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TRANSACTIONS

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DIGEST OF INFORMAL DISCUSSION

MARKETING TRENDS

A. What steps can life insurance companies take to regain a greater share of the available savings dollars?
B. Is a trend likely to develop toward a separation of the insurance and investment elements of life insurance contracts?
C. Would the ability of insurance companies to attract savings dollars be improved by providing a "variable" return with respect to (*a*) the investment element of life insurance contracts or (*b*) settlement provisions?
D. Is it feasible to make endowment and other investment-type contracts more attractive by reduction or redistribution of first year expenses charged against such contracts, with a corresponding increase in nonforfeiture values?

Toronto Regional Meeting

MR. FREDERIC P. CHAPMAN: The Ordinary policies issued by the Metropolitan during 1960 had an average premium about 23% larger than that for policies issued in the preceding year, and changes made by the Company at the beginning of 1960 contributed to this increase.

A change in recognition of field sales performance was made when the basis for placed business credit, which is an important factor in determining various merit awards, was changed from insurance to first year commissions. This placed business credit has been a very powerful factor in the motivation of our agents.

Preferred risk policies and credit for size (lower premium rates for larger policies), previously allowed only on whole life plans, were made available on practically all plans, including endowments. All endowment policies issued in the Tower Series ($5,000 and over) maturing prior to age 70 are written as endowment policies maturing at age 69 with the amount of insurance equal to the amount of the cash value as of some predetermined period. This means that if the maturity value at the initial endowment date (really a cash value) is not desired, the policy may be continued and the cash value rises above the face just as in retirement income policies.

In 1960 the proportion of our business written on endowment plans and especially on such plans as endowment at age 65 more than doubled; and the proportion of insurance written in the form of term coverage, either as separate plans or as part of combination policies, decreased about one-sixth.

MR. JOHN F. RYAN: Life insurance has lost ground as a savings medium in recent years. Premium income just about doubled in the decade from 1950 to 1960, but the proportion of premiums representing savings has declined from roughly 1/2 to 1/3. While new savings in life insurance have remained fairly stationary at around $5 billion a year, other savings media have shown substantial increases.

The main reasons why savings through life insurance have not increased are:

(1) growth of term insurance (including group) versus cash value insurance (due to emphasis on volume and on protection aspects of life insurance)
(2) seemingly greater attractiveness to the public of other investment media
(3) economic and investment conditions which have led to withdrawal of funds from insurance companies
(4) the growth of uninsured pension plans (due in part to the more favorable tax treatment accorded such plans until recently)
(5) restrictions on life insurance company investments
(6) increased reliance on security provided by government.

Life insurance industry must make its savings aspects more attractive or lose position in the nation's economy and, like casualty companies, simply exchange protection dollars for premium dollars. We need:

(1) to put greater emphasis on cash value life insurance versus term insurance through advertising programs, particularly to meet important financial needs, retirement, college funds, etc. Our agents must be sold on the advantages of cash value insurance, and our compensation plans, "Club" recognition and contest awards for the field force, managers, etc., should all favor cash value insurance over term.
(2) to eliminate "gimmick" selling such as minimum deposit insurance where the insurance company gets nothing but volume and no savings dollars.
(3) to sell the public on our unique "plus" points of lifetime guarantees, flexibility of coverage through special options, etc.
(4) to assist the government in its efforts to control inflation.
(5) to keep the declared rate on deposits competitive with current bank rates.
(6) to take advantage of the tax relief recently afforded companies to develop a more suitable product in the small pension field.
(7) to give more attractive annuity rates and discount rates on premiums and improve the product line where possible. For example, in the New York Life the 20 payment life plan had gone into a steady decline. We developed a new 20 payment life policy, with good rates, cash values, and options. As a result, sales increased about 25%.

These and several other steps helped reverse the downward trend of our average premium, which has increased about 50¢ per $1,000 over the last 3 years.

MR. CHRISTOPHER H. WAIN: The most important step insurance companies can take to increase their share of the savings dollar is to emphasize how effectively they now perform the job of providing long-term savings and protection. A trend toward the separation of the savings and investment elements of the contract might make the apparent cost of insurance so high as to be unattractive, or make the savings portion not competitive with other media, so that we might wind up getting less of the savings dollar than otherwise.

From the standpoint of a mutual company, a variable return is now provided through adjustments in dividends, and more elaborate adjustments would reduce the over-all return to policyholders.

