

**TRANSACTIONS OF SOCIETY OF ACTUARIES
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INTEREST

- A. During the period that the 1941 CSO Table has been in general use, there has been a general tendency for interest rates to rise. What is the present outlook?
- B. As regards policies to be issued on the basis of the 1958 CSO Table, what considerations are involved in determining interest rates for:
 - (i) Premiums?
 - (ii) Reserves?
- C. With the federal income tax law previously in effect, it was customary to treat the amount of a tax as a deduction from interest. With the new law, what changes have been deemed appropriate? How do these changes affect various plans of insurance?
- D. What methods are being used to reflect, in the cost to policyholders under insured qualified retirement plans, the income tax credits for such plans under the federal income tax law?

Toronto Regional Meeting

MR. FERGUS J. McDIARMID: The discernible pressures on interest rates seem to be upward rather than downward. Against these pressures interest rates are not likely to be pushed down by government action for any long period of time.

This conclusion is based to a considerable extent on supply and demand factors. There is a demand for more borrowed money than people are willing to save in the form of fixed currency media. We are running into another period in both the United States and Canada of unbalanced federal government budgets, which will add substantially to the demand for borrowed money. Also such demand on the part of local governments has been rising and will probably remain high. Business recovery will sharply increase demand on the part of corporations.

Now consider the supply side. The life insurance companies, which used to be the largest source of loan funds, have shown a flat trend with respect to their asset increase in recent years. They are therefore not a growing source of borrowed money. The savings and loan societies, which have recently outstripped the life insurance companies in asset growth, confine themselves largely to the residential mortgage field. The private pension funds, which are growing rapidly, have become increasingly equity-minded. At the end of 1960, according to a Securities & Exchange Commission release, common stocks made up one-third of their assets at book value and 44% at market. In 1960 50% of their new funds available for

investment went into common stocks, and their purchase of these was equivalent to 52% of all new issues of common stocks in that year. The public pension funds, which in recent years have probably been the largest buyers of publicly offered corporate bond issues, are going into equities to an increasing extent. The supply of loan funds on the whole seems to be a rather static one.

Interest rates cannot be considered apart from inflation. In an inflationary period quoted interest rates are fictitious, and a heavy tax rate adds to their fictitiousness. In the ten years 1950-60 the U.S. dollar, according to one index, lost value at the rate of 2.1% a year compounded and the Canadian dollar at 2.2% a year. This of course was not as bad as in Bolivia, where money lost value at the rate of 37% a year, nor in Australia, where the annual loss rate was 5.5%. It was not even as bad as in the United Kingdom, where the average annual loss rate in money value over this decade was 3.9%. However it was bad enough to have a marked effect on the meaning of interest rates.

The fact seems to be that, because of inflation and the threat of more of the same, fixed currency securities have lost status as an investment medium in the eyes of some investors. These include the pension funds and a great many individuals. This probably accounts in part for the behavior of the stock market. Some investors, including some important institutional ones, now buy common stocks rather automatically and regardless of price, with little or no consideration given to bonds as an alternative. The action of the stock market, therefore, seems to constitute a vote of lack of confidence in money. The recent news out of Washington with respect to government spending hardly inspires confidence in this regard.

The great rise in stock prices during the last decade can hardly be ascribed, except in small part, to increased corporate earnings. In the United States the dollar earnings of all corporations were actually about the same in 1960 as in 1950, about 23 billion dollars in each year. The return on invested capital was much lower in 1960 than in 1950, even after a great deal of leverage created by debt. It therefore takes more than earnings trends to explain the stock market. The Dow-Jones industrial averages are now at about 23 times latest reported earnings, as compared with 7 times in 1949. It is well known that stocks now yield a great deal less than bonds.

