

# MUTUAL INSURANCE UNDER RATE REGULATION

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## I

A large part of the mutual fire and casualty insurance business now finds itself in the second phase of a great transition. It is in the process of moving from a substantial degree of nonregulation to a high degree of regulation under the patterns which are evolving under rate regulatory laws modeled upon the "All-Industry-Commissioners" Bills.

The first phase of the movement may be thought of as being the period between the *South-Eastern Underwriters Association* decision<sup>1</sup> and the end of the legislative sessions of 1948. The decisions and accomplishments of this period were definite and dramatic. Under the stress of grave dangers, the degree of unity of thought and action was extraordinary. It was marked by (1) a period of becoming aware of the meaning of the decision, (2) failure of efforts to avoid wholly its effects, (3) agreement that we should strive to achieve a system of state regulation which excluded the Federal Government, (4) willingness to pay, or at least a recognition that it was necessary to pay, a high price, in terms of degree of state regulation, for the privilege of not abandoning concert of action in rate making, (5) devising the legislative formulae, *i.e.*, Public Law 15 and the All-Industry Bills, and (6) securing their adoption.

The second phase of the transition is that of finding out whether the basic solutions, so hopefully projected, so vigorously defended, and to which (barring some cataclysm with consequences approaching those of the *South-Eastern Underwriters Association* case) we seem so thoroughly and irrevocably committed, will become sufficiently implemented to serve the public welfare so demonstrably as to enable us to regard them as permanent, needing only such adjustments as may be needed to correct minor faults of design and only such improvements as normal progress and development will indicate.

A factor which contributes importantly to the difficulty of the transition is that it began at a most inauspicious time. Wartime dislocations had resulted in great curtailment of normal statistical procedures. In some lines the keeping of classified

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<sup>1</sup> United States v. South-Eastern Underwriters Association, 322 U. S. 533 (1944).

experience had virtually been discontinued. We are trying to reestablish normal procedures and overcome the effects of the gaps. Thus, in a sense, we are going through two transitions at once. Either would be difficult, and perhaps it is unfortunate that there was not a much longer moratorium before it became necessary for the states to begin judging rate filings in accordance with the standards of the various rate regulatory laws. The job would be far easier if adequate statistical tools had existed at the beginning instead of being built during the course of the work.

It is not easy to be wise, even in retrospect, and it is extremely difficult not to fall victims to our own predilections. It is easy to deceive ourselves with propaganda, especially if the propaganda is of our making. But some time, it seems likely, the present insurance regulatory system is going to be subjected to searching and, it is to be hoped, dispassionate analysis and appraisal. Whether that examination will be done by ourselves, or by others, we cannot predict. I suggest that we, of the industry, would be well advised to at least try to do it ourselves, not necessarily in a large-scale, formal way with all the trappings of "an investigation" but in the course of our daily work, as individuals and as members of committees of rating organizations, advisory organizations, and of the numerous trade associations with which the business is at least amply supplied,<sup>2</sup> and by way of regarding each decision we make as forming a part of and having an influence upon the whole regulatory structure. In the course of this work we must compel ourselves to make the utmost effort to avoid self-deceptions of all sorts.

Whether we, and those who follow us, shall succeed depends in part upon the availability of a record of what has actually transpired and of what people who were participating in making the history of the industry in our times were thinking at the time and shortly after some of the vital decisions were being made. Such a record is not easy to find. Part of it is in the proceedings of the National Association of Insurance Commissioners; part is in the minutes of committee meetings of trade organizations; part is only in the fading memories of those present at many an all-day, and sometimes half the night, session in some hotel conference room; part is in the records of the All-Industry Committee, part in the proceedings of the Insurance Section of the American Bar Association, part in the various addresses of insurance commissioners, and a part in the dusty stenographic records of legislative hearings. Unfortunately, only a small portion of the whole story is to be found in the law review literature, a deficiency which will, in a measure, be restored upon the publication of this series of articles.

The reader may, at this point, recall the scope of the title and may ask himself, for whom does this writer speak and what are the boundaries of this effort?

<sup>2</sup>Harold V. Smith, President of the Home Insurance Company, has been quoted as saying that a company would have to be a member of 144 organizations if it wanted to do a multiple line business in forty-eight states. *Journal of Commerce*, April 27, 1950. More recently Robert E. Dineen, in an address, "The Battle of the Bureaus," Syracuse, May 9, 1950, was quoted as stating that 155 trade organizations, bureaus, and boards served the fire insurance business at a cost (1949) of over \$31,000,000 and that in the casualty business there were 77 such organizations, costing almost \$1,500,000.

This paper does not deal at all with operations of mutual life insurance companies, nor with mutual fire or casualty companies not subject to rate regulatory laws.

There are, it is believed, 2,749 mutual fire, casualty, and livestock companies doing business in the United States.<sup>3</sup> Many of these are exempt from rate regulatory laws. Most of the exempt carriers are small organizations, doing business in one state only, and indeed sometimes in a single county. Many of them do business on the assessment basis, simply collecting enough money at the end of the year to pay the losses of that year.<sup>4</sup>

Of the 624 advance premium mutual fire companies (writing about 90 per cent of all fire business written by mutual companies), and the 193 advance premium mutual casualty companies (writing virtually all of the casualty business written by mutuals), some 150 are members of the Mutual Insurance Advisory Association and another 150 or so have appointed the Mutual Insurance Advisory Association as official statistical agent. Fifty-four casualty companies are members of or subscribers to the Mutual Insurance Rating Bureau.

While there is great diversity of viewpoint among the companies making up these organizations, and this writer is not making a conscious effort to present the attitudes of these groups, it should be noted that my opportunity to observe the operations of mutual fire and casualty companies under rate regulation has been, for the most part, confined to the operation of companies in these organizations.

What is being attempted is to set down some observations as to the general background of a few of the current problems of transition and to relate them to their past. No one is bound to accept them as representative, and the writer, although receiving help from many sources, is solely responsible for errors and shortcomings.

It would be a great mistake to think the effects of rate regulation are strikingly different with respect to mutual carriers than with respect to any other type of carrier. Most of the problems of the business are not "mutual" or "stock" or "independent" or "agency" or "direct" but are truly industry-wide problems and are being approached by supervisory authorities as such. Surely we must all make an effort to pitch our own individual efforts on such a level, not losing sight of self-interest but trying to integrate it with the essential needs of others.

I suppose that twenty years or so from now we may experience considerable difficulty in explaining to a newcomer in the business why it was that back in 1944 the business did not jump at the chance to rid itself of state regulation and start developing a system of federal regulation. This newcomer will quickly see that insurance is a business generally regarded as needing regulation, and that it is a

<sup>3</sup> II THE MUTUAL MEMORANDUM, No. 14, April 3, 1950.

<sup>4</sup> The subject of exemptions of mutual companies from rate regulatory laws is an interesting little study in itself. Twenty-eight states have some sort of exemption, usually limited to fire companies doing business in a limited area on a post-loss assessment basis. It is believed that there are 1805 such companies and that the total number of exempt mutuals is about 1950. The general theory of such exemptions is that the operations of these companies are so small that little would be accomplished if they were brought under rate regulatory laws, and that when charges are not fixed in advance but only after loss there is really no problem of adequate or excessive rates. (Data on this subject were supplied by the research department of the American Mutual Alliance.)

very diversified business with so many interstate aspects as to make it really impossible for it to function with any reasonable degree of efficiency if very many states have regulatory systems which differ widely among themselves. He will say to himself, "Here is a business the very nature of which requires a high degree of similarity of regulation in all geographical areas in which it functions. It has obvious need of strong, centralized, but not over-elaborate, supervision. Yet this same business went to great trouble to create for itself a regulatory system under which it has as many masters as there are states. This system can easily create sufficient diversity of regulation to wreck the business, because the inefficiencies thus engendered make the business extremely vulnerable to competition from self-insurance, from unregulated alien insurance, and from the government itself. Why then should this great business favor and support a system quite capable of bringing about its ruin?"