The principal cash outlays for expenses that might be reduced or redistributed are commissions. Our retirement annuity at the Prudential applies this principle by having level commissions for 15 years, but it doesn't sell even though its first year cash value is 85% of the premium.

MR. ELMER R. BENEDICT: There are three principal classes of savings:

(1) Those which are in savings banks, company credit unions, etc. They are similar to savings under life insurance contracts.
(2) Those which are invested directly in fixed dollar obligations where the investor secured the current market rate on his "new" money.
(3) Those which are invested in mutual funds and other equities where the dollar value of the savings varies and there are no dollar guarantees at all.

The "new money" concept is already being applied in the group pension field, but probably most of the savings lost in the individual area have been lost to the "variable" class of savings. Hence it would seem unrealistic to expect to attract much of these savings unless the variable concept is made available. There is probably a greater need for introducing the variable concept in the settlement option area than in the accumulation period where it can now be effectively obtained by combining low cost policies with equity ownership.

MR. EDWARD RUSE: Before the life insurance industry can regain the confidence of the public and our field forces, we must publicize that a policy of permanent insurance is a safe, attractive, practical and unique blending of decreasing term insurance and increasing investment with many "hidden values"—such things as tax-shelter, guaranteed values, preguaranteed annuity values, protection against creditors, close government supervision and the outstanding record of solvency of life insurance companies. That the laws give special favorable treatment to life insurance companies as investment companies has made the investment element in permanent insurance the most attractive and reliable investment contract available except, perhaps, on our shorter term endowments.

A 10 year endowment might pay a general agent commissions of 40% first year, 10% second, and 8 renewals of 5% and a production bonus of, say, \$2 per \$1,000. At $4\frac{1}{2}\%$, the gross premium needed to absorb this level of compensation, premium taxes and overhead would give a yield of only $1\frac{1}{2}\%$ and we do not think this is good enough.

I think some reduction in—and flattening of—agency compensation for shorter term endowments, accompanied by an increase in earlier cash values and a lowering of net costs to maturity, would go a long way towards restoring public acceptance of permanent insurance.

MR. RICHARD M. SELLERS: Of the 20 largest companies, based on volume in force, only three had a larger percentage gain of assets in 1960 than of insurance in force. The median asset growth for these companies was 4.85%, compared with a median volume growth of 7.47%. Of these 20 companies, seven experienced an asset growth of less than 4%. We must take steps to publicize and emphasize assets and to de-emphasize volume.

Our expenses must be spread over a larger base if we are to regain a greater share of the available savings dollar. The development of accident and sickness insurance by the life companies has been very helpful, and together with new product lines, such as fire and casualty insurance, may be a means of financing the continued expansion of our sales organization and provide us with a means of reducing unit expense rates. Participating insurance and annuities reflect improvements in investment yield through increases in the dividend scale, and those who do not sell participating policies should re-examine their position.

MR. STANLEY W. BOYLE: An amendment to the Industrial Life's charter from the Province of Quebec was obtained in 1960, enabling us to enter into variable contracts of capitalization and of annuity or rent supported by a segregated account of which the assets are not subject to the investment limitations of other insurance funds.

The internal operations are based upon a valuation of units as of the last day of each month. At the end of that month, the net investment factor will be 1.0000 +

$$\frac{\text{net investment income} \pm \text{unrealized and realized capital gains or losses}}{\text{net assets at end of previous month}}$$

− rate charged for investment management fee.

The value of an accumulation unit at the end of a particular month is

value at end of previous month $\times$ net investment factor.

The value of an annuity unit is obtained by multiplying the value at the end of the previous month by the net investment factor and also multiplying by a correction factor to take into account the interest rate assumed in the determination of the annuity conversion factors.

At the end of any month, the total assets equal the accumulation fund plus the annuity fund plus any liabilities of the account with respect to taxes and expenses.

Upon retirement of an employee, the accumulation units available for the purpose of providing a variable annuity to him are converted into annuity units according to the respective dollar values of each unit at that time. The resultant number of annuity units is divided by the appropriate conversion factor according to the age and the sex of the individual to determine the number of annuity units payable each month.

The number of annuity units required at the end of each month to provide for future annuity payments will be determined and the company will contribute to the fund the necessary number of annuity units for all living annuitants and will withdraw from the fund annuity units released on death.

As an alternative to the variable annuity, a level fixed dollar annuity may be elected, in which event the dollar value of the accumulation units is transferred on the retirement date from the variable contract account to the regular group annuity fund.