In Great Britain a similar or still more extreme situation prevails. Over there a number of government bond issues, including one issue due in only seven years, now sell to yield 6% or more. The well-known 2½% consols sell at 41½ to yield over 6%. These were close to par in 1946, so anyone who bought them then took a terrible shellacking. There is available a

history of the yields and prices of consols going back 210 years to 1751, a respectable look into the past. In only two of those years, 1797 and 1798, were yields on these bonds as high as they are today. In fact the entire period from 1830–1914, which was a period of stable money value, yields on these bonds varied from 2.8% to 4%. To put it bluntly, the present yields on British government bonds reflect rather plainly the declining status of bonds as an investment medium. This is scarcely an augury for lower interest rates.

MR. GORDON L. CORNEIL: I propose to discuss the outlook for Canadian interest rates and to limit my discussion to long-term rates. Before attempting to forecast future interest rates, it would be beneficial to review Canadian long-term interest rates over the twenty year period from 1941 to 1960.

During this period, it has been possible for Canadian life insurance companies to invest in high grade bonds and mortgages at the following average gross yields before investment expenses:

Period	Bonds	Mortgages
1941–1945	3 %	5 %
1946–1950	3½	4½
1951–1955	4¾	5½
1956–1960	5½	6½

The decade from 1941 to 1950 was influenced by heavy war financing at 3% and government price controls. It was only during the 1950's that interest rates were free of political influences and were allowed to find their natural level as the price which should be paid for the use of money based on the risk of the investment, and to equate, at any given time, the demand for and the supply of credit.

At the present time, Canadian high grade securities and mortgages can be purchased at the following yields:

Government of Canada bonds	5½%
Provincial bonds	5¾
Municipal bonds	5¾
Industrial bonds	5¾
National Housing Act Mortgages	6¾
Conventional Mortgages	7

These yields are about ½ of 1% below the peak postwar rates which were reached in February of 1960 when long-term Canada bonds were

available to yield $5\frac{1}{8}\%$ and conventional mortgage rates were $7\frac{1}{4}\%$ and higher.

Canadian life companies have been able to increase the net interest rate earned after investment expenses during the latter part of the past twenty years. In 1941 many of the companies were earning about 4% on net invested assets. This net rate declined to a low of about $3\frac{3}{8}\%$ in 1948 and then improved steadily to an average of about 5% in 1960. If we attempt to forecast Canadian long-term interest rates over the next decade, consideration must be given to many factors, some of which are:

(1) *Economic activity.* From a consideration of the last six years, there can be little doubt that interest rates tend to reflect the pace of economic activity and in particular the relative intensity of the demand for credit. The figures in the following table indicate the demand for credit by Canadian borrowers, the increase in the money supply, and the average yield rate on Canadian bonds:

Year	Funds Raised by Canadian Borrowers from Securities Markets and Banks	Mortgage Approvals outside Banks	Total Funds Borrowed by Canadians	Increase in Money Supply	Average Rate on Long-Term Canadian Bonds
1955.....	\$2.5 billion	\$.6 billion	\$3.1 billion	\$+1.0 billion	$3\frac{3}{8}\%$
1956.....	2.3 "	.5 "	2.8 "	+ .1 "	$4\frac{5}{8}\%$
1957.....	2.7 "	.6 "	3.3 "	+ .4 "	$5\frac{1}{4}\%$
1958.....	3.5 "	.9 "	4.4 "	+1.5 "	5
1959.....	3.5 "	.8 "	4.3 "	- .1 "	$5\frac{3}{4}\%$
1960.....	2.3 "	.7 "	3.0 "	+ .7 "	$5\frac{3}{4}\%$

After allowing for the increase in money supply and net borrowings from external markets, the increase in Canadian bond yields has been closely related to the total demand for credit. It is expected that on the average the Canadian economic scene will be quite active during the 1960's and, hence, provided the money supply is rigidly controlled by the Bank of Canada, long-term interest rates will tend to high levels.

(2) *Government deficits.* On a national accounts basis, the over-all deficit of all three levels of government rose sharply during 1960, reaching a seasonally adjusted annual rate of \$1.2 billion in the fourth quarter of 1960. There appears to be no curtailing these heavy deficits and they will have their influence on long-term interest rates.