Perhaps this newcomer will also be able to point to a quarter century or so of not overly successful effort by the business to adjust itself to the paradox of having a system under which one of its greatest needs is almost impossible of attainment. These questions will not be easy to answer, nor are they easy now, but probably some effort along this line will help us a little in dealing with the problems of today and make it a bit easier to accept the idea that ". . . moderate imperfections had better be borne with; because, when once known, we accommodate ourselves to them, and find practical means of correcting their ill effects."<sup>5</sup>

In my view the reason we have state regulation today is not so much that a choice was made but rather that the business had a pretty clear, although inarticulated, appreciation that, as Holmes once put it, "Continuity with the past is a necessity, not a duty." Rate regulation in the insurance business did not begin with the *South-Eastern Underwriters* decision. Well before the decision, workmen's compensation insurance rates were regulated by law in some thirty-six states on a basis very much like the present; the same can be said for automobile insurance in seven states<sup>6</sup> and for general liability in two states<sup>7</sup> and for fire insurance in about eighteen states.<sup>8</sup>

In addition, of course, there was a very large area in which some degree of regulation under law existed, and also areas of self-regulation of and by companies belonging to rating bureaus, this self-regulation directly applying only to members willing to be bound and depending upon the compacts of the organization, rather than upon the law, for enforcement.

Also, the office of insurance commissioner was well-established in all states and powerful in many.

<sup>5</sup> 15 THE WRITINGS OF THOMAS JEFFERSON 41 (Memorial ed. 1904).

<sup>6</sup> New York, Louisiana, Virginia, North Carolina, New Hampshire, Massachusetts, and Texas.

<sup>7</sup> New York and Louisiana.

<sup>8</sup> The Government in its brief in the *South-Eastern Underwriters Association* case states: Texas fixes rates; Nevada requires approval of company-filed rates; Louisiana, Minnesota, Mississippi, South Dakota, and Virginia require that rating bureaus be established but also require prior approval; in Arkansas, Colorado, Indiana, Kentucky, New York, Ohio, South Carolina, Vermont, West Virginia, Wisconsin, and Wyoming rates fixed by a bureau are subject to disapproval. Brief for Appellee, pp. 128, 129, *United States v. South-Eastern Underwriters Association*, 322 U. S. 533 (1944).

Quite apart from any question of what might have been desirable or logical, would it have been possible to disregard even a substantial part of all this and to have created either the same sort of system or a better one under federal auspices? I think it would not have been possible and that even the most wholehearted effort to do any such thing would, at the most, have resulted only in a dual system of fearful complexity. While probably not able to prove the point, it is my belief that most of the people participating in the drafting of the All-Industry Commissioners Bills and in their subsequent enactment were of the same mind.

But if a clear choice had been presented, what would the outcome have been and why? Probably the outcome would have been the same and, while each would have had his own reasons, some of the compelling ones would have been: The Sherman Act is quite inappropriate for the fire and casualty insurance business. This was well known to the states but would Congress accept the idea that a *federal* regulatory system should be founded upon the premise of necessity for concert of action in fixing prices? Probably not in time, if at all.

Where would we have been had we committed ourselves to a federal system and then found that we could not get the sort of system we felt sure we needed?

If we had embraced the idea advanced by the Department of Justice that we could safely operate under a system of fixing in concert only the pure premium (loss) portion of the rate, with all the underlying agreements as to classifications and coverages implicit in such a system, how long before a majority of the Supreme Court would come to hold that illegal concert of action had thereby been committed?

And transcending all else, we wanted to remain a free part of the capitalistic system and to avoid nationalization. Didn't we have a better chance under state than under federal regulations? Of course we did, or at least we thought so *if* the system could be made to work with reasonable efficiency.

Thus, the "choice" was made—for better or for worse—and thus the necessary thing now is to accept the idea that the theory of the system is, as Emerson said of the theory of the world, "a thing of shreds and patches," but that it will work because it must, and to get on with the job of correcting its shortcomings and of so conducting ourselves as not to let its imperfections prevent us from solving the problems of the day the best we may.

## II

### FIRE INSURANCE RATE REGULATION

At the time of the *South-Eastern Underwriters Association* decision, about twenty-two states had laws which could be regarded as regulating fire insurance rates. In four of these states regulation was not directed to approval of rates prior to use but did enable the commissioner to order rate changes.

Today there are fire rate regulatory laws in all forty-eight states, in the District of Columbia, in Alaska, Puerto Rico, and Hawaii. Obviously a great change has

occurred. It should not be supposed, however, that the actual degree of change in the way in which rates are made and used is as great as would be indicated by the change in the number of laws. To a substantial extent the change, so far, is from a system of partial regulation under law plus considerable voluntary self-regulation by private agreement, to a system of state supervision of the rating organizations and of the rates which they produce.<sup>9</sup>

If the revolution ended at this point, the mutual fire insurance companies might observe the contemporary scene with some feeling of satisfaction. Under the new rate regulatory laws of practically all of the states, mutual fire companies now have a legal right to become subscribers (not members) to the fire rating organizations originally created by the stock fire companies.<sup>10</sup> When these bureaus were first created and for many years thereafter, the stock fire companies which control them did not make rating services available to mutual companies and to reciprocal insurers or to certain other stock fire companies. However, this situation changed gradually, and long before the *South-Eastern Underwriters Association* decision, such rating services had been made available everywhere to the mutual fire companies and the other previously excluded insurers. Indeed, in many of the stock fire rating bureaus, mutuals were admitted as members, in a few they were given the option of membership or subscribership, and in most they were permitted to receive rating services as subscribers. Thus, for a good many years, the mutual fire companies had participated in the expense of maintaining the necessary fire and allied lines rating organizations and, by filing their experience, assisted in the development of fire insurance statistics. Since the enactment of many of the new rate regulatory laws, several of the stock fire rating organizations have amended their constitutions or by-laws so that the mutual fire companies are no longer eligible for membership. However, the mutual fire companies now have the statutory right to subscribership in those bureaus where there is not a statutory right or duty to become a member. All that is necessary for a mutual fire company desiring rating service as a subscriber is that the company pay reasonable fees and be bound by the reasonable rules of the organization. Therefore, to the extent that the mutual fire companies lost the right in some bureaus to be members, there are certain compensations because there is now an absolute legal right to subscribership. Couple all this with the fact that the rate regulatory laws patterned upon the All-Industry model reflect a keen appreciation of some important aspects of fire rating, namely, that the stock companies write a very large proportion of the fire business, control the fire rating business, and that it would be difficult and economically unsound, the mutuals having

<sup>9</sup> This observation does not, of course, apply to "independents," *i.e.*, those companies not parties to any private regulatory compacts. As to them the change, in several states, was from no regulation to regulation under law. This, however, was not as drastic as it sounds because many "independents" followed the lead of bureau members and thus accepted the results of the private compacts.