One of our objectives was to be in a better position to discuss objectively with employers the various funding media, the nature and security of guarantees under group annuity plans and the risks involved with equity investments. Perhaps we have achieved this objective, at least in part. Although sales of variable contracts have been few, there has been a considerable increase in the number of regular group annuity contracts written this year to date.

We are also preparing to offer individual variable annuities on a single premium immediate annuity basis and on an annual premium deferred annuity basis. Under the single premium immediate annuity, the amount of initial annuity payment is significantly smaller than for a similar fixed dollar annuity because a higher rate of interest is used in determining the premium for the fixed dollar annuity than that assumed for the annuity factor of the variable contract. The annual premium deferred annuity contracts will be sold only when they qualify as registered retirement savings plans with the premiums deductible for income tax purposes under Section 79B of the Income Tax Act of Canada.

MR. MELVIN C. PRYCE: Canadian companies can legally issue individual variable annuities, but to my knowledge only one company is at present considering entering the field. If not issued for registration under Section 79B, such contracts would have many difficulties with cash values and loan values. Only 1% of the policies we are currently issuing are registered and it is doubtful that registered variable annuities would achieve much popularity either. Our agents would find it difficult to explain how one of these policies works when they are trying to sell permanent insurance at the same time.

MR. PEARCE SHEPHERD: You have to have consistency with respect to premium rates and I think there should be consistency with respect to compensation. It is hard to justify contracts which promise withdrawing policyholders in the early years a high value compared to their initial outlay, at the expense of the agency and sales force compensation.

MR. LESLIE A. CANNON: From a review of our own expense studies I find it difficult to justify any material reduction in first year expenses on this type of policy except as expense rates can be reduced generally.

A reduction in first year commissions on high premium plans by a company now paying reasonable commissions would have an unsettling effect on the agency force, and would not produce any substantial increase in the ultimate return to the policyholder, particularly if the reduction in commission was reflected in higher early cash values.

Redistribution of first year expenses would permit an increase in early cash values, but would reduce later cash values and the ultimate return unless accompanied by a compensating improvement in persistency. The ultimate return seems more important than higher early values. Deferment of part of the first year commission would permit an increase in early values without affecting later values, but would not be favorably regarded by the majority of the agency force and might increase financing costs.

My conclusions are, therefore, that redistribution of first year expenses and deferment of some first year commission in order to increase early values will not have a significant effect in stimulating sales.

Los Angeles Regional Meeting

MR. DEAN A. WAHLBERG: In order for our industry to regain more of the savings dollars we must educate the public and instill in our sales force these facts: (1) that only through life insurance can all four of life's hazards be met (need for ready money, disability, loss of earning capacity because of old age, and death); (2) that life insurance in effect can provide funds for retirement at less than fifty cents on the dollar; (3) and that the annual increases in life insurance cash values are not taxable income until the insured chooses them to be, and then upon retirement the life insurance funds can be transferred directly into tax-favored annuity income without paying a tax first before getting the income. To produce the same investment return as is available on a retirement income endowment policy, the investor in any other median must earn 4.53% (age 30, married, $25,000 net taxable income), or 6.29% if single or a widower, and this without the guarantees of family security in event of death.

Another step which would help would be to make life insurance contracts more intelligible, particularly in the matter of determining the current cash value. The savings and loan association investor can tell at a glance from his passbook just what the status of his investment is.

A separation of the insurance and investment elements is being done by Minnesota Mutual in group permanent retirement income endowment contracts by writing decreasing term insurance under a separate group life policy along with a group annuity. This saves on premium taxes in those states which tax annuities more favorably, and provides total coverage identical to the contracts which are familiar to the ordinary agent. It could well be that extension of this principle to individual contracts would also be desirable, partly in order to counter misunderstandings to the effect that the insurance company confiscates the policyholder's cash value in event of his death. But this separation of insurance and investment element would have to be done in a way which would not be more complicated for the individual to understand than the combined policies of today.

MR. VICTOR E. HENNINGSEN: In regard to the suggestion of making current cash value easier to determine, the Northwestern Mutual shows, by means of their electronic equipment, upon the premium notices for permanent plan policies the increase in cash value for the past policy year. Some agents feel this will help persistency, while others fear it may be an invitation to withdraw the cash value.

MR. JOHN F. RYAN repeated the discussion on section A which he had given at the Toronto regional meeting.

MR. ARNOLD B. BROWN: The industry should re-examine which is more important—volume of life insurance written or amount of first year premium written. Life insurance should, of course, be sold on the basis of the need and the amount of premium the applicant can pay and the amount of insurance should be secondary. The increased business must, therefore, come from training and motivation of the field force.

