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Résumé de l'article

En mars, notre collaborateur a traité devant les membres de l'Insurance Institute of Ontario d'un sujet très sérieux, sur un ton badin. Nous reproduisons son texte ici à l'usage de nos lecteurs. M. Murray parle, en particulier, de l'acceptation de certains risques non pour leur qualité ou pour leur acceptabilité, mais pour la liquidité immédiate qu'ils apportent à l'assureur. C'est ce que l'on appelle le *cash-flow underwriting*. Il en montre les conséquences qui se font rapidement sentir, tant la sélection et la tarification des risques ont d'importance, si l'on veut empêcher un rapide affaiblissement de l'entreprise. L'auteur rappelle également quelques qualités essentielles de l'assureur. Si son texte paraît léger, au premier abord, il ne manque pas d'à-propos.

The bingo-brain syndrome

by

J.B.M. MURRAY ⁽¹⁾

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I am not going to make any attempt today to try to foretell the future — I prefer to leave that to the crystal ball gazers. Instead I am going to relate to you some insurance scenarios which I hope will enable you to distinguish between the bingo-brain syndrome and what I refer to as "objectively-oriented decision making". If you follow this precept in your insurance career you will gain much more value than any short-term loss ratio forecasts that I might pick out of the air.

I have chosen as the text for my sermon today a passage from the gospel according to the Green Book, the 1981 edition at page 84 reading at the second paragraph. This is the statistical ex-

⁽¹⁾ M. Murray est président de J.B.M. Murray Ltd., membre du groupe Sodarcan.

⁽²⁾ C'est-à-dire, en somme, la production quantitative, par opposition à la production qualitative ou sélective. Elle prend en ligne de compte d'abord le montant de la prime : elle ne se préoccupe qu'accessoirement du tarif, en espérant que l'écart sera comblé par le rendement des fonds au niveau du marché.

perience for miscellaneous public automobiles (country-wide) showing earned premiums, incurred losses and actual loss ratios for the three most recent policy years — 1979, 1980 and 1981.

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And it came to pass that in policy year 1979 the earned premiums for all coverages combined amounted to \$2,565,273. Now the permissible loss ratio for automobile insurance in Canada is about 75% so one would expect that the incurred losses should be in the region of \$2,000,000, leaving the balance of \$565,000 to pay for commission, taxes and expenses and hopefully a small underwriting profit. But verily I say unto you that the actual incurred losses for this class for 1979 were \$9,107,033 for a loss ratio of 355%.

Now those among you who know anything about ratemaking can easily calculate that the indicated rate increase as the result of such an experience is $(355 - 75) / 75$, or + 373%. In other words for every \$100 you received last year in premiums you need to increase to \$473 in the coming year. Or to put it in another perspective the \$2,500,000 you received in 1979 should be increased to \$11,800,000 in 1980 and that doesn't take inflation into account.

Let us now look at the statistics again and see what the premiums actually earned in 1980 were. Would you believe \$2,972,299? A paltry increase of 16% instead of the needed 373%. And the losses incurred in 1980 amounted to \$12,819,693 for a loss ratio of 431%. For the three years combined the premiums were a total of \$9,181,449 and the incurred losses \$35,022,003 for an overall ratio of 381%. The collision coverage loss ratios were 530%, 650% and 500% respectively for each of the three years.

Don't you read the *Green Book* anymore? How can you call yourselves professional underwriters if you permit such a horrendous loss ratio situation to continue year after year?

The *Green Book* was not found in a garbage dump. This is not the time and this is not the place to consign the *Green Book* to a mud puddle. On the contrary the *Green Book* is considered to be one of the best exhibits of automobile insurance statistics to be found anywhere in the world. It tells you quite clearly what premiums you should charge next year in order to pay losses, commission and expenses and to produce an underwriting profit. That is its sole reason for existence. It has served the industry well for over 50 years.

But some of you may say that the Green Book indications must give way to *cash flow underwriting*. My answer to that is that so-called cash flow underwriting is not underwriting — at least not according to my definition of an underwriter.

An underwriter is an expert in his field with a background of academic, technical and practical experience. He should be invested with maximum responsibility with full scope for initiative. He, and only he, should be the man to decide what risks should be undertaken by the company, how much should be reinsured, the coverage to be provided and the rates to be charged. Once he signifies acceptance of a risk he is, of course, answerable to senior management for the results. It goes without saying that an underwriter must keep up to date with current knowledge including the latest statistical experience.