<sup>10</sup> Professor Gardner appraises this result in these words: "The opening of the rating bureaus, not legal regulation of insurance rates, is the real achievement of the *South-Eastern Underwriters* decision and of the legislation which has followed it." *Insurance and the Anti-Trust Laws—A Problem in Synthesis*, 61 HARV. L. REV. 246, 272-273 (1948). This comment seems to over-state the matter considerably, however, in view of the previous general availability of bureau services.

invested in the existing bureaus, for the mutuals to create rating organizations of their own to do general fire rate making, and that fire rates were more the result of art than science. Thus, most of the fire laws, unlike the casualty laws, permit deviations on a very liberal basis, and also permit partial subscribership so that in certain special fields such as "mill and elevator" the mutuals can continue or establish their own rating organizations and receive the services of the stock company organizations as to other lines, and all this without any legally imposed responsibility for the operation of the stock fire rating organizations, because as subscribers the mutuals have no voice or vote.

But is the cycle of change complete at the point where regulation under law has merely replaced voluntary regulation and where one group no longer has exclusive rights to indispensable services? I suggest that it is not, and that the mutuals may find it impossible, whatever their desires may be, not to assume some burden of responsibility for the changes which are in the making.

Only the naïve would assume that the combined scrutiny of more than 50 insurance supervisory officials, plus the ever present pressure of Congressional watchfulness along with an attitude of critical self-analysis (not altogether absent in the fire business in spite of some opinion to the contrary),<sup>11</sup> would not engender, or at least encourage, strong efforts to improve or justify existing fire rate making practices. These efforts are being made, and the pace is very rapid.

The effect will be to bring about changes of the utmost importance in making and administering fire insurance rates.

Here is a list of some of the things which have happened since the *South-Eastern Underwriters Association* case, or are now going on:

1. Re-examination of the basis upon which underwriting profit will be allowed.<sup>12</sup>
2. Development of improved classifications of fire occupancy hazards.<sup>13</sup>
3. Promulgation of uniform classifications of expenses.<sup>14</sup>
4. A study of schedule rating practices and their application to specific risks.<sup>15</sup>
5. Development of formulae for adjusting rates more equitably on a class-by-class basis.
6. The introduction of experience rating plans for multiple location risks (con-

<sup>11</sup> See, for example, the address by James F. Crafts, President of the Firemen's Fund Insurance Company, at Los Angeles, on September 4, 1947.

<sup>12</sup> See PROCEEDINGS OF THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS, REPORT OF SPECIAL SUB-COMMITTEE OF THE COMMITTEE ON FIRE AND MARINE INSURANCE 80 (78th Sess. 1947); PROCEEDINGS N. A. I. C., SECOND REPORT OF SUBCOMMITTEE ON UNDERWRITING PROFIT 72 (79th Sess. 1948); Statement of the Committee on Laws National Board of Fire Underwriters, June 30, 1948; PROCEEDINGS, N. A. I. C., REPLY TO STATEMENT OF COMMITTEE ON LAWS 258 (80th Sess. 1949); PROCEEDINGS N. A. I. C., REPORT OF THE SUBCOMMITTEE ON UNDERWRITING PROFIT 455 (80th Sess. 1949).

<sup>13</sup> See NEW YORK INSURANCE DEPARTMENT, CLASSIFICATION OF FIRE OCCUPANCY HAZARDS (1947).

<sup>14</sup> See NEW YORK INSURANCE DEPARTMENT, PRELIMINARY REPORT ON THE UNIFORM ACCOUNTING INVESTIGATION (1946), METHODS OF EXPENSE DISTRIBUTION IN CASUALTY INSURANCE COMPANIES (1947); PROCEEDINGS N. A. I. C., UNIFORM INSTRUCTIONS FOR CLASSIFICATION OF EXPENSES OF FIRE AND MARINE AND CASUALTY AND SURETY INSURERS 43 (80th Sess. 1949).

<sup>15</sup> It is understood that the New York Insurance Department has been working for two years on such a study and that the report will be available soon.

tents),<sup>16</sup> some of which seem to involve special expense treatment for this class and for the larger risks within the class.

7. An examination of the justification for discounts for long-term policies.<sup>17</sup>

8. Controversy as to whether plans for installment payment of premiums are regulated under rate regulatory laws.<sup>18</sup>

9. Introduction of statistical plans for reporting experience upon an "earned premium-incurred losses" basis, rather than upon a "written-paid" basis.

Several of these items are directly applicable to casualty as well as fire rates and practices, *i.e.*, numbers 1, 3, 7, 8, and it is no longer possible to regard fire or casualty practices as being unaffected by each other.<sup>19</sup>

Quite naturally the pace and scope of all this activity is such that certain momentums develop which may carry to unwise lengths the swing toward extreme reliance upon statistical method. As these dangers become apparent it becomes the duty of the business to point out the limitations which seem to be imposed upon the use of statistics in fire rate making.

Such a warning has appeared in the form of Classification Bulletin No. 49-1, July 29, 1949, *Statement of Principles—Classified Experience*, issued by the National Board of Fire Underwriters, which, in the course of arguing against local departures from standard classifications, also asserts that, while a nationwide classification system will furnish information of value in determining the adequacy of fire rate *levels*, local refinements will not, in view of the volume of fire experience needed for credibility, furnish statistical support for local differences in rates.

In many of these activities the mutual fire carriers have found it necessary to play some part even though they have little or no share in the management of most of the fire rating organizations. The vehicle which has enabled the mutual companies to work together in studying these matters has been the Mutual Insurance Advisory Association (formerly named the Mutual Insurance Statistical Association), and even a moderate degree of familiarity with the affairs of this organization will demonstrate that the mutuals have taken very seriously the challenge of this era of change to, at the very least, become aware of the nature and significance of these stimulating and important developments.

In addition to the virtual certainty that the resolution of many of the problems now so pressing in the fire field will have important repercussions in the casualty field and thus involve vital interests of the casualty associates of the mutual fire carriers, it also seems unlikely that solutions reached without the active participation of mutual carriers will invariably be such as to enable the mutual companies to accommodate themselves to the results without important and perhaps harmful

<sup>16</sup> The Escott Plan, the Liberty Mutual Plan, the Pearl Plan, the North America Plan.

<sup>17</sup> See *Fire Insurance Terms and Discounts*, report by Deputy Superintendent Thomas C. Morrill to Robert E. Dineen, Superintendent of Insurance, New York, January 18, 1950.

<sup>18</sup> See Ruling of Robert E. Dineen, Superintendent of Insurance, New York, to the effect that such plans are not regulated under the New York rating law, March 23, 1950.

<sup>19</sup> See ROBERT E. DINEEN, *THE LEFT HAND AND THE RIGHT HAND* (1948).

adjustments. It is at least a matter of doubt if such solutions so reached can form a stable and permanent base upon which the fire rate regulatory structure can rest.

Likewise, one cannot but wonder whether, in years to come, it will be feasible to continue without some modification a pattern of regulation under which a substantial portion of the business actually has no effective vote or voice in the councils of the rating organizations even though, in many respects, it must accept the results of those councils.