(3) *Current account deficits in Canada's balance of payments.* For each of the past eight years, Canada has experienced a deficit in its balance of payments current account ranging from a low of \$432 million in 1954 to a high of \$1.5 billion in 1959, aggregating some \$8 billion over the period.

The Canadian government is becoming alarmed about these unfavorable balances and indicated in the Baby Budget of December 1960 that they would prefer Canadians to borrow in the internal market. This legislation will put pressure on the Canadian bond market and may make our securities less attractive to some foreign investors. At the present time, the spread in yield between long-term Canadian and U.S. government bonds is about $1\frac{3}{8}\%$, a postwar peak. It is quite conceivable that for short periods of time, Canadian bond yields may act quite independently of the New York Market.

(4) *Average term to maturity of Government of Canada debt.* The average term of the Government of Canada debt decreased to slightly over 9 years from a recent high of $10\frac{1}{2}$ years after the conversion issues of 1958. It is conceivable that the Canadian Treasury might have to consider further conversion issues in the future with consequent pressure on long-term interest rates.

So far we have considered only influences which may maintain high interest rates. Let us now consider factors which may tend to decrease long-term rates.

(1) *Mortgage demand and rates.* There are many indicators that would suggest that much of the unsatisfied demand for new housing in Canada has been taken care of and that during the next few years the housing market and the demand for mortgage money will be closely related to family formation which is going through a low point in its cycle. Consequently, it can be argued that the heavy mortgage lending years of the late 1950's will not be repeated until the late 1960's when family formations are expected to increase.

In this connection we should also mention that the Canadian government intends to make a secondary market in National Housing Act mortgages. It is possible that a successful market in mortgages will make for lower mortgage rates paralleling yield changes on Canada long-term bonds.

(2) *Government taxes and levies.* It is widely indicated that provincial and municipal governments will impose sales taxes and capital tax levies to lessen the need for frequent debt issues. This will relieve to a considerable extent the upward pressure on interest rates for such issues.

(3) *Industrial borrowing.* At the present time there is considerable unused industrial plant capacity in Canada and ways are being found to make use of existing capacity in a more efficient manner. For this reason industrial borrowing for new plant and equipment may not be a big factor in the securities markets for some time to come.

(4) *Government controls.* In the event of a war, we might expect strict

government control in all prices including the cost of borrowing money. In the past decade Canadian officials have been content to let interest rates find their own levels and this condition is expected to continue, barring war or a government with socialistic views.

On the basis of this limited review we may conclude that the outlook for the Canadian economic scene over the next decade appears buoyant and, barring a war and controls, we might expect long-term interest rates in Canada to remain high. During this period we can be certain that interest rates will be subject to many new forces and that they will continually fluctuate as a result. It is impossible to predict the future changes in the fiscal and monetary policy of the federal government and the effect of these changes on interest rates. However, Canadian long-term interest rates might average about the same over the next 10 years as over the last 5 years, say $5\frac{1}{2}\%$ to $5\frac{3}{4}\%$ on the average for bonds and 6% for mortgages.

If we can invest our funds at such rates during the 1960's then we should be able to increase our net rate after investment expenses above the current 5% . I would expect to see the net rate go to at least $5\frac{3}{4}\%$ during the next decade provided we are not subject to an income tax on interest earnings.

MR. PAUL T. HARKNESS, JR.:*

MR. B. FRANKLIN BLAIR: These remarks represent my own views and not necessarily those of the Provident Mutual. While there are some sound reasons for using $2\frac{1}{4}\%$ in preference to a higher rate of interest in both premiums and reserves, two reasons are frequently advanced which seem unsound to me. These are, first, that 20 year ledger costs (*i.e.*, net payments less cash value) are better at low interest rates and, second, that commissions to the agents are higher if a low rate of interest is used in computing the premium. We have a greater obligation to the continuing policyholder than to the one who surrenders. Thus we should be more concerned with keeping down net payments than with keeping down the 20 year illustrations of ledger costs. One of the best ways to reduce net payments is to reduce the amount which must go into reserves; one of the best ways to reduce reserves is to use a higher rate of interest. In my opinion 3% is not too high a rate for participating policies.

