Article from:

The Actuary

May 1976 – Volume 10, No. 5

The Actuary

The Newsletter of the Society of Actuaries

VOLUME 10, No. 5

MAY, 1976

CAPITAL ADEQUACY IN PROPERTY INSURANCE

A Simulation Analysis of Capital Structure in a Property Insurance Firm, by David J. Nye, S.S. Huebner Foundation Monograph Series, University of Pennsylvania, $5.00.

by David J. Grady

Editor's Note: We are indebted to The Actuarial Review *for permission to publish this review of the latest volume in the Huebner Foundation Monograph Series. Mr. Grady is a Fellow of the Casualty Actuarial Society.*

Dr. Nye's monograph is a carefully constructed academic who-done-it in six acts. The victim is an apparently innocuous monoline insurance company with dreams of multiperiod survival. In order that we should not mistake the character of the victim for any company familiar to us in real life, the author reveals that the single line is automobile physical damage coverage. We are introduced with meticulous care to those who sustain close relationships with the potential deceased: the cheerful and optimistic common stock portfolio, the ever-faithful but possibly overvalued presence of long-term bonds, the uncertain support of the debt/equity ratio, and the brute strength of blind growth. As we become more deeply involved with these interrelationships, the suicidal tendencies of the victim are revealed to us. Suspense is heightened when we begin to suspect that the true culprit has been unmasked in a footnote on page 89. However, with the introduction of further complexities in the latter half of the work, the reader comes away with a feeling of relief that it has been, after all, only a simulation.

A careful perusal of the monograph should provide the reader with a much greater depth of understanding of the

(*Continued on page 3*)

20TH INTERNATIONAL CONGRESS OF ACTUARIES

The deadline for final registration for the 20th International Congress of Actuaries in Tokyo this October has been extended to June 30. One hundred actuaries from the United States have already registered for the Congress and there are a number of registrations still available. United States actuaries can obtain information from Fredrick E. Rathgeber, Prudential Plaza, Newark, N.J. 07101. Canadian actuaries should contact Colin E. Jack, Tomenson-Alexander, 680 University St. W., Montreal, Quebec. □

ENCYCLOPEDIC SOCIAL SECURITY

Robert J. Myers, *Social Security*, pp. 691. Richard D. Irwin, Inc., Homewood, Illinois 60430. $17.50.

by Geoffrey N. Calvert

For all of us who have to work with employee benefit plans that relate in some way to the Social Security system, this book by Bob Myers is a godsend. While it has been described by one of my actuarial friends as "a Niagara of detail", it does give all of us a marvelous reference source from which to draw in getting a fix on literally hundreds of the finer points relating to eligibility, the method of calculating benefits, in fact the whole background and evolution of these benefits and methods. Bob has a rare facility for communicating this detail in an accurate and readable form.

The Social Security system is not a static system. It is constantly evolving. And it has its quirks and anomalies. It is the product of forty years of political hassles.

(*Continued on page 5*)

CARRUTHERS' REPORT ON INSURANCE IN THE PROVINCE OF ONTARIO

by L. Blake Fewster

In January 1973, the late G. E. Grundy, then Superintendent of Insurance for Ontario, appointed Douglas H. Carruthers, Q.C., as special legal counsel to review the relationship between insurers and the public and in particular, the role of insurance intermediaries.

Mr. Carruthers' final report was submitted to the Superintendent in July 1975 and was made public earlier this year. His review appears to have been extensive, providing an independent perspective of the insurance industry. The report may have gone beyond its original intent, but Mr. Carruthers feels that the insurance industry in Ontario has important problems to resolve with respect to licensing practices, policy wording, and cost disclosure. His report, will now be exposed for appraisal by knowledgeable persons and groups inside and outside the insurance industry.

Prior to the final report, there were some interim reports to the Superintendent: in December 1973, a report on the life insurance business and in February 1975, a similar report on the non-life business. These reports have now also been made public, although it is doubtful if they were intended to be more than working documents. A rather mysterious leak to the press several months ago concerning the 1973 report brought some unfavourable reaction from the life insurance industry.

In his final report, his main criticisms of the present legislation are:

(1) It is not clear to the insured in whose interest insurance intermediaries act.

(2) Inadequate information on cost and benefits is available to consumers.

(*Continued on page 8*)

Carruthers' Report

(*Continued from page* 1)

(3) The claims settlement process, particularly in non-life insurance, is hard to predict and often unnecessarily frustrating.

(4) There would be substantial long-run cost benefits to the consumer from more price competition.

