TRANSACTIONS OF SOCIETY OF ACTUARIES
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MISCELLANEOUS

A. (i) Has there been any reduction in bank loan and minimum deposit business?

(ii) Is there a reawakening of interest in the sale of a combination of a single premium immediate life annuity and either a single premium or annual premium life policy issued without evidence of insurability? What is currently being offered in this area and what restrictions, if any, are being imposed?

(iii) What is likely to be the result of recent court decisions and attention currently being given by the Treasury Department to the question of the allowability of interest on indebtedness as a deduction in calculating individual income taxes?

B. Many actuaries become involved in managerial duties for which their professional training does not make any direct preparation. What is being done to prepare them for such responsibilities? Is there any function in this area which the Society of Actuaries might consider performing?

New York Regional Meeting

DR. CARL H. FISCHER: My son, Patrick C. Fisc[illegible] and I recently made a cost study of financed ordinary life policies. The [illegible]y, performed on an electric computer, covered all durations under 20 ye[illegible]s, quinquennial ages at issue and 6 different interest rates. Except for the interest assumption, costs were computed on the traditional basis used by agents.

The cost of a financed policy was compared with the costs of various term policies. The financed policy was considerably more expensive than the term policies in the very early years but cheaper in the later ones. Our results also showed that issue age was not too important in the comparison of a financed policy with a term policy. The interest rate was, of course, obviously important.

In addition, as a small part of this study, we considered the cost of the replacement of an "encumbered" policy—an ordinary life policy with a high cash value, the premiums for which had been paid by policy loans. Our results showed that for any effective interest rate below 5%, and even there at almost all the ages of issue, it was cheaper to maintain the original policy and not to replace it.

MR. MORTON A. LAIRD: Answers to the question of whether there has been any reduction in bank loan and minimum deposit business are so importantly affected by how one obtains the data on which to base his reply that it seems worthwhile to consider several of the methods which may be tried.

For two years now, National Life has required that on all applications of $15,000 or more (other than term and pension trust) a questionnaire be completed which is aimed at identifying financed insurance. There is no reason why these questionnaires should overstate the proportion of financed insurance.

A second approach is to review recently paid-for policies to see whether or not an assignment has been reported. We have tried this approach on a sampling of our business and found that, as compared with the questionnaire, the assignment test grossly understated the proportion of financed business. A few months after the second annual premium had fallen due the results would be appreciably more accurate, but correspondingly farther removed from what is happening today.

In our experience, whether or not the fifth dividend option or the one year term dividend option is elected is not a meaningful criterion when judged against the results of the questionnaires.

Finally, there is the armchair or general impression approach. We consider this to be unreliable. The only way which a great majority of applications which we receive can be identified as involving financed insurance is from the questionnaire, and hence any impressions formed without such a questionnaire are almost certain to be erroneous. Also, we repeatedly hear from reliable agents of their being in competition on a financed insurance proposal with agents of other companies whose home offices publicly proclaim that they write little or no financed insurance.

The proportion of financed business which we are experiencing is consistently higher in terms of applications received than in terms of paid-for business. Cases involving financing for at most the first 5 years are very definitely in the minority. During 1960, our proportion of financed insurance remained relatively stable until the closing months of the year, when a distinct increase occurred. This increase has carried into 1961. Just why this increase should have occurred is not known. One hypothesis advanced is that more members of the field force have established connections from which the requisite borrowing can be made.

We have experienced a reduction in our in-force on 10 Premium Life issues of the early 1950's. At that time, 10 Premium Life was sold on a bank loan basis which involved paying the first premium plus four premiums in advance. We have been experiencing termination rates on this business at the end of the fifth policy year which are more nearly akin to what would be expected at the end of the first year on business generally.

MR. HAROLD G. INGRAHAM, JR.: The Massachusetts Mutual has, since 1953, been issuing policies which have relatively high early cash values. These policies currently constitute about 50% of new issues. The combined proportion of first year bank assignments and policy loans on these policies for issues in the period 1955–1960 were as follows:

1955	12%	1958	27%
1956	15%	1959	15%
1957	15%	1960	5%

The reduction in 1959 and 1960 was effected by our removing the right of first year policy loans from these contracts.

In 1960, there was a reduction of more than $100 million in the amount of new business assigned in the first policy year, which would seem to indicate that we have been successful in discouraging the sale of financed business. However, we have found that there are loans under about 40% of all such policies which renew in the second policy year.

Largely because of financed business, our policy loans increased last year by $28.6 million, an increase of about 29% over the amount of policy loans outstanding at the end of the previous year. Since we are currently investing new funds at an average rate of interest in excess of 6%, it is obviously disadvantageous to the Company to make policy loans at a rate of 5%.