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To such a man cash flow acceptances — let us stop calling it underwriting — cash flow acceptances — are an exercise in the preservation of stupidity. Like shovelling sand against the sea, or nailing jelly to the wall or sending lettuce by rabbit.

Cash flow acceptances in my view are a product of the *Bingo-Brain Syndrome*. You can play Bingo with your brain in neutral. Any office boy can write risks at an 80% discount. It does not call for any expertise to give away \$5 policies for 2-bit premiums. The business of insurance can not long endure those bargain-basement prices. Before many more months have passed, premiums must go back up to their proper risk levels. And remember that a 50% discount at last renewal will mean at very least a 100% increase at next renewal.

Remember also that when risks are written at, say, 50% of their proper rate levels, the unearned premium reserve is only half of what it should be. The cumulative effect over the whole industry of massive wide-spread unbridled rate cutting must be a matter of grave concern to the monitors of company financial security. And do not forget that if your *IBNR* is set up as a percentage of earned premiums and if you do not revise the percentage upwards to counteract the premium reduction for no reduction in risk, you may be sowing the seeds of your own downfall. Never forget that if we do not run our own business on sound principles, big brother is waiting in the wings to do it for us. 1984 is next year.

I have seen references to the estimate that in the United States as many as 300 insurance companies may be technically insolvent. No doubt there are also a few in Canada. When companies go belly-up the rest of the industry has to fork-up. Should your company be setting up a reserve for this very real contingency?

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You know there is one man who has been completely forgotten in this cash flow acceptance disease. The shareholder. A shareholder by definition only wants three things — dividends, dividends, dividends. And if he doesn't get them he takes his money elsewhere. The necessity for all companies, including insurance companies to produce a profit is paramount and must take precedence over all other considerations.

But you may say that you have to cut prices in order to keep business on the books or to regain business lost to competitors. Well it is one thing to discount a risk 10% or 15% because you have had the risk on your books for some years with a known good experience, but it is an entirely different matter to go out and grab a risk for \$9,500 which had previously commanded a premium of \$88,000 for the same coverage and deductibles.

I am reminded of the story of the four golfers — an Englishman, and Irishman, a Welshman and a Scotsman who were playing on the Old Course at St. Andrews. They were all square going to the 15th green. On the green, the Englishman claimed to have won the hole by conceding himself a 3-foot putt. On the 16th green, the Irishman conceded himself a 10-foot putt. On the 17th, the Welshman claimed the hole by conceding himself a mashie shot 140 yards from the green. On the 18th, the Scotsman hooked his tee shot. It sailed over the 1st fairway, over the sands and into the North Sea whereupon he conceded himself a hole-in-one and claimed the match.

The above risk — \$88,000 premium written at \$9,500 premium — was not a Canadian Risk — it was a petroleum refinery in South America — but it is typical of what has been happening in Canada and elsewhere in the last two or three years.

My answer to you is that there comes a time when you have to bite the bullet. You have to say "Thus far and no farther". And if you lose substantial volumes of business to competitors at non-economic premium levels, then you may have to cut back on ex-

penses, even reduce staffs or close branch offices when that is the only apparent way to produce an acceptable bottom line result. At least you will stay in business.

If my experience has taught me one thing above all others it is that you have to stick to the sound principles of insurance — the ones you first encountered as a student of the Insurance Institute. Like the Green Book, these principles were not found under a stone. They were devised and developed and enshrined by the great insurance men of past generations. And if our forebears in this business had not followed them, we would have no insurance business as we know it today. And it is up to your generation to see that the business is passed on in good condition to those who will follow after you. For my own part, I acknowledge having gained much valuable knowledge and advice from some of the great insurance men of the past who have now passed on to their greater rewards. Men like John R. Mirrlees, Colin E. Sword, Harry Myers and John Burgar to name but a few. I remember them now with respect and affection.

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In our second scenario, we meet two underwriters whom we shall call A and B. Mr. A was 20 minutes late in getting back from lunch one day, and as luck would have it he met his boss in the elevator. The following conversation ensued.

The Boss : "How come you're late in getting back from lunch ?"

Mr. A : "Please sir, I went for a haircut."

The Boss : "You are not supposed to get your hair cut in office time."

Mr. A : "Please sir, it grows in office time."

The Boss : "It didn't all grow in office time."

Mr. A : "I didn't get it all cut off."