A company which chooses a high rate of interest can not only have the advantage of low net payments on its ordinary life policy but at most ages can also use a long-term limited payment life policy with net outlay

* Mr. Harkness reviewed a discussion presented by Mr. Gladstone Marshall at the New York regional meeting (see pages D56-D58).

closely approximating that of $2\frac{1}{2}\%$ ordinary life to provide a policy with a favorable ledger cost. Further, although the maximum difference between the $2\frac{1}{2}\%$ and 3% 20th year reserves on ordinary life policies is only about \$20, why should the insured be asked to accumulate an extra \$20 in reserves during the first 20 years—the period of life when the typical family man finds it most difficult to meet his life insurance payments?

Higher premiums mean higher commissions for an agent if he sells the same amount of insurance. But it is quite possible that an agent selling 3% policies with consequently lower premiums might take some sales away from agents selling $2\frac{1}{2}\%$ policies, and in some cases the former agent would be able to sell a larger amount of insurance with the same premium. Higher premiums do not help an agent if he loses sales because of them. Taking into consideration the competition from other agents pushing term plans and nonparticipating plans, I think it has not been demonstrated that higher premiums are an advantage to the agent.

Finally, I would like to mention an important reason why I favor a comparatively high interest rate. Under the current federal income tax law and at current interest levels the net rate after Phase 1 tax will be approximately 0.1% higher if the reserve interest rate is 3% than if it is $2\frac{1}{2}\%$. Although it is conceivable that the law might be changed so as to eliminate the present differential in favor of high reserve interest rates, in my opinion the differential in favor of high reserve interest rates is more likely to be increased than decreased, and it is not conceivable that there might be a differential in favor of low interest rates.

MR. EDWARD D. GIBB: The North American Life sells on both a participating and nonparticipating basis in both United States and Canada. Consequently we have four interest rates to choose. Traditionally we have kept an interest differential of $\frac{1}{2}\%$ between our participating and nonparticipating reserves. Traditionally also we have preserved interest differentials of approximately $\frac{1}{2}\%$ between our Canadian and United States rates. Consideration might be given to extending this differential between Canadian and United States rates, but this would mean that United States interest rates would have to be pushed very close to the lowest rates that are considered even feasible.

Because our agents, in common with the agents of other companies, sell policies on a ledger cost basis, the 20th year cash value acquires real importance. The shift to the 1958 CSO Table would depress the values as compared with the 1941 CSO Table. However, a shift from discrete functions to continuous functions will go some distance in narrowing that gap and also permit us a somewhat higher interest rate without unduly

depressing the 20th year cash value. The use of continuous functions is very logical because death claims are actually paid at death and not at the end of the policy year of death. This will also involve a shift in company practice from a true premium basis to an earned premium basis, which creates some more problems which we have not yet completely solved.

MR. SAMUEL P. ADAMS:*

MR. NORMAN BRODIE: At the Equitable Life Assurance Society we have adopted a method for allocating the federal income tax among lines of business which has the effect of charging each line with approximately the same tax that it would have experienced if it were a separate company. This means that, even though the Equitable as a whole has not been subject to a Phase 2 tax, our charge to some of the individual lines has included a Phase 2 element.

For annual statement purposes we include our federal income tax with insurance taxes rather than with investment taxes, because the amount charged to the individual lines is not based entirely on the investment earnings credited to the line. In our premium and dividend computations, however, we treat this tax largely as an investment expense. For purposes of our asset share tests of Ordinary premiums and dividends the interest rate used is based on the net investment income credited to the respective line reduced by 52% of the calculated taxable investment income of the line.