MR. FREDERICK W. CLARK: I also have the impression that there has been an increase in interest in financed life insurance dating back to some time in November of last year, but I have had no facts to go on.

As an actuarial group, I suppose our primary concern with this problem is what we should do about it. If we have a conviction that there is something approaching sacredness in savings, or cash values as a specific form of savings, perhaps we could influence our company's product design in the direction of minimizing the attractiveness of the tools that are most appropriately used in the sale of financed business and encourage development of the tools that tend to make the savings feature more attractive.

MR. T. ARNOL CROWTHER: There is evidence of an increase in the use of new insurance on the minimum deposit plan by the representatives of some companies to replace existing insurance. In this connection, any comparison which indicates that it might be advisable to make such a change should be given very careful scrutiny. Due to the complexities of the minimum deposit plan, the usual net payment and net cost comparisons are not enough. The accounting problems alone proved perplexing to even the controller of a corporation considering new insurance on the minimum deposit plan to replace business insurance carried on the traditional basis. Imagine the possible confusion and disillusionment which these same comparisons may bring to the general insuring public. We, as actuaries, have a responsibility to the public in this respect.

MR. WAID J. DAVIDSON, JR.: I shall open the discussion of subsection (ii).

The United States Life will write a combination of a single premium life and an immediate single premium nonrefund annuity provided the single premium for the combination is 110% of the face amount of the life policy, subject to a $110,000 maximum single premium. We will also write an ordinary life and an immediate single premium nonrefund annuity combination where the single premium for the annuity is 110% of the face amount of the life policy. The premium for the ordinary life policy may be paid by any mode normally available. The minimum face amount of the ordinary life policy is $25,000 and the maximum $100,000. These contracts are nonparticipating because we do not write a participating annuity. No evidence of insurability is required. The life insurance is issued standard with no benefits or riders. Premium rates, commissions, and contracts are the same as used with regular issues.

In deciding to offer the ordinary life and life annuity combination, we studied the cash position of the Company in the event the insured dies in the early years. The worst case is where the monthly premium payment mode is elected and at the highest age on which the contract is issued. Our maximum age is 75, at which point we are in a deficit cash position at the end of 8 months and remain in a deficit position until the end of 21 months. The maximum deficit which occurs during the twelfth month is $2,500 on a $100,000 case. At age 70, the deficit lasts for only 5 months and never exceeds $1,000 on a $100,000 case. We felt that, in view of the small chance that the insured would die when the fund was in a deficit position, we were willing to issue this contract at any age up to our normal maximum of 75.

One other problem involved in the use of ordinary life in combination with the single premium annuity is that the insured may place the policy on extended term. We did not feel this was serious, since the period of extended term per dollar of cash value is short at the high ages where these combinations are normally sold. Also, assuming that the policyholder is uninsurable, once he places his policy on extended term we would not reinstate it under any circumstances.

To date, the number of inquiries about these combination plans has been substantial but sales have been nil.

MR. INGRAHAM: Since June of 1960, the Massachusetts Mutual has made available two types of combination plans: a single premium immediate nonrefund life annuity combined with either a single premium life insurance policy or an ordinary life insurance policy. The premiums for both policies are at regular rates (standard for insurance), but no evidence of insurability is required for either contract. However, the annuity policy must be paid for before the life policy becomes effective.

We impose the following restrictions: for the single premium life combination, the total single premium must be \$1,100 for each \$1,000 of life insurance purchased; for the ordinary life combination, the total initial outlay for each \$1,000 of life insurance purchased must be \$1,100 of single premium for the life annuity, plus the first annual premium for the ordinary life policy; the "fifth" dividend option and extended term nonforfeiture options are not available in connection with insurance sold under the ordinary life combination; the combination plan is not available above age 75; the minimum single premium and maximum income for the annuity policy will be determined in accordance with the usual rules for single premium annuities.

These combination plans permit an individual, under present tax law, to reduce estate taxes. However, the following situations should be carefully noted.

1. Any gifts made by the annuitant within 3 years of his death to pay premiums might be regarded as gifts made in contemplation of death, and such premiums (or, possibly, that portion of the proceeds attributable to such premiums) could be subject to estate tax.
2. Since the tax code will allow the annuitant to deduct charitable contributions up to 20% of his adjusted gross income, the ordinary life combination may be more advantageous to the annuitant, where a charity is designated as irrevocable beneficiary, than the single premium life combination.
3. Using either combination plan, if the annuitant makes a gift to his spouse, a marital deduction will be allowed of one-half of such gift in addition to his usual gift tax exemptions and exclusions.

