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# Deductible Insurance

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Résumé de l'article

Nous présentons à nos lecteurs une étude que M. Fred. W. Wrenn a donnée devant les membres du Montreal Chapter of the American Society of Insurance Managers, le 19 novembre 1959. Nous attirons leur attention sur le fait que si le marché américain utilise cette forme d'assurance contre l'incendie, tous les assureurs au Canada ne l'ont pas encore adoptée. Nous croyons intéressant, cependant, de reproduire ici le texte de Monsieur Wrenn, qui, avec un entier sens pratique, indique le fonctionnement de la « Deductible Insurance », c'est-à-dire de l'assurance contre l'incendie avec une franchise allant de $5,000 à $75,000. L'auteur signale à ce sujet une distinction faite par la pratique aux États-Unis entre l'assurance avec franchise et l'assurance d'excédent, laquelle commence quand la franchise atteint ou dépasse $100,000. Simple distinction des gens du métier, semble-t-il, mais qui existe et que Monsieur Wrenn se devait d'indiquer. A –

# Deductible Insurance

*by*

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Deductible insurance is sound insurance, it is true insurance and not a mere maintenance contract. To the thinking buyer, it appeals as a means for purchasing protection, not against every two dollar loss, but to the extent that real protection is needed. To the thinking seller — the insurance company — it provides a form of coverage for which there is a growing demand — with small, comparatively inconsequential claims eliminated — and with a reasonable reduction in premium to amply compensate for the reduced claims and expenses.

[1] Il faut noter à ce sujet que la C.U.A. la défend dans ses règlements sous le titre d'assurance-excédent.

Buyers have been quick to recognize the merits of the plan, but many insurance interests have indicated concern over the possibility that insurance buyers may find the venture into this limited form of self insurance so attractive that the practice could grow until the overall premium volume was seriously affected. Some opposition developed from the fear that loss statistics would be distorted, making them unsatisfactory as the basis for rating levels.

*220* We are confident that such fears are groundless, and equally confident that deductible forms are here to stay and that the advantages of such forms of coverage will make them a standard basis for all large insurance programs.

The same conclusions were reached when Chubb & Son undertook the development of a deductible plan about ten years ago. With minor changes, it is the same plan we are using today and which is now widely used by other companies. It has been approved by the Insurance Commissioners of forty-one states and the District of Columbia.

When Chubb & Son was developing its plan for "deductibles", the Insurance Company of North America presented a plan for writing what they called "Excess of Loss" or "Catastrophe" Insurance. This plan applies only to risks where the insured assumes a deductible or "retention", as it is termed, of not less than one hundred thousand dollars. These two plans were originally thought of as competing with each other, partly because of the difference in the rating procedure, but it quickly became apparent that each had its own special field of application and they now very properly supplement each other. However, for identification, I will refer to the small deductible amounts as the "Deductible Plan", and the deductibles of one hundred thousand dollars or over as the "Excess of Loss" Plan.

The important points of the Deductible Plan are these:

1. The Deductible Plan was developed to apply in har-

mony with rating bureau tariff or board rates. It involves a series of credit which vary according to two factors:

a. The amount of the deductible.

b. The percentage the deductible amount bears to the full amount of insurance. The term "full amount of insurance" is held to mean the total of all the contributing insurance as normally required by coinsurance conditions in the policy.

2. All special clauses or warranties which are required by the tariff base rate are also required in the deductible policy; in fact, the deductible endorsement is the final step in the preparation of the policy, which in other respects is subject to board or tariff forms and conditions. The deductible credit is the final adjustment applying to the net rate.



3. There are only seven deductible amounts provided in this plan, but any of them may be selected at the option of the insured. They are \$5,000, \$10,000, \$15,000, \$20,000, \$25,000, \$50,000 and \$75,000. No interpolation is permitted. The filed plan actually provides two additional amounts, that is \$100,000 and \$250,000 but they are as a rule now only treated under the Excess of Loss Plan.

4. The deductible amount may not be insured. It is a policy condition that it will be retained at the risk of the insured.

5. The plan may apply to other perils attached to the fire policy such as extended coverage, vandalism, etc., with the same percentage of credit.

6. It may be attached to policies covering time element coverages such as business interruption, profits, extra expense, etc. It should be noted that it would apply in dollars, it does not provide for any special waiting period.