During the depression the large amount of straight life and endowment insurance in force was almost the bulwark of the American economy. On the other hand, during the 1920's, assets of investment companies had increased rapidly, and then we all know what happened. Today we see a similar trend developing. Mutual funds, building and loan associations, and the stock market put a great challenge to our field force.

By education and training over a long range, we need to convince ourselves, our employees, our agents, and the public of the unique advantages of the savings features of straight life and endowment policies.

Our salesmen must use all their ingenuity and fall back on cash values, settlement option guarantees, and disability and double indemnity benefits in competing with mutual fund salesmen, etc., especially those mutual fund salesmen who try to induce a policyholder to cash in his permanent insurance and buy term and invest the difference. This type of competition is becoming more serious, and some insurance departments are issuing bulletins against twisting, misleading comparisons, etc.

As an example of a change in philosophy which can help stop the trend away from permanent life insurance, the Metropolitan began on January 1, 1960, to annualize all first year commissions and to place recognition of agents upon a basis of annualized commission rather than volume of insurance. During 1960 our average annual premium per $1,000 of life insurance sold increased from $20 to $25.

Each company should decide what steps of its own will help regain a greater share of savings dollars.

MR. HAROLD J. BROWNLEE: The insurance industry should emphasize how effectively we now perform the job of providing long-term savings and protection rather than try new devices which imply our products are deficient. The "buy-term-and-invest-the-difference" program may appear superior over a short period of years, but the typical buyer will live for a good many years, during all of which he will need protection, and over 10 or 20 years competitive media can achieve a result equal to life insurance only by the taking of substantial risks. Also, it is hard to keep up a savings plan without pressure of premium bills and an agency force.

The insurance industry's many special services plus the providing of both protection and savings require a costly organization and put us at a disadvantage. If our costs were allocated between savings and protection in such a way as to make the savings element competitive with the banks, the apparent cost of protection would look extremely unattractive.

If first year expense allocations were reduced without actually reducing first year expenses, then persisting policyholders would have to shoulder the additional burden. This would only make long-term net outlays less attractive and add to the already difficult problems of building agency organizations.

MR. GARNETT E. CANNON: The chief competitor of life insurance companies is the savings and loan associations, by a wide margin. Their deposits are guaranteed up to $10,000 by the federal government, and their returns are very attractive. As an example, deposits for approximately 10 years, plus payments for group insurance which results in death protection over the period for approximately the amount of the final 10 year accumulation, will give an over-all yield of 3.15% on all amounts paid, including the group insurance premium.

As contrasted to this, the typical 10 year endowment policy at age 35 provides the same protection, but a yield of only 1% on the amounts paid. Even if all commissions were eliminated, the return would be only 2.4%. Thus, reduction or redistribution of commissions provides no solution.

The one advantage life insurance has is its settlement options, but this will not be powerful enough to attract business. We must see if a lower allocation of expense to these short-term endowments is justifiable, or find a procedure to reduce the actual expense, and perhaps reduce or reallocate commissions.

MR. HAROLD R. LAWSON: The Canadian and British Insurance Companies Act has just been changed to permit establishment of any number of segregated funds, and the liabilities attached to business that is handled through these segregated funds are related to the assets of the funds. There must be an insurance element; companies are not allowed to just start savings plans like a bank or to sell contracts like a mutual fund.

While the quality of securities in the funds is subject to the same restrictions that apply to other investments, the quantitative restrictions are removed. For example, while in Canada no more than 15% of assets may be invested in common stock, in a segregated account the whole fund may be invested in common stock. Such a fund would not then be considered in meeting the condition that 15% of assets is the limit for common stocks.

In my opinion this new facility will only be used to help employers fund their pension plans at least in part with equities. But I know of no company planning to issue such contracts with benefits related to the market value of the fund, and no federally licensed Canadian life insurance company has any intention at present of issuing individual variable annuities.

At the National Life Assurance Company of Canada, we have had some connection for a couple years with a mutual fund and a variable annuity offered through that mutual fund. By insuring the mortality element, we have made it possible for that fund to offer, in effect, a settlement option in the form of a stock annuity instead of a dollar annuity. If his life expectancy is 10 years, we guarantee that a shareholder can get the redemption value of one-tenth of his shares each year for the rest of his life.

We think that, much as we believe in life insurance, it is unrealistic to expect everyone to save all of his money through life insurance.