As for the credit granted policyholders under insured qualified retirement plans, we compute each year the ratio to mean pension plan reserves of 52% of the reduction in taxable investment income because of the different treatment of pension plan and non-pension plan reserves. For pension trust business in the Equitable this ratio will approximate .3% in 1961 when the full pension credit is effective. This tax saving is reflected in our dividends by the use of higher distribution interest rates with respect to policies issued under qualified pension plans. This increased dividend is granted in the case of all identified qualified policies, including those where ownership has been transferred to the insured. The larger dividend is also paid in the case of supplementary contracts which arose from qualified pension plans.

MR. ROLAND F. DORMAN: The Connecticut General is returning the federal income tax credits on qualified pension plans through a combina-

* Mr. Adams reviewed a discussion presented by Mr. Henry F. Rood on section B of the *Interest* topic under "Ordinary Insurance Premiums" at the New York regional meeting (see pages D62-D64).

tion of higher rate credits, dividends, and lower premiums. In experience rating group pension contracts the credited rate of interest reflects the tax saving. Premiums have been reduced for new group annuity business and the accumulation rate for funds under deposit administration contracts has been increased. On participating pension trust business the scale of dividends has been increased. We have reduced nonparticipating pension trust rates for new business and have extended the reduction to existing business as well.

MR. HENRY E. BLAGDEN: The Prudential bases its rates for non-qualified group plans on interest rates $\frac{1}{4}\%$ lower than those used for qualified plans.

A fundamental part of our method of surplus distribution under group annuity contracts is the maintenance of an experience accumulation for each contract, or aggregation of contracts, depending upon size. In allocating the portion of the Company's federal income tax to the group annuity branch, recognition is given to the fact that reserves held on qualified pension plans generate a proportionately larger interest credit than other reserves. Federal income tax allocated to the group annuity branch is then split into the tax arising from qualified plans and from nonqualified plans. The result for each type is then allocated to the experience accumulations in proportion to the interest bearing funds. The actuarial reserve for pensions on nonqualified plans are calculated using a lower interest rate than is used for qualified pension reserves.

Where we have been able to identify for our individual retirement annuity business those situations where our policies are being used to implement plans that meet the definition set up by the law for pension plan reserves we are reflecting in their dividends the lower federal income tax resulting from our being able to show the reserves on these contracts as pension plan reserves. Similar treatment cannot be given individual insurance contracts because identification is not feasible.

MR. ARCHIE R. McCracken: The North American Life is a mutual company and is not likely to be subject to other than Phase 1 tax in the near future. For any series of ordinary pension plan policies we determine the additional tax as a percentage of mean reserves that would be payable if the reserves could not be classed as pension plan reserves. After our average earnings rate has been calculated each year in accordance with our income tax return for the preceding year, we determine the tax saving with respect to each qualified pension trust and that amount is then paid to the trustee in cash. For ordinary retirement annuity policies purchased by a so-called 501(c)(3) organization we have a special dividend scale

which at present involves an interest factor $\frac{1}{4}\%$ higher than that in other policies. While the $\frac{1}{4}\%$ is somewhat lower than the actual tax saving currently being realized, we feel that the margin is justified in view of the additional expense of handling the special policies. For qualified group annuity contracts we calculate dividends using expense and interest factors that are based on no federal income tax being payable with respect to such policies.

MR. BRIAN L. DALY: The Penn Mutual deals primarily with individual policy pension and profit sharing trusts. Some of these are of moderate size and a few are quite large, but a significant number include only a very small number of policies where the aggregate effect of the tax credit is quite small. A study revealed that on 25% of our accounts the total additional dividend for the account would be less than \$10 while at the other extreme only 7% of the accounts would have an additional dividend of over \$500. Some of the trusts to which we have issued policies have little occasion to handle cash other than the once a year payment of premium. Under our own policies it appeared to us that a proper person to receive an additional dividend would be the policy owner before maturity of the contract, and the payee after maturity.