There is also a question whether the administrative handicaps of a system which now involves numerous independently operated state or regional rating organizations will not become so obvious and so burdensome as to create considerable pressure for a national fire rating organization. Indeed, there appears to have been at least some discussion of such an organization.<sup>20</sup> But, of course, it may take a long time for such an idea to become accepted. One recalls that a National Rating Organization for Multiple Location Risks was proposed as early as 1942 by the Industry Fire Committee on Interstate Rating,<sup>21</sup> and that such an organization has not as yet been created, although the need for it continues, only slightly abated by the creation of the Multiple Location Service Office, an advisory organization which performs some of the functions essential to the rating of interstate multiple location risks.

### III

#### LOSS AND EXPENSE RECORDING AND REPORTING

However widely the rate regulatory pattern may vary among the states or between fire and casualty insurance, it will be found that practically every pattern includes the basic requirement that rates must not be "excessive, inadequate, or unfairly discriminatory." But how shall the ratemaker know enough to construct a set of rates possessing these characteristics, and how can the regulatory official know whether it is his duty to permit such a set of rates to be used or to prevent their use?

The answer is that, as a matter of necessity, there must be some objective standard, usable by both the maker and the judger of rates, against which the loss elements in a filing under consideration can be measured. This standard is, of course, the accumulated experience of the past.

Full recognition of this fact is present in the text of the All-Industry Bills, and in the writings of those who participated in drafting the bills.

Thus, we find that most state rate regulatory statutes provide:<sup>22</sup>

The commissioner *shall* promulgate reasonable rules and statistical plans, reasonably adapted to each of the rating systems on file with him . . . which *shall* be used thereafter by *each* insurer in the recording and reporting of its . . . experience, in order that the

<sup>20</sup> See *National Rating—Talk of a National Fire Insurance Rating Organization Won't Down*, Journal of Commerce (New York), April 4, 1950. See also Kenney, *This Question of Streamlining the Fire Insurance Business*, United States Investor, April 15, 1950.

<sup>21</sup> See the three reports of this Committee, Nov. 19, 1942, Oct. 27, 1945, and April 13, 1948, PROCEEDINGS N. A. I. C.

<sup>22</sup> This was Section 13(a) of the All-Industry Bill. (Italics supplied.)

experience of *all* insurers may be made *available . . . in such form and detail as may be necessary* to aid him in determining whether rating systems comply with the standards set forth in Section 3. . . . No insurer shall be required to record or report its loss experience on a classification basis that is inconsistent with the rating system filed by it. The commissioner may designate . . . agencies to assist him in gathering such experience *and making compilations* thereof, and *such compilations shall be made available*, subject to reasonable rules promulgated by the commissioner, to insurers and rating organizations.

Also the *Explanatory Memorandum, Casualty and Surety Rate Regulatory Bill* prepared by the All-Industry Committee, contains some very explicit statements referring to the necessity of combining experience:

*Combining experience is essential* in casualty and surety ratemaking . . . rates are made upon the assumption that the future will, within reasonable limits, repeat the past. The broader the basis of past performance, the greater is the probability that it is not distorted by chance and the greater becomes the degree of accuracy of prognosis. The average insurer does not have a sufficient volume of business to render its own experience a safe guide for the future. Hence, it is usually *necessary* that the experience of a number of insurers be combined in the making of rates.

Even though we may have an appreciation that a degree of truth is contained in Lord Halsbury's observation, "My Lords . . . in construing a statute I believe the worst person to construe it is the person who is responsible for its draft," we should have no difficulty construing statutes based upon Section 13(a) of the All-Industry Bill, if we bear in mind that a fundamental principle of statutory construction is to ". . . consider from the start the legislative purpose and intention."<sup>23</sup> The purpose of the Rate Regulatory Acts is ". . . to promote the public welfare by regulating insurance rates to the end that they shall not be excessive, inadequate or unfairly discriminatory. . . . (Sec. 1.) If, as the drafters of the explanatory memorandum stated, combining experience is essential, it cannot be doubted that Section 13(a) contemplates statistical plans under which experience can be combined. In determining the legislative intent, "the purpose for which a law was enacted is a matter of prime importance in arriving at a correct interpretation of its points," and "a thing within the object, spirit and the meaning of the statute is as much within the statute as if it were within the letter."<sup>24</sup>

The purpose of the limitation upon the power of the commissioner is entirely clear and logical. An insurer should not be required to set up a statistical plan which bears an inconsistent and illogical relation to his rating system—to that extent the individual insurer may be accommodated, but he must not be permitted to defeat the purpose of enabling rates to be made and judged on the basis of combined experience, and he should not reasonably expect to use rating systems more detailed than his statistical system.

Thus, it is clear that Section 13(a) contemplates and in fact requires the promulgation and use of statistical plans under which all insurers record and report their loss experience on a basis consistent with and at least in the same degree of de-

<sup>23</sup> II J. G. SUTHERLAND, STATUTORY CONSTRUCTION §4701 (3rd ed., Horack, 1943).

<sup>24</sup> II *id.* at §§369, 379 (2d ed., Lewis, 1904).

tail as their rating systems.<sup>25</sup> Otherwise, the primary purposes of the law are defeated. If the rating systems are *more* detailed than the statistical plans, which are relied upon to produce the ability to judge whether the rating system possesses the essential attributes, neither the supervisor nor the ratemaker will ever be in the position of possessing an objective standard capable of being used in either rate-making or rate-judging. A simple illustration will be useful. The insurer desires to use a rating system for private passenger automobiles (representing a very large volume of experience) which involves territorial differentials within each classification. The statistical plan which it desires to use makes provision for reporting state-wide results *by class*. Territorial results, however, are not reported by class but combine all classes. If this is permitted as to a kind of insurance producing a large volume of experience, several very undesirable results follow, and the statutory purpose is defeated. Unless statistics are available on a basis which permits territorial variations within classes to be judged according to the standards of the law, not only is the insurer deprived of ability ever to furnish statistical justification for his filing, but the supervisor is forced to rely upon his judgment in accepting or rejecting the filing. While judgment is, of course, necessary, especially in dealing with kinds of business as to which the volume of experience, by territorial classification or otherwise, is too small to be credible, it should not be resorted to when objective standards can easily be made available.

Although it is recognized that over-refinement in statistical plans is as much to be avoided as excessive crudity, still it would seem necessary before long for each supervisor to bring about the use of statistical plans which do, in fact, make available the experience of all insurers in such form and detail as will make it possible for him to be aided by such experience in determining whether rates do or do not meet the standards. Only then will compilations of such experience be of sufficient value to the ratemaker to enable him to rely strongly upon them in making filings on a basis which assures that their use is in accordance with law, and only then will we be confident that the system fully merits the degree of public and legislative confidence which we must have if we are to continue without governmental competition.

#### IV

##### RATE REGULATORY LAWS

While it is not uncommon to refer to the rate regulatory law of a particular jurisdiction as though it, in and of itself, supplied the actual pattern of regulation, it will be appreciated that several different patterns of regulation can exist under the same law. In any of several states it is entirely possible under the law of that state to have some such situation as this:

<sup>25</sup> A. Lawrence Lowell once gave this account of the solution of a problem of statutory construction. A Chinese woman, holding a proper permit to come to this country, landed in San Francisco with a child born during the voyage. The immigration officer asked his supervisor whether the child, having no landing permit as the statute required, must be sent back to China. The answer was appropriate, "Don't be a damned fool."

