

## MULTIPLE COVERAGE EXPERIENCE RATING PLAN

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Mr. Klaassen's paper develops an experience rating plan utilizing the multi-split principle for automobile liability, miscellaneous liability and automobile physical damage combined. This combination of coverages for rating is proposed in order to achieve a larger and more stable base upon which to predicate an individual risk's experience modification. Mr. Klaassen's basic assumption underlying the combination of experience of different lines for a particular risk is that "the inherent hazard of any one coverage is correlated with that of other coverages for a given risk".

Experience rating is an attempt to prospectively measure the deviation of an individual risk's loss exposure (as reflected by the individual risk's loss experience) from the average loss exposure contemplated in the manual classification rates under which the risk is rated. There may exist correlation of this loss exposure between various coverages written for an individual risk. All coverages written for a given risk are subject to certain overall characteristics (e.g., safety programs, good or bad housekeeping and other broad, general categories) and it would seem logical that some degree of correlation would be present. I have no statistics at my disposal which can confirm or deny this assumption; however, I feel that while the correlation between automobile liability and automobile physical damage may be quite good, correlation of these lines with miscellaneous liability may be suspect. If this correlation does exist, it would be of varying degree between coverages and would also vary greatly between individual risks.

While automobile liability and automobile physical damage might possess a high degree of correlation in the area of loss exposure, I would also question the inclusion of this indemnity line in an overall experience rating on the basis that the liability lines, particularly in the bodily injury area, are subject to relatively severe fluctuations due to large losses. This fluctuation would be controlled to a degree through the use of the multi-split approach which Mr. Klaassen advocates; however, it should not be allowed to affect the relative stability of a line of indemnity insurance. Conversely, the stability of the indemnity line should not dampen the effect of fluctuations in the liability lines. We have a precedent for the combination of coverages for the purpose of premium determination in Retrospective Plan D; however, this plan develops and allocates indicated premiums (within the area between the minimum and maximum premium) in direct relation to the experience of each line. The fluctuations in experience are reflected by line and the results for each line are readily available.

This area of hazard correlation would require extensive study before any plan of rating which combines the results of different coverages could be inaugurated and offers an excellent field for further actuarial studies.

The present liability experience rating plans have been in use for a number of years with very little change. At the time these plans were introduced, the amount of loss excluded by the application of the maximum loss limitation was not serious. However, with an inflationary economy operating to increase the cost of claims and larger limits of insurance becoming the rule, an experience rating utilizing only a portion of the basic limits experience is producing an experience modification based on a relatively small amount of a risk's actual experience.

A similar situation has existed in Workmen's Compensation insurance where the D ratios have been eroded to the point that from 40% to 50% of the total incurred losses are never considered in the development of the experience modification. This situation has been reviewed by a subcommittee of the Actuarial Committee of the National Council on Compensation Insurance and their proposals of raising the eligibility requirements and increasing the initial primary loss value and the maximum loss value should reverse the trend and help develop D ratios more closely in line with the ratios contemplated by the designers of the plan.

The multi-split approach proposed by Mr. Klaassen is designed to incorporate more of a risk's actual experience in the determination of a risk's experience modification. The automobile and miscellaneous liability experience rating plans for a few states (New York, Louisiana and Texas) have employed the rating of excess limits experience for the larger risks, but the proposed plan goes a step further by rating these excess losses for all risks. The effect upon the rating of the smaller risks is limited by the application of the excess credibility values built into the proposed experience modification formula. The multi-split concept has been used successfully in Workmen's Compensation insurance in the rating of risks without causing undue fluctuations in the risk's rate level and the method would seem well suited to the rating of the liability lines where fluctuations in loss severity are most marked.

The experience modification formula developed by Mr. Klaassen places more emphasis on stability than on responsiveness but achieves a greater recognition of loss severity through a built-in bias in the size of loss distributions used in developing the credibilities. The question of whether an experience rating plan should place emphasis on stability or responsiveness has always been with us, and undoubtedly will remain, but Mr. Klaassen's plan presents a logical and conservative approach to the problem.