Taking all this into consideration we concluded that we wish to include an additional amount in dividends for policies under qualified pension and profit sharing plans and to 501 (c)(3) type policies. For unmatured policies we concluded that an appropriate basis was to allow an addition equal to $\frac{1}{4}\%$ of the initial reserve. For matured policies on the interest only option we would increase the interest rate by $\frac{1}{4}\%$, and on matured policies with life income payable we would increase the income by a level amount which would be equivalent to the desired increase in interest rate. We felt our objective should also be to do this in a way which would be simplest for the administrators of the plan, and we therefore merged this additional dividend with the basic policy dividend.

By doing this we produce total dividends without a separation of the basic dividend and the additional portion reflecting the tax credit. However we can supply a plan administrator with a close estimate of a total additional dividend that would be paid in the course of a year. The approach we have adopted would in some insurance companies be an expensive one to administer. We were fortunate that our magnetic tape records for each policy were such that we were able to make these calculations as a by-product of our regular dividend calculation and at minimum cost.

MR. ROLAND E. NELSON: A company which is able to use only a portion of its \$250,000 operations loss offset against taxable investment income would produce spurious rates of investment income after taxes if it charged the resultant taxes directly to investment taxes. These rates would fluctuate inversely with changes in its gain from operations.

It would be preferable for such a company to treat as an investment tax the amount of taxes it would have had were there no offset. The difference would then be treated as a negative insurance tax.

Los Angeles Regional Meeting

MR. NIELS H. FISCHER: At this year's New York regional meeting Mr. C. A. Spoerl reported the results of a survey conducted about a year ago by five Hartford life insurance companies as to the future interest rate levels and the most important point gained from that study was that there is a considerable difference of opinion as to whether the peak in interest rates has been reached or is still ahead of us. Since the late 1940's we have seen increases in interest rates brought on by inflation, and probably what is more important, the expectation of continued inflation which has acted to discourage savings and to expand the demand for capital funds.

At the present time we see other forces at work that will influence the future trend of interest rates for long-term investments. The Treasury is still limiting its new security offerings to short-term issues, and in recent months we have seen a shaving of the nominal rate for FHA mortgages, first from $5\frac{3}{4}\%$ to $5\frac{1}{2}\%$ and then, just last week, from $5\frac{1}{2}\%$ to $5\frac{1}{4}\%$. The Federal National Mortgage Association has raised the scale of prices at which it is prepared to buy or sell in the secondary market. Potentially most important, the Federal Reserve has directly intervened in the bond market by abandoning its long-standing policy of confining open market operations to short-term securities.

The present administration's policy is thus intended to depress the future course of interest rates with the idea that it will stimulate business activity, particularly home building and capital spending. They find it desirable, at the same time, to sustain short-term rates to maintain our competitive position with foreign markets. There is a question of whether this policy of reducing long-term rates while maintaining short-term rates can succeed. It therefore remains to be seen whether the demand for money in the free market will be such as to overbalance this substantial force and result in a continuation of the rising interest rate trend we have seen during the years in which the 1941 CSO Table has been in use.

MR. CHRISTIAN L. STROM: Some considerations which will affect the choice of interest rate to be used for policies issued on the 1958 CSO Table are as follows:

1. What is our investment outlook? This will depend on the expected net yield of the company's future investments.
2. How will the company's net cost position be affected? With lower reserves produced by the 1958 CSO Table, assuming a low interest rate will preserve its net cost position.
3. What effect will the guaranteed interest rate have on the slope of the dividend scale? The lower the interest rate the steeper will be the dividend scale. In order to be compatible with our previous business we assumed the same interest rate on our participating business as previously assumed.
4. What effect will the choice of the interest rate have on the company's federal income tax? If a company has only a Phase 1 tax the variation in the interest rate will have little effect except for qualified pension business where there is an advantage of assuming as low a rate as possible. If a company has a Phase 2 tax, variation in the assumed interest rate has more of an effect on the tax.