The National Council on Compensation Insurance, a bipartisan organization, balanced as to stock and non-stock control, will make rates for workmen's compensation insurance, based upon the experience of all carriers and uniform among all carriers (except for a few deviations) as to pure premiums. The rates will also be uniform among stock carriers as to expense loadings, and uniform among non-stock carriers as to expense loadings.

The National Bureau of Casualty Underwriters and the Mutual Insurance Rating Bureau, each a partisan organization, will be cooperating in making automobile bodily injury and property damage liability rates on the basis of the experience of all carriers. Or instead the National Bureau may be making automobile bodily injury and property damage liability rates on the basis of its members' experience only, the Mutual Bureau may be making automobile bodily injury and property damage liability rates on the basis of the experience of all companies, to the extent available, and various "independents" will be making and filing their own automobile rates.

The National Automobile Underwriters Association, a stock company controlled rating organization having mutual companies as subscribers, will be making rates for automobile physical damage coverages on the basis of the experience of members and subscribers only.

A stock company controlled fire rating organization having mutual companies as subscribers will be making rates for fire insurance.

These various patterns tend to develop without being greatly affected by minor variations in the rate regulatory laws, and such variations are entirely permissible under the All-Industry Bills. There are, however, a few jurisdictions having laws so different from the normal as to require special mention.

Idaho has no casualty rate regulatory law. One effect of this is to create a certain amount of fear among bureau members, who would normally and naturally desire to follow the same practices in Idaho as elsewhere, that the similarity in actual practice may lead to inferences that such similarity results from some sort of tacit illegal agreement to act together. Another result has been to increase somewhat the cost and trouble of doing business in Idaho—this because many carriers accustomed to rely upon the bureaus for numerous services find it necessary to perform them unaided. There has been no noticeable effect as yet in terms of increased or decreased rates or in terms of coverages being available there which are not available elsewhere.

The Missouri casualty law does not require that rates be filed, a situation to discourage the most conscientious of administrators.

California also has a kind of law (fire and casualty other than workmen's compensation) which could cause the administrator to conclude that his task was almost hopeless. Rates are required to be not excessive, inadequate, or unfairly discriminatory, but members of a rating bureau may not agree to adhere to its rates, and rates need not be filed with the commissioner but only with the rating organization, or

in the case of a non-member, in the company's California office. Here, as in Missouri, only the most extraordinary docility on the part of the carriers will prevent the states from becoming the proving ground for a considerable assortment of bizarre rates, rating plans, and forms of coverages.<sup>26</sup>

We must assume that not every commissioner is apt to combine the technical knowledge of the most able of actuaries, the investigatory skill of the Federal Bureau of Investigation, the agility of the Green Hornet, and the luck of Dick Tracy.

While the companies can probably learn much of value from such facile experimentation, the problem which the buyer faces of distinguishing between the good and the spurious becomes increasingly difficult as the number of choices increase, especially if the administrator is hard-pressed to catch up with "the burglars."

Montana's law has no provision requiring the filing of casualty rates by non-bureau members.

Several states have provisions which define or interpret one or more of the standards (*i.e.*, reasonable, adequate, and not unfairly discriminatory) in a way to make it virtually meaningless and impossible of practical application, *e.g.*:

"No rate shall be held to be excessive if the commissioner finds that free competition exists in the area and in the classification. . . ."<sup>27</sup>

Montana's law provides that "No rate shall be held to be inadequate unless the Commissioner finds that the continued use of such rate shall endanger the solvency of the insurer. . . ."<sup>28</sup>

It would seem that a very large strong company could charge inadequate rates for any given kind of insurance for a long time before insolvency threatened—meanwhile acquiring considerable volume in that class and perhaps endangering others whose volume of business did not permit such manipulation.

Also, many states omit any requirement that rates be on file for some stated period before they are used and fail to provide any means whereby overcharges or undercharges may be recovered, thus making it virtually impossible consistently to enforce the standards, if carriers desired to "get away with" violations.

In view of the fact that the Arkansas law, which closely follows the All-Industry pattern, has withstood legal attack in both a Federal District Court and in the Federal Court of Appeals for the Eighth Circuit,<sup>29</sup> and that it has by this time been

<sup>26</sup> Bulletin No. 96 issued by the Department of Insurance of the State of California, April 14, 1950, in order to assist insurers in obtaining a proper understanding of the California Rating Law, includes the following statements:

"Certain insurers have established sub-standard classifications for which they have adopted rate surcharges or rate increases above their normal rates for standard or preferred classifications. After review by the staff of the Bureau of Rate Regulation, it has been found that in very few cases is the use of sub-standard classes and rates by insurers justified by the experience data accumulated and maintained by them; nor have these rates been formulated in accordance with the standards enumerated in Section 1852." P. 2.

"An investigation made as a result of complaints received by this Department has revealed widespread inconsistencies in the correcting or changing of policies affected by rate changes or rate revisions." P. 3.

<sup>27</sup> IDAHO CODE tit. 41, §2003(b)(1) (1947); ARIZ. CODE c. 61, §1102(a)(2) (Cum. Supp. 1949).

<sup>28</sup> Mont. Laws 1947, c. 255, §7.

<sup>29</sup> North Little Rock Trans. Co. v. Casualty Reciprocal Exchange, 85 F. Supp. 961, 181 F. 2d 174 (8th Cir. 1950).

amply demonstrated that the All-Industry pattern of rate regulatory law does, in fact, permit great flexibility, it would seem to be a wise thing for states having laws containing important departures from a pattern of law which has been found to be legally sufficient, to bring their laws into harmony with the established standard.

## V

## COMPETITION

The late Clarence W. Hobbs, a man who knew as much as anyone about the workmen's compensation rating system—under which a high degree of initial price uniformity was the prevailing situation—once remarked that "competition is a form of warfare, and its consequences are frequently only slightly less harmful to the victor than to the vanquished."<sup>30</sup>

S. Bruce Black, President of Liberty Mutual Insurance Company, the largest writer of workmen's compensation insurance, attributes to competition among workmen's compensation carriers the development of loss prevention services and a large share of the credit for the magnificent results achieved by private insurance in the field of industrial safety. The record is indeed a proud one. In New York the fatality rate per 100,000 workers has dropped 50 per cent since 1924; in Massachusetts, 69 per cent; in Illinois, 60 per cent, and in Pennsylvania, 78 per cent, all since 1917.<sup>31</sup>

Actually there is no conflict between these statements. Mr. Hobbs was speaking of the sort of unrestrained competition which occurs in the absence of reasonable regulation, and Mr. Black is speaking of the competition which occurs within the framework of the most complete rate regulatory system now existing. The point is that the effect of the highest degree of regulation now existing in the insurance business, the system which involves the most scientific ratemaking methods and a high degree of uniformity among carriers in the various groups, has not been to stifle competition but to turn it into channels where it has been of enormous benefit to our economic society and to the individual worker.

Rate regulation does not end competition, it does not end old rivalries, it need not end progress in developing new coverages and new rating plans. It does require these developments to take place in a manner consistent with the attainment of the ideal of fairness implicit in the requirement that there be no unfair discrimination, and with the maintenance of a price structure which is neither too high nor too low.

Nor does rate regulation confer any special competitive advantage upon any particular group of companies, a claim often asserted as to the mutuals by those

<sup>30</sup> XXVIII PROCEEDINGS OF THE CASUALTY ACTUARIAL SOCIETY NO. 57, STATE REGULATION OF INSURANCE RATES pt. 1, 37 (1941).