Underwriter B was going to lunch one day with his boss. They were walking up Yonge Street on a warm Spring day. The boss noticed a very attractive young lady coming towards them through the crowds of people, and the following conversation took place.

The Boss : "Look at that beautiful young lady."

Mr. B : "What. . . where ?"

The Boss : "You missed it."

Further along the same thing happened.

The Boss nudged the underwriter : "Did you see that — vision. . ."

Mr. B : "What. . . where ?"

The Boss : "You're too late again, why don't you keep your eyes open ?"

170 A few minutes later the Boss again nudged the underwriter :
"Did you see. . ."

This time the underwriter replied : "Of course I saw it."

Whereupon the boss said : "Well, why did you step on it ?"



For Scenario No. 3 come with me now for a few moments to visit the Bingo Brain Insurance Company where the Vice-Presidents are having their weekly meeting in the Conference Room. The particular item on the agenda which they are discussing is whether anyone from the company should attend an industry seminar to be held in San Francisco next month.

Vice-President A says : "Jones has been working hard and deserves a break."

Vice-President B says : "Brown has been under a severe strain recently because of personal problems — maybe a change would do him good."

Vice-President C says : "Robertson is the most senior man. Maybe he should go."

Vice-President D says : "Let's send Murray. He's the one we'll miss the least."

Now come with me across the street to another Vice-Presidents' conference. This time it is in the Head Office of the Objectively-Oriented Decision Insurance Company, and they also are discussing the San Francisco Seminar.

Vice-President A says : "How much will it cost, and what will we get out of it ?"

Vice-President B says : "Who is conducting the seminar ? Is it worth our while sending someone out of the office for 4 days ?"

Vice-President C says : "Who in our organization can profit most from this Seminar ?"

Vice-President D says : "Smith is the man we should send. It is right in his area and in addition he is one of our best students of the business."

You will have noticed no doubt that in the Bingo-Brain Insurance Company they did not even consider the cost of the seminar or what value was to be gained for the company. They looked upon the whole thing as a junket instead of as a business proposition.

Objectively-oriented decision-making on the other hand never loses sight of the fact that the company's number one objective is to make a profit.

We live in an imperfect world, we work in an imperfect profession. Our business is essentially concerned with uncertainty. Will it happen, and if it does happen, how much will it cost ? Frequency multiplied by severity.

In recent years it seems that over and above the uncertainty which is an inherent part of our business, we have been faced with seemingly insurmountable problems. In such an environment it is sometimes easy to become despondent and pessimistic about the future. This is a human characteristic.

The Psalmist David was in similar doubt when he asked Jehovah ;

What is man that thou art mindful of him ?
And the Son of man that thou visited with him ?
For thou hast made him a little lower than the
angels and crowned him with honour and glory.

What is man that thou art mindful of him ? A little lower than the angels.

But what meaning can this have for us as we struggle with the cares and problems of day-to-day living and working ?

It means that man is intelligent, man has imagination. Man has ingenuity. Man can exercise judgement, he can discern right from wrong, truth from falsehood.

Each one of you has immeasurable potential. There is no limit to your capabilities or to your achievements. Each one of you can

do your job, however great or however small — in a way that only you can do it.

The Past is gone, and gone forever.
The present disappears as soon as we touch it.
That leaves only The Future.

And the Future is what you will make it.

L'assurance-vie et ses problèmes

Sous le titre de *Level commissions can solve the replacement dilemma*, un collaborateur de la revue *Canadian Underwriter* de mars 1983, M. Mike J. Englert, exprime son opinion. En toute simplicité, nous signalons que nous avons fait la même suggestion il y a quarante ans. Personne ne nous ayant écoutés, nous n'avons pas insisté : mais peut-être qu'avec la situation actuelle, les assureurs se laisseront-ils convaincre qu'il vaut mieux répartir la commission que de la payer en presque totalité dès la première année. M. Englert mentionne aussi une opinion exprimée par des actuaires à Atlanta il y a environ un an. La voici en un paragraphe :

« The consensus was clear enough : the only really effective way to deal with the inherent mobility of life insurance policies was through such techniques as front-end deposits, flattened compensation schedules, and surrender penalties or persistency bonuses. »

Si l'assuré perd beaucoup en annulant sa police, il est possible qu'il y renonce. Par ailleurs, un boni de durée peut aussi convaincre de laisser un contrat en vigueur à cause des avantages qu'il apporte.