7. Separate deductible amounts may be selected for more than one location, if desired. The deductible may apply to a single incident, or to each location individually or separately to each item of the form. Under the fire coverage, it

may apply to a single location whereas it may apply to an occurrence which involves more than one building under the extended coverage endorsement. These variations in applying deductibles have developed during our experience with the Plan in making it fit the individual needs of insurance buyers, and their consideration depends largely on the premium savings, degree of exposure to loss and distribution of property.

222 8. The plan provides for the possibility that other contributing insurance may not be written on the deductible basis. For illustration, if the Jones Manufacturing Company carried insurance for one million dollars with a twenty-five thousand dollar deductible clause, and also carried one million dollars additional insurance in another company but not on the deductible basis, the endorsement provides that the deductible would apply only pro rata under our policy — or to the extent of twelve thousand five hundred dollars. If Jones suffered a loss of say twenty-five thousand dollars, our usual pro rata share, disregarding the deductible clause, would be twelve thousand five hundred dollars, but on account of the deductible provision, Jones would have to bear that much of the loss himself. The other company, not having any deductible clause in their policy, would be liable for the full amount of their share of the loss, or twelve thousand five hundred dollars. If the loss were fifty thousand dollars, the deductible policy would pay twelve thousand five hundred dollars and the full insurance policy twenty-five thousand dollars, making the total amount collectible from insurance, thirty-seven thousand five hundred dollars. In this case, the insured would also bear twelve thousand five hundred dollars as his share of the loss. Note that the arrangement must be stated in the endorsement — otherwise the entire amount of the deductible would apply to the deductible policy.

The foregoing are the principle features of the Deductible Plan.

The Excess of Loss or Catastrophe Plan, which is generally used only when the proposition involves deductibles of one hundred thousand dollars or more, theoretically has an entirely different approach. It is naturally assumed that this plan will only be attractive to the giants of industry, the very large buyers of insurance.



The problem of determining a fair rate and premium for such risks is quite different from the procedure of ordinary full insurance rating or even in rating smaller deductibles. While we are still subject to laws demanding reasonable uniformity to avoid unfair discrimination, and to obtain adequate but not excessive rates, it is generally conceded that in the area of very large deductibles the number and variety of factors involved in developing the premium are such that general rating plans cannot be devised. Each contract must be dealt with as an individual problem, and the underwriter must have a considerable degree of freedom to reach agreement with the buyer on terms which fairly represent the exposure.

The important points of this plan are as follows:

1. The deductible must be at least $100,000. In fact, the plan, as it was introduced, contemplated the insured's bearing the first loss up to the extent of the "normal" loss to be expected with full consideration of the values at risk, the construction and effect of fire protection — even if such "normal" loss to be anticipated should exceed $100,000.

2. As in the "deductible" plan, the deductible amount must be carried at the insured's own risk.

3. The premium is determined by judgment to reflect:

a. the perils covered;

b. the occupancy, construction, protection, distribution and value of the properties;

c. the cover granted and its relationship to the risks retained by the indemnified party and to the remaining values at risk, if any;

d. the past and present loss experience both of the property and of similar properties within and outside the State as indicated by the underwriter's own experience, if any, under other excess of loss agreements and the experience under standard insurance policies.

4. The flexibility which governs the rate and premium
224 for this type of insurance also applies to the contract conditions. The conditions of rating bureau forms are not necessarily followed to the same extent as they are under the "deductible" plan. For instance, policies may be issued without coinsurance, but subject to an adjustment of premium based on expiration; the amount of insurance may be established as the maximum amount at risk at the highest valued location, instead of the total of all values; syndicate forms of policies are the rule rather than individual policies for each company.

To sum up, deductible insurance is a sound method for many insurance buyers. It was certainly not designed to encourage self-insurance or non-insurance. Its purpose is to provide the means for an insurance buyer to obtain protection on a more realistic basis, to insure against large losses where insurance is really needed, not to swap dollars where losses are small enough to properly be treated as ordinary maintenance expense. Naturally premium must reflect such losses, as well as the expense of the insurance industry for its service. In most cases, this service is quite unnecessary and the expense unjustified.

It is gratifying to note that more insurance companies are entering the market to offer their facilities for these forms, and that more buyers are using the forms to improve their insurance plans. A spokesman for mutual insurers recently stated that over 25% of their business, representing aggregate amounts of over fourteen billion dollars, is now written on the deductible plan.