<sup>31</sup> See 38th Annual Report of Liberty Mutual Ins. Co. for the year ended December 31, 1949. ". . . Results bear out the statement that competition reduces accidents.

". . . Competition among insurance companies has helped industry make jobs safer and safer for workers." *Id.* at 3, 5.

who opposed the all-industry type of rate regulatory legislation.<sup>32</sup> It is difficult to prove this statistically because so many factors contribute to overall results. However, it can be shown that the mutuals have enjoyed no extraordinary growth in the lines as to which regulation has been so greatly extended, *i.e.*, automobile and general liability. In 1941 mutual carriers wrote 27 per cent of the total automobile insurance written. Stock and reciprocals wrote 73 per cent. In 1948 the percentages were exactly the same, although there are of course many fluctuations among the various states and companies. In 1941 mutual carriers wrote 15.5 per cent of the total liability and property damage (other than automobile) premiums, while stocks and reciprocals wrote 84.5 per cent of the market. In 1948 the stocks and reciprocals wrote 84 per cent and the mutuals 16 per cent.<sup>33</sup>

In workmen's compensation—a field in which the mutuals generally enjoy a good degree of success—the mutuals wrote 29.9 per cent in 1941 and 30.3 per cent in 1948.<sup>34</sup>

Doubtless these figures were affected by wartime difficulties, nor do they give any indication of the relative degree of success each group will attain in the future.

It would, however, seem to be sound to conclude that factors other than the kind of rate regulatory pattern which may happen to exist will determine the degree of competitive success. Probably Ray Murphy, the distinguished General Counsel of the Association of Casualty Companies, a stock company organization, put the matter about as succinctly and accurately as possible when he said, after reviewing statistical data, “. . . there is no rhyme or reason to the claim that rate regulation, *per se*, is what governs the placement of business”<sup>35</sup> (as between stocks and mutuals).

## VI

### CASUALTY INSURANCE

Apart from the regulatory pattern which exists in Texas and Louisiana, where the state actually *makes* and *promulgates* rates for casualty insurance, as distinguished from merely permitting, with or without express approval, the use of rates filed by insurers or rating organizations, four principal systems of casualty insurance rating

<sup>32</sup> See CARLETON I. FISHER, *STATE REGULATION OF INSURANCE—THE CASE AGAINST THE ALL-INDUSTRY BILLS* (pamphlet published by the Rhode Island Association of Insurance Agents). See also OTTO PATTERSON, *INSURANCE AT THE CROSSROADS—THE MENACE OF THE ALL-INDUSTRY BILLS* (1947). This discussion, in addition to predicting great competitive advantages for mutuals, also asserts that the All-Industry Bills “. . . start the American Agency System down the primrose path to oblivion; that within a few years it would become as extinct as the dinosaur and the dodo.” A fate which, happily for us all, as yet shows no faint sign of being accomplished.

Edward C. Stone, U. S. General Manager and Attorney, The Employers' Group, also, on various occasions, expressed the view that the All-Industry Bill gave participating carriers “undue competitive advantage.” See, *e.g.*, *Comments on Commissioners' Fire and Inland Marine Rating Bill*, Insurance Advocate, December 22, 1945.

<sup>33</sup> Data from Liberty Mutual Research Department.

<sup>34</sup> SPECTATOR YEAR BOOK (1941), (1948).

<sup>35</sup> *Hearing before the Insurance Committee of the Massachusetts Legislature* (March 21, 1947).

may be said to exist, all under the same or similar rate regulatory laws. These are: (1) The workmen's compensation system, (2) the general casualty insurance system in states where the two principal rating organizations cooperate as to all general casualty lines, (3) the automobile insurance system in states where the two principal rating organizations cooperate as to automobile liability only, and (4) the system in effect where the rating organizations do not cooperate. As to (1), (2), and (3), rates are based upon the combined loss experience of all carriers.

If we seek to make a sound decision as to which of these patterns furnishes the best model for the future, we might well make an exhaustive analysis of each and attempt to determine the extent to which the purposes and ideals of rate regulation have been achieved or are achievable under each. It would first be necessary to settle upon what those purposes and ideals are, and then to seek to compare characteristic results of each system with the agreed-upon purposes and ideals. A full performance of such an undertaking would be far beyond the space limitations of this article and would require the work of many people. Perhaps, however, it will be possible here to state what the purposes and ideals are thought to be and to state some of the history and characteristics of two of these patterns, possibly as a starting point for further exploration by others.

The mutual carriers have, at various times in the past, undertaken to state their beliefs as to the ideals and objectives of rate regulation. In a memorandum drafted by a special committee of the American Mutual Alliance some time in 1946, the following appears:

Insurance affects the lives, property, welfare and security of a large part of the total population. Insurance takes small amounts of premium from great numbers of people for the benefit of the few who are struck by catastrophe. Insurance, through the safeguarding and investment of funds in effect held in trust for claimants, exercises a tremendous influence upon the economic life and organization of the country. Insurance contracts are complicated legal documents, the interpretation and evaluation of which are entirely outside the scope of ordinary activities of most insurance buyers. Manifestly it is greatly in the public interest that the public be able to buy such contracts easily, that the public can rely on the contract without legal advice, that the price charged for the protection of the contract be fair, reasonable and not excessive, that all buyers are treated alike without unfair discrimination, and above all, that the protection so purchased will be given when needed through the continued solvency of the issuing insurance carrier. These legitimate public interests cannot be protected in full measure without sound and effective rate regulation.

In another memorandum, *State Regulation of Casualty Insurance Rates*, November 1947, there is the following passage:

Probably all would agree that the great objective is solvency and that the next most important objective is equity or fairness in the practices of companies and their agents. One arrives at each of these great objectives by studying the role of insurance in our economic system and its inherent characteristics.

There is, however, another objective which derives from the essential character of our economic and political systems. It is to preserve as much competitive opportunity as is consistent with the attainment of the great objectives.

Thus every important decision as to ratemaking and administration requires the considered balancing of diverse and complex factors. There must be a balance between elasticity and uniformity, between the greater equity which comes from lack of such refinement, between freedom of competition and safety from combination. Such balancing must be done in light of the goals to be sought and in light of their relative importance.

This is not to substitute regimentation for enterprise, much less to despair of the private enterprise system. It is the sort of balancing of power and freedom, safety and risk, which must be wisely done if private enterprise is to continue to function in a complicated world.

These two statements probably may be taken as expressing the fundamental beliefs of a large group of mutual casualty and fire companies, and to constitute the bench marks against which we would measure the merits of the various regulatory systems existing today.

Let us now look briefly at the workmen's compensation system. A national ratemaking body, the National Council on Compensation Insurance, makes rates for about thirty states.<sup>56</sup> As to these states, the classification system is uniform, and the loss experience of virtually all carriers is collected according to such classifications. This collection is under a uniform statistical plan. The loss experience of all reporting carriers is combined for ratemaking purposes. The stock carriers as a group use a set of expense loadings which is designed to produce enough to enable a well and economically managed stock company to pay its expenses, experience a normal loss ratio, and have left over a small margin for profit. The mutual carriers as a group use a different set of expense loadings, designed to enable a well and economically managed mutual to pay its expenses, experience a normal loss ratio, and have left over such margin of safety as prudent management policy may require, returnable to policyholders in the form of dividends to the extent not otherwise required. Either group is free to change its expense loadings if such change can be justified.

