be given to graduating this percentage downward as the size of the risk increases. Investigation of the incidence of expense has shown that such a gradation is logical and in accord with statistical evidence. As pointed out in the paper, this has been recognized in two states,—Massachusetts and Maine,—and it is felt that further consideration should be given to this feature in other states.

Taxes should be provided for as a percentage of the retrospective premium developed for the risk, in accordance with the tax

requirements of the individual state or states involved. Since the retrospective premium is for full coverage of the assured's obligations under the various state Compensation Acts, this basis of providing for taxes is consistent with the customary procedure of tax loading.

It is hoped that this further explanation of the underlying fundamentals will serve to clarify the treatment of the expense provisions, which, as additional results of applying the Plan become available, may be verified as to their adequacy and reasonableness.

The fact that risks written under the Plan are fully covered for their Compensation obligations differentiates it from any plan of "stop-loss" coverage or "partial self-insurance." In other words, as its name implies, the Plan is a method for rating the risk for the purpose of determining premium and does not have any effect upon the scope of coverage afforded to the risk under the standard Compensation insurance policy. This distinction is one which should be understood by all underwriters and explained to any assured who may have a misconception as to the effect of the Plan upon his coverage.