

## RATE MAKING IN FIRE INSURANCE.

Mr. S. Epstein, Commissioner of Insurance, State of Colorado, in a statement published in *Insurance Report*, says:

Fire insurance men frequently assert that state officials do not, and cannot, understand the question of rate making; and, indeed, that no one can understand it who has not devoted all his life to the business. My own limited experience rather confirms this statement. I have made an effort to understand the question of rate making in fire insurance and have not been successful. Were the legislature of Colorado to pass a law requiring the Commissioner to revise the rates in this state I do not see how I could do this, either wisely or well. To be perfectly frank, I suspect that the company executives do not understand the rate making question either. In fact, some of them have admitted as much to me in conversation. They are selling goods before they know what the goods will cost; i.e., they make a rate before the fire occurs, and it is well nigh impossible, on account of our insufficient statistical data, for anyone to do this correctly, be he state official or company executive. Since the rates are based in a measure on guess work, it is impossible to gainsay the assertion that the company executive who has devoted thirty years to the problem is more likely to make a good guess than the state official who has studied the matter only during his brief term of office.

The average citizen looks at fire insurance from a rather narrow point of view. He thinks because he has been paying premiums for twenty years and has never had a fire, that his rate is too high. He does not stop to realize that if every house which is insured, would burn, fire insurance companies would have to go out of business. The entire public sentiment on the question of rates in fire insurance is a most unfortunate one, and is based on unfounded prejudice against insurance companies and on a lack of understanding of the business of insurance.

To my way of thinking, this public antagonism can only be removed by education. It is but a short time since it was announced that Commissioner Done of Utah had resigned in order to take up the publicity and educational work on behalf of the fire insurance companies on the Pacific Coast. Obviously this is the beginning of a great and valuable line of work, viz., the education of the public on the value and the merit of insurance.

The fact of the matter is that even the state is not a sufficiently large unit. The loss ratio in one state may be low and in another state high. Therefore a company operating in both states must base its affairs on the average of the two states instead of the experience of each separate state.

It is therefore obvious that the unit for rates cannot be the town; that the problem is larger than a problem of towns. The unit is not even the state; the problem is larger than a problem of states. The unit is really the Nation, the entire United States.

Of course some modifications, due to the fact that some communities are more hazardous and others less hazardous, come in, but to my mind, this is really a subsidiary qualification and does not affect the main theme, which is that the unit for rates is not the town, nor the city, nor the state; the true unit is the Nation. Other modifications can easily be thought of. For instance, the existence of fire

prevention apparatus, sprinklers, extinguishers, up-to-date electric wiring, etc., entitles the assured to special credits or allowances on his rates. However, proper provision is made for credits to cover all such cases; witness the Dean Schedule, now in force in our own state, and also in about two-thirds of all the United States. But one must not lose sight of the fact that these are minor modifications and in no way negate my main proposition.

Further, I do not think that the time unit should be the year. A company may do very well one year and may do poorly the next year. A company may seem to be accumulating a large surplus and suddenly a Chicago conflagration comes; a Baltimore conflagration; a San Francisco catastrophe; and the seemingly enormous earnings are wiped out in less than a week.

My position, therefore, may be summarized as follows:

*For the making of rates, the unit of area is the Nation and the unit of time should be twenty-five years.*

I trust that you will construe this in a reasonable and not in an extreme way. For example: I do not mean that after there has been a readjustment of rates, a community should wait twenty-five years for another readjustment. What I mean is, that after a certain reasonable lapse of time, say after five years, there might be another readjustment, based on the experience of the preceding twenty-five years.

I realize, of course, that I am treading on dangerous ground to suggest that the prevalent public tendency to demand lower rates is based on a misconception due to the selection of units of area and time which are too small. I presume it is scarcely the part of wisdom for a public officer to open himself to the criticism that he is not siding with the public demand for lower rates. The truth of the matter is that I do not stand for higher rates; I stand for adequate rates. Should adequacy require higher rates, let us have higher rates. Should experience prove that a lower rate is adequate, then by all means let us have the lower rate; and that immediately. In taking this position, I believe I am acting for the best public good. I believe that *the prime need in insurance is safety; cheapness is a secondary consideration.* What a man wants to know when he takes a life insurance policy is, first, that his widow and orphans will be paid the face of the policy if he dies; the amount of premium is a secondary consideration. What a man should want to know when he takes a fire insurance policy is that he will receive his indemnity in the event of a fire; the amount of the premium should be a secondary consideration. What a man should want to know when he takes an accident or liability policy is that he will receive indemnity in the event of loss; the premium which he pays should be a secondary consideration. In view, therefore, of the fact that a fire insurance company is always in danger of being wiped out any day by an unexpected conflagration, the prime need for safety is adequate rates, and not low rates.

A very simple illustration of all this is the case of the city of San Francisco. For forty years it had been a very profitable field for fire insurance and suddenly we woke up one morning to find that every company operating in that city had suffered a staggering loss, and that some of the companies were even completely wiped out of existence.