The organization is run by committees composed of an equal number of stock and non-stock carriers. Rates are revised annually on the basis of the most recent available experience. Judgment factors are not generally employed, and it is generally recognized that under normal conditions this system should, over a period of time, produce the desired result, *i.e.*, a permissible loss ratio. At any given point in the economic cycle rates may be somewhat too high or somewhat too low. Those who defend the system point out that these departures from perfection are apt to be less serious than would be the case if judgment factors had been employed and turned out to be wrong.

The system produces a high degree of stability. Well-run companies of reasonable

<sup>56</sup> States in which a state fund has a monopoly of the workmen's compensation insurance business are Ohio, West Virginia, Wyoming, Nevada, Washington, Oregon, and North Dakota.

States having independent bureaus, cooperating in varying degree with the National Council on Compensation Insurance, are Massachusetts, New York, New Jersey, North Carolina, Michigan, Wisconsin, Pennsylvania, Delaware, Virginia, Minnesota, Indiana, and California. In Texas and Louisiana, the rates are promulgated by the state. In all other states the National Council is the rating organization for workmen's compensation insurance.

financial strength can be confident of their continuing ability to stay in business at a reasonable margin of profit. The ideal of no unfair discrimination is attained in maximum degree, assuming of course that expense loadings are correct by size of risk. Considerable price competition exists even among companies of each group because several rating plans are available which make it possible for risks to earn premium credits or refunds because of favorable loss experience. This causes the companies to place great emphasis upon loss prevention activities, to the very great benefit of both employer and employee.

How did such a system happen to get started? The late Clarence W. Hobbs gave his opinion in these words:

Non-partisan bureaus appeared, partly, at least, as the result of pressure from supervisory authorities. The authorities wanted uniformity in classifications, underwriting forms, manual rules and statistical methods; without these, rate supervision would become enormously difficult. Rate competition was generally not desired. Thus, in state after state, bureaus were set up: when this became expensive, and productive of diverse practices, a central organization, or rather a succession of them was set up, culminating in the National Council on Compensation Insurance. Centralization however is by no means complete, and was not intended to be: but the central performance of statistical functions has saved much money, and a central unifying influence has saved much more.

The reference to centralization not being complete is by way of recognition of the existence of "independent bureaus," *i.e.*, not branches of the National Council, in New York, Massachusetts, Pennsylvania, Delaware, New Jersey, California, Minnesota, Wisconsin, Virginia, North Carolina, and Indiana. In all of these, however, a considerable degree of uniformity in statistical and ratemaking procedures, manuals, and forms exists, and in some much of the basic data is prepared by the National Council.

The National Council, and also the independent workmen's compensation bureaus, have generally been under the watchful eye of the National Association of Insurance Commissioners or of the supervisory authority in the state in which the bureau functions, although that circumstance has not prevented the Commissioner from manifesting a highly skeptical attitude when rate increases are sought, even if he has been fully informed as to every detail of the proposal at the time it was being developed by the bureau. Indeed, a disheartening aspect of the workmen's compensation system is the lack of greater understanding of its workings and lack of greater confidence in its results, in spite of its scientific nature and lack of unjustifiable procedures. One would naturally suppose that a system which operated so entirely under the eye of the rate regulatory officials would be strongly defended by them against criticism by policyholders and, more recently, by labor representatives. The paradox becomes more acute as one realizes that but for the ready availability of the masses of exact and detailed information used to produce the rates, the opponents of a rate change would have a most difficult task to produce factual data of any degree of reliability whatever upon which to base their attacks. Actually

the attacks upon proposed rates are largely by way of arguments as to the manner in which the data should be interpreted.

The system has produced a vast and invaluable body of statistical information, thus enabling rates to be made and judged with confidence. The policy contracts now in use are broad and reliable and are still improving. Buyers are treated without unfair discrimination. Claimants can be confident that they will be paid. Competitive opportunity is not lost, and great economic and social waste has been prevented by the emphasis on safety engineering and good medical care which the system encourages. Changes are introduced whenever the composite judgment of the experts on the Committees indicates that change should occur. A spirit of critical self-analysis has been preserved.

One can only hope that such difficulties as have been encountered in the recent past will not deter and discourage those who believe in the system, and in the value, validity, and fairness of its results, from continuing to strive for perfection, and for the degree of public acceptance which the system deserves and requires.

## VII

### AUTOMOBILE LIABILITY

In the automobile liability field there are two principal rating organizations—the National Bureau of Casualty Underwriters (a stock company organization), operating in all states having rate regulatory laws which permit bureau operation, and the Mutual Insurance Rating Bureau, operating in (or in the process of obtaining licenses in) 42 states.

In a few states, New York being one, rates are made on the basis of the combined experience of all carriers, but in most states the National Bureau makes its rates on the experience of National Bureau companies, and the Mutual Bureau makes its rates on the basis of the combined experience of all carriers, to the extent combinable experience is available.

In New York, and the other states where full cooperation exists, until very recently rates were uniform among all carriers. More recently independent filings which differ from Bureau filings have been permitted.

The history of automobile liability rate regulation in New York is a fascinating one, worthy of close study today.

Uniformity in automobile liability rates came about as a result of an order of Superintendent of Insurance George S. Van Schaick, on February 23, 1932. This had been preceded by a period of turmoil. Early in 1929 a group of stock companies found it necessary to complain to the New York Insurance Department that abuses were occurring in automobile fleet rating. The National Bureau proposed that it become a stamping office through which all fleet policies would clear. The mutual companies acting through a committee (the Mutual Bureau not being in existence at that time) suggested a non-partisan bureau to which all carriers would belong. The National Bureau did not favor the proposal. The Superintendent sug-

gested that each group should have its own bureau and that plans should be made for the exchange of experience.

At the same time these activities were occurring the legislature was enacting a Safety Responsibility Law which had the practical effect of requiring rates for automobile liability insurance to be approved before use. Thus, in July, 1929, the Superintendent called upon all carriers to submit rate filings, effective September 1, 1929, with full supporting data. It was also indicated that uniform rates would be established, except for deviations, and that each carrier would have to be either a member of a bureau, adopt the rates of a bureau (or deviate uniformly), or file a complete manual and support it by the *combined* experience filed under official calls. All filings would be reviewed but only one approved (subject to uniform deviation).

The prospective burden upon individual carriers was such that this, combined with the fleet rating situation, caused the mutual companies to organize the Mutual Bureau. It began to function in November, 1929, and plunged into the work of consolidating stock and mutual company experience and calculating a set of rates based upon the combined experience. In due course these rates were filed.

Meanwhile the National Bureau prepared and filed a set of rates based upon the experience of its members only. Thus the Department had two sets of rates before it. After weighing all of the evidence, the Department selected a set of rates which were forwarded to the National Bureau, Mutual Bureau, and the non-Bureau companies with the statement the Department was prepared to approve such rates for all companies. The rates selected by the Department were virtually the same rates as filed by the Mutual Bureau based upon the combined loss experience of all companies, stock and mutual. The Mutual Bureau, accordingly, filed the rates proposed by the Department. The National Bureau strongly objected to filing the proposed rates and, after considerable discussion, filed a set of rates with an over-all effect higher than the rates proposed by the Department, but lower than the rates originally filed by the National Bureau based upon the experience of their members only. The two sets of rates filed by the Mutual Bureau and the National Bureau, respectively, became effective February 3, 1930, and immediately thereafter, one by one, non-Bureau companies received approval of deviations, not all of which were uniform, and in a short time there were about as many sets of rates as before.