To be an attractive proposition, a combination plan requires that the annuitant be in high estate and income tax brackets. Furthermore, if the circumstances of a particular combination plan do not substantially conform to the facts of the recently favorable court decisions, the tax consequences are quite uncertain.

Our more sophisticated agents have been enthusiastic regarding the potential market for combination plans; however, only one combination plan has actually gone on the books.

MR. LAIRD: I shall open the discussion of subsection (iii).

There are at least 3 types of situations where interest is not currently allowable as an individual income tax deduction. One is interest on indebtedness associated with carrying obligations, the interest on which is exempt from taxation. The second is where the interest is associated with carrying a single premium life insurance policy, including any policy on which substantially all of the premiums are paid within the first 4 years or on which a substantial number of future premiums are paid to the insurer. The third type of nondeductible interest is that associated with an essentially "sham" transaction where there is no indebtedness in fact.

In any case involving life insurance which may arise in the future, it is probable that the view will be taken that life insurance protection is present and does cost the purchaser something, so that the life insurance policy cannot be viewed as having been purchased solely to avoid taxes.

It would seem reasonable to anticipate that the Treasury Department will continue to scrutinize with increasing thoroughness all interest deductions and will continue to seek to narrow the availability of the deduction, both through amendments to the Internal Revenue code and through court action.

MR. INGRAHAM: There are persistent reports that the Internal Revenue Service is closely scrutinizing interest deductions under bank loan and minimum deposit plans.

It does not seem likely that the courts will hold arrangements, such as minimum deposit plans, to be "sham" transactions, as has been held in the *Knetch* case and may be the government's theory in the *Brown* case, since the policy still serves a very real and substantial life insurance purpose in providing, at the least, decreasing term insurance protection to the insured and his beneficiaries.

MR. JAMES G. BRUCE: I shall open the discussion of section B.

Few companies have sufficient staff to allow an individual to attend the various business seminars conducted by colleges on such topics as executive responsibilities. There are professional organizations which will conduct a managerial course in the company. Those who take the course have an opportunity to learn from the experience of others. However, the nature of the material covered lends itself to sagacious generalities and platitudes. Unless there is a convincing hope of success, it takes a heap of faith and courage to invest extensively in such intangible benefits.

I am not sure that there is any better way to train for managerial duties than to get experience under a capable supervisor and to assume successive stages of responsibility. For many small companies, there may be no alternative. However, if there is an improved method of giving such training, every effort should be made to develop it.

It is suggested that the Society of Actuaries, by stepping up its program of qualifying actuaries by the successful passing of the examinations, would alter the nature of the problem greatly, if not solve it. So great is the shortage of actuaries that Associates and Fellows, and even students who are almost Associates, may find themselves in highly paid positions with a minimum of seasoning and experience.

Any possibility of action which might be taken by the Society involves tremendous energy and thought. Seminars could be conducted which would help young actuaries to benefit from the experience of others. We have as precedents the Life Office Investment Seminars conducted by the American Life Convention for two weeks in the summer of each year. The Society might well establish an analogous type of seminar. Management problems, leadership, human relations, public relations, broad problems related to the life insurance business, and the philosophy which governs or ought to govern our business suggest themselves as subjects to be covered.

MR. J. HENRY SMITH: Most actuaries have an opportunity to—in fact are expected to—assume managerial and policy-making function. But their technical training is not very good training for management responsibilities. Concentration on the analytical approach to problems, and emphasis on logical interpretations and solutions, overlook the sometimes whimsical and unstable factors, the psychological and emotional elements, inherent in human behavior and the necessities of decision-making in situations where intuition seems more useful than facts.

A considerable body of opinion is developing these days to the effect that the increasing importance of the technician is going to place greatly increased emphasis on his orientation as a business executive. Therefore, it seems to me that the employers of actuaries, and possibly our own professional society, have some extra responsibility to their younger men to help them acquire the characteristics, attitudes and skills which executives must bring into play. Management training systems are usually devised with an eye on the usual business students, many of whom have already had the advantage of courses and reading in management. This may not be enough to give the young actuary all of the orientations he should have to compete well with others long aimed in the direction of management work. It would be only prudent, therefore, for the Society of Actuaries to consider the extent to which it should undertake some function in the education of the young actuary to give him a more rounded background which will increase his facility for dealing with executive responsibilities.

It is my recommendation that the Board of Governors assign this subject to a standing committee, if one is appropriate, or otherwise to a special committee, for study and recommendations.

MR. RALPH E. EDWARDS: At the present time, I am Chairman of the Life Office Management Association Institute's Educational Council and the question of industry educational programs has been a considerable concern to me and the Council. There is evidence of considerable need for flexibility in educational arrangements, yet, at the same time, coordination of educational efforts would seem in the best interest of the industry.