He sets forth a model regulatory system which might solve the problems he perceives. He redefines the roles of intermediaries. One element of particular interest is the dual concept of (1) a sales representative serving one insurer whose remuneration is determined between him and his employer, and (2) a broker who serves only buyers of insurance with remuneration being set between the broker and the buyer.

A suggestion that insurance companies might then need two sets of rates, one for business sold by sales representatives and one for business sold by brokers, would seem to play havoc with cost comparisons and be of doubtful practical acceptability.

Mr. Carruthers expresses concern about the indiscriminate use of the word "consultant" and suggests it should be restricted to those who have the attributes of independence and the highest level of competence. While he suggests that the use of the term "consultant" be prohibited for three or four years after the start of his proposed new system, he does make an exception for consulting actuaries "because the qualifications are already established and tested."

He recommends the establishment of a self-regulatory council made up of representatives of the industry and the public to (1) make and administer rules of conduct for its members, (2) establish and test qualifications for licensing, and (3) organize educational programs.

On disclosure Mr. Carruthers makes his biggest pitch, He is in step with the times but will likely get many arguments on the nature and degree of disclosure. Ideally, he feels that in most cases all technical details should be shown since, even if the consumer cannot understand them all, his qualified professional advisors can.

For product disclosure, he feels there is a need for standard terms of common contracts and a need to make the contracts more readable and understandable. His comments about policy language are well taken, even though most existing contract wording has been developed by members of his own profession who are aware of the kind of scrutiny that policy wording has experienced in courts of law. He would make some changes in terminology such as "insurance contract" for "policy"; "contract charge" for "premium"; and "rebate on contract charge" for "dividend".

On price disclosure, Mr. Carruthers feels it is essential to separate the charge for the contract into two components—the estimated financial benefit and the insurer's markup. The formula used for calculating expected values would account for payments by the insured and possible receipts, modified by the probability of the receipts and the time value of money. The recently popular interest-adjusted indices would not seem to fit the suggested requirements. He also hints at the need for evidence of past performance to assist in evaluating the insurer's claims, promises and forecasts.

The timing of disclosure would also be important and should be made before a purchase is made and before renewal premiums are paid. Mr. Carruthers does not develop actual disclosure rules but suggests this would be the responsibility of the Department of Insurance.

Mr. Carruthers' first public appearance after the release of his report to the public was as a luncheon speaker at the March meeting of the Canadian Institute of Actuaries. During his talk he stressed the role that actuaries should play in price disclosure. He suggested that actuaries possess the most expertise in this area and that if they do not come forth they can expect to have a small voice in the final result. He did imply, in a somewhat more moderate tone than his report suggests, that no single set of figures would serve everyone and too much detail could lead to confusion. It will, therefore, be an industry responsibility to make sure the buyer can understand, that he will understand and that he can make use of what he understands. We can only hope that the benefits will equal the cost.

Mr. Carruthers' talk at the Institute meeting was very helpful in setting the perspective for his report, because a mere private reading of the written report can invite negative and defensive reaction. Dialogue with Mr. Carruthers would doubtless help considerably in better understanding his report. There can be little argument about the developing need for more disclosure, partly because of the wave of consumerism and partly because the cost of adequate insurance protection has been going up and leaving more to disclose.

Some closing observations:

(1) As is often typical of an exhaustive study the solution recommended or suggested involves a complete restructuring of the present insurance legislation. Such all-inclusive changes in the past have proved to be costly ventures often with unexpected and some unsatisfactory results, e.g. changes made in Canadian income tax laws in the past decade.

(2) The report does not distinguish between life insurance and general insurance. In actual practice these two lines of business are quite divergent and legislation appropriate for one line cou[ld] create unnecessary complications for the other.

(3) The distribution system for insurance is costly often because insurance, particularly life insurance, has to be sold rather than being bought. Mr. Carruthers' proposed system, which admittedly is just in the discussion stage, may or may not be less costly.

(4) Mr. Carruthers' report was prepared for the Province of Ontario. It contains many new and interesting ideas, but it would be desirable to maintain as much uniformity as possible across Canada. Unilateral action by Ontario or any other province cannot be prevented unless the industry itself helps to solve mutual concerns.

(5) The future of the Carruthers' report is not clear at this time. It is now being perused by industry groups who will report back to the Superintendent of Insurance for Ontario. Mr. Carruthers himself has returned to private practice. The model legislation suggested is still too ideal for implementation and will require considerable massaging befo[re] acceptable changes can be determined. Even if it serves only to highlight areas of the business that need to be improved, the Carruthers' report may have served its purpose. □