Late in 1931, the National Bureau again filed a revision of rates on the basis of experience of their members only, which became effective January 18, 1932. This revision involved a substantial over-all increase in the National Bureau rates and, accordingly, materially increased the existing differential in rates between the two Bureaus, the Mutual Bureau rates being considerably lower. This wide difference in rates created considerable disorder in the business.

In the meantime, the Mutual Bureau was working on a revision of rates, based upon the combined loss experience of all companies, which produced a set of rates generally lower than the National Bureau rates which became effective January 18, 1932. When the rates developed by the Mutual Bureau were submitted to the De-

partment, Superintendent George S. Van Schaick called for conferences and insisted that an agreement be reached upon a uniform set of rates, underwriting rules, and rating plans, and stipulated that consideration be given to the combined loss experience of all companies as compiled by the Mutual Bureau. Finally, uniform rates were approved, effective March 1, 1932, and the National Bureau revision of rates, effective January 18, 1932, was rescinded retroactively. Deviations from the uniform rates were viewed much less liberally and actual uniformity prevailed, which state of affairs has continued substantially up to the present. Recently several departures from prevailing rates and rules raise a question as to how far the Department is willing to go in permitting a return to earlier conditions.

Obviously when absolute uniformity is approached, the degree of public confidence that the rates are correct should be at its maximum. Competition as to initial price is at a minimum, and the responsibility of the supervisor to make sure that regulation is serving as a satisfactory substitute for competitive pressures on prices is great. It is, however, possible for this great responsibility to be discharged, if such conditions prevail. At the other extreme, *i.e.*, any number of sets of rates being permitted, it is difficult to see how the public can have any confidence that it is being fairly treated, and difficult to understand how the administrator could possibly be enough of a superman to be able to pick and choose among the numerous filings which ones will and which ones won't meet the statutory standards.

To avoid utter administrative impotency it would seem essential that at the very minimum a detailed uniform classification system be in effect, that loss experience collected under this system be available on a combinable basis, and that each company or group be required to justify its expense loadings.

## VIII

### FIRE INSURANCE

As mentioned earlier, the fire rating system is characterized by numerous bureaus, nearly all stock company controlled, and by rating methods in which judgment plays a very large part. Statistics are collected but it is said that these are not in form suitable for ratemaking.<sup>37</sup> Among the great questions facing the fire business are: Can its rating methods become more scientific and based more upon statistical experience and less upon judgment? Is the system of numerous bureaus a satisfactory one? Are organizational changes desirable? Can jurisdictional difficulties be solved in such a way as to enable multiple line underwriting to develop without undue restrictions?

That all these questions must be approached with the view of developing the maximum public confidence in the business should be self-evident. That some of the leaders of the business understand this very clearly is encouraging.

<sup>37</sup> Donald C. Bowersock, President of the Boston Insurance Company, is quoted by *The Standard*, April 21, 1950, as testifying: "The statistics that have been compiled for a number of years by the National Board of Fire Underwriters are not adequate for rate making purposes."

## IX

## RATING ORGANIZATIONS

Except with respect to those states which make and promulgate rates for all carriers, it is very doubtful that it could be shown that any pattern of rate regulation, whether under law or by way of "self-regulation," applied to a major and competitive kind of insurance, has ever been successful in bringing about general adherence to rates which even approximated being reasonable and adequate and not unfairly discriminatory, without there being, as the very core and essence of the pattern, a strong rating organization exercising discipline over its membership.

If, under any of the various patterns of regulation existing under legislation modeled upon the All-Industry Bills, rating bureaus should cease to attract and hold members constituting a substantial part of all those engaged in writing any given major kind of insurance, adequate regulation of the rates for that kind of insurance would become administratively impossible. No insurance department is now staffed, nor is apt to be, to the point of being able to make a prompt and adequate review of a very large number of different filings. Nor is it likely that the public would long tolerate being forced to make such difficult choices as would be presented if a myriad of forms and rates were available to them.

The freedom which exists today to be an independent filer rather than a member or subscriber, can soundly endure only so long as not too many choose to exercise it.

Thus, one of the great questions of today and tomorrow is how the rating organizations can hold their membership in the face of the temptations which exist when non-member independent filers succeed in obtaining the right to use rates or coverages not easily available to members, because a majority are not willing that the bureau file such rates or coverages.

In the two years or so since rate regulation became widespread, the bureaus have tended to show a great increase in membership. For example, the Mutual Insurance Rating Bureau's membership increased by about 50 per cent from January 1, 1944 to January 1, 1950. It should be recognized, however, that not all of the increase in Bureau membership is a direct result of the passage of rate regulatory laws. The rapid enactment of multiple line underwriting legislation, bringing fire companies into the casualty business and casualty companies into the fire business with each requiring assistance as to the new lines, the broadening of the territorial scope of Bureau operations in many cases, resulting indirectly from the passage of rate regulatory laws, the incorporation of new companies, and companies moving from subscribership to membership status all contributed to the increase in Bureau membership. However, some increase was to be expected as a result of rate regulatory laws, because as to many companies the task of making and supporting rate filings was new, strange, and difficult, and the services of a rating organization were, as a practical matter, essential. But as the task becomes more familiar, even though

still difficult and burdensome, how many will continue to be willing to remain obligated to use bureau filings in the face of attrition from non-members, one having a competitive edge in one line, another in another, this one having a rate advantage, another an attractive form of coverage?

Part of the answer lies in a clear recognition by the bureaus that they must remain alert and progressive. They must not serve to stifle but rather must furnish a means of expression for the progressives within the membership. Innovations must not become the prerogative of the independent but a normal part of bureau operation. Coverages utilizing newly acquired multiple line underwriting powers must not be forced to remain on the drafting boards because of the extremely difficult and delicate adjustment of spheres of authority which may have to occur.

Happily it may be said that as to some lines of insurance, groups working within the framework of the rating organizations have been able to bring about, in an orderly way, many very great improvements in coverages and in rating methods. Such zeal must somehow continue within the groups heretofore possessing it, and some way must be found to cause it to grow in the heretofore more conservative organizations.

Another part of the answer lies with the regulatory authorities. They should not apply a more strict standard to innovations made by rating organizations than to those attempted by independents. Indeed the standard should be precisely the same, not only with respect to innovations but with respect to all filings. Moreover, each filer, whether independent or bureau, should be willing to, and probably required to, justify his filing on the basis of the whole body of experience accumulated and made available to all under Section 13 of the All-Industry Bills.

Philosophic justification of rate filings is doubtless necessary at times, especially as to new ideas and frequently during the development stage of any regulatory system. But since such justification rests upon logical assumptions, rather than upon factual support, it seems not to offer a very sure way to maximum public acceptance of our product, and should be resorted to less, rather than more, as data accumulates and as the many efforts to improve statistical methods begin to make better information available to ratemakers and supervisors alike. Here again balance must be sought. The limitations of statistical methods must be understood and over-rigidity should not be allowed to, nor is it apt to, occur.

In the insurance business, as in others, there is no easy way to be right. Always we must balance opposing forces, constantly assimilating, validating, corroborating, and verifying our ideas, hoping that Bacon was right when he said, "If we begin with certainties, we shall end in doubts; but if we begin with doubts, and are patient in them, we shall end in certainties."