It is my personal belief that we should look to the Life Office Management Association to furnish management education. I feel confident that a program could be developed which would meet the needs of the Society of Actuaries. Such developments might take two to five years because of coordination problems, but I am confident of a satisfactory end result.

I would suggest that the Board of Governors of the Society of Actuaries appoint a committee to work with the LOMA Educational Council to solve this problem.

MR. W. TRIS STEVENS: If, by management, we include not only managing people working for us, but also managing (*a*) people working with us, (*b*) people we work for, and (*c*) ourselves, then every one of us is actively engaged in managerial duties every day. I think the topic of management should be introduced into our syllabus and at a fairly early stage. The arguments I can think of for not including this subject in the syllabus just don't hold water. For example, "Management is easy, just common sense." While I agree that common sense is the basis of good management, that doesn't make it easy. It is also argued that every company or firm has its own management philosophy and that it is its sole prerogative to train in this line. This too has its elements of truth but, on the other hand, the same might also be said of other subjects in our syllabus. Finally, it might be argued that it's too hard a subject to set a syllabus and examination for. However, progress is not made by saying we can't do it because it's too hard.

For us as actuaries, I think one of the most fertile fields for improvement is in the broad area of management. We can learn, by studying, how to become better managers. Of course, as with any other subject, study must be coupled with practice to be effective and of value. I think the Society should take the lead in promoting the study of this subject so vital to success in our everyday lives. Making the study mandatory by including it in our syllabus would, I feel, be the most effective procedure.

MR. CHRISTOPHER H. WAIN: Generally speaking, if a man hopes to or does get into management functions he should expect to broaden his knowledge of this field after finishing the examinations. Local colleges and universities can be helpful in this, since a good business school can present the latest developments of management practice.

In one function, however, the Society of Actuaries could make a significant contribution. Modern management practices endeavor to develop standards for future performance so that deviations can be promptly measured and corrected. These standards, as reflected in budgeting operations, are deficient if they don't consider the ultimate effect on operating earnings of various possible changes in sales or expenses. I think we could go further in developing budgeting techniques for the life insurance business that will be intelligible to lay executives and that will help them to understand the complete consequences of any change in the budgeted operations.

MR. ELLSWORTH E. STROCK: At the Prudential, a young student will, in his early years, have a job that requires supervision of a small group of people. Fellows of the Society attend our own "Advanced Management Program" held during the summer at Princeton. For top actuarial executives, we have taken advantage of the program for executives given by Harvard, Columbia, Carnegie Tech, Northwestern and the University of Western Ontario.

In view of the necessity for a company, government or consultant to train nonactuarial managers, it would be my opinion that actuaries involved in managerial duties should be exposed to the same training and that it is not necessary for the Society to consider performing any functions in this area.

Dallas Regional Meeting

MR. LLOYD K. FRIEDMAN: Speaking from the point of view of a small consulting office dealing with small companies, I have been successful in dissuading all of my clients, but one, from issuing the kind of business indicated in section A (i). This one exception issued several million dollars before ceasing, with about two-thirds lapsing within two policy years.

MR. DAVID G. SCOTT: The Continental Assurance is not very active in the bank loan and minimum deposit business but has sold a good deal in the past and now has about $50 million of it in force. The first year lapse rate has been about 17% to 18%, but would probably be under 15% if business on the lives of agents were excluded.

We brought out a new policy along this line which has not sold well at all, a contract providing for return of cash value in addition to face up until age 65. We felt that, since this was a guaranteed benefit, it would be preferred to one year term insurance under the fifth dividend option. However, our experience has proved us wrong and we are introducing the fifth dividend option on May 1, and I suppose we will then be back in the minimum deposit field again.

MR. RALPH H. GOEBEL: The Northwestern National issues between 5% and 10% of its business on plans with moderately high early year cash values. Business on these plans has been cautiously underwritten and so far the persistency is a little better than on other business.

MR. CHARLES W. McMAHON: The Union Central was very early in this field with a full cash value plan. When it became an undue proportion of our business, it was replaced by the sort of modified plan now popular in the industry with a somewhat lower early cash value and the fifth dividend option.

The experience on this plan is not out of line with regular business. However, with the growing loans inherent in these plans we may well look forward to a continuing high lapse rate.

A few years ago we designed a special combination, referred to in item (ii), of single premium life and immediate life annuity. We did so at the suggestion of one of our leading agents, who visualized large sales on this plan. Actually, although there are certain tax situations where this combination has an appeal, we have written only a small volume of this business.

MR. LESLIE A. CANNON: The Great-West has issued a high early cash value plan with the fifth dividend option in the United States since September 1957. We never wrote over 18