MR. CLARENCE H. TOOKEY: When the new federal income tax law was passed it appeared that because of the Phase 1 and Phase 2 separation it would no longer be practical to treat the tax as a deduction from interest. However, the actual results that have emerged from application of the new tax formula to the last three years of operation indicate that this may not be true.

The high rates of interest combined with a high percentage of capital funds tends to give a taxable investment income greater than the entire operating gains. This is particularly true when a company is writing a substantial amount of new business. The limitation of \$250,000 credit where there are substantial dividends paid to policyholders also acts to minimize the importance of Phase 2 taxes. Certain specialty companies will not of course be in this position because of low reserves minimizing the effect of the present high interest rates. Most of us, however, are fairly safe in considering the tax as a reduction in interest earnings for the present. A weakening of the money market could change this situation in the future.

In computing our asset share factors for the 1961 ratebook we have divided the tax into its two parts, since the effect on various policy forms will be different. However, at the present time the over-all tax is such that a company can pay a tax on an amount in excess of its earnings.

MR. HENRY F. ROOD repeated the discussion on section B which he had given at the New York regional meeting.

MR. ALTON O. GROTH: At the Equitable of Iowa we issue only individual policy pension and profit-sharing plans and we have passed along to plan trustees the income tax credits we received in 1959 and 1960 because of the exemption granted to reserves under qualified pension and profit-sharing plans under Phase 1 of the federal income tax law applicable to life insurance companies. We made this distribution recently in the form of checks to the various plan trustees, covering the credits for the two years. The refunds reflected the tax savings on reserves held in connection with future benefits payable to both active and retired employees. Also, we passed along the tax credits on both participating and nonparticipating business. The credits, because of the nature of the tax exemption, are a function of the reserves being held on policies in force under the trust.

MR. BLACKBURN H. HAZLEHURST: Prior to release of the regulations in connection with the new federal income tax law there was a question as to whether reserves under deposit administration contracts could be treated as pension reserves. With this in mind the Pacific Mutual designed a contract providing for the crediting of full earned interest directly to the deposit fund, subject to stated minimum credits. It was felt that reserves under this contract would qualify as deposit funds, with deduction being allowed for all interest credited. This contract was offered not only to new policyholders but also to in-force policyholders with the result that the bulk of our deposit administration business is now on this type contract.

Now that the final regulations are out it appears that the few policies remaining under the standard deposit administration contract are subject to a large measure of tax relief. Our new type policy still seems preferable for many reasons, including somewhat more complete tax relief. This additional measure of tax relief will be of real consequence if and when a current money approach is used in allocating and crediting investment yield. The actual income tax assessments against each policyholder's experience reflect as nearly as possible the actual tax developed because of that particular case.

MR. WALTER L. REYNOLDS: Since the Prudential has done very little in the individual policy plan pension trust field, the problem in our company of reflecting the savings in federal income taxes from qualified pension plans is mainly confined to group annuities. In allocating to the

group annuity branch asset shares their share of the federal income tax, recognition is taken of the fact that interest on qualified pension plan funds bears a smaller share than the funds for other purposes. Although most of our group annuity funds are on qualified plans, we do have a few nonqualified plans. In making the federal income tax charge, it is split between nonqualified and qualified plans. This is then distributed in proportion to the interest bearing funds in each class. The net effect, of course, is to generate a larger interest credit in the asset share for qualified pension plans.

In determining dividends, we also recognize that qualified plans will in the future generate larger interest credits, and in the actuarial liabilities for these plans used in our dividend formula a quarter of one percent higher interest rate is used than for nonqualified plans. Our rate guarantees also recognize this difference and for qualified plans we use for both rates and guaranteed interest on funds a quarter of one percent higher interest than for other plans.

Although we have a very minute amount of individual retirement policies which are used to implement plans that meet the definition of a qualified plan, we do have some. On these policies which we can so identify we reflect in their dividends the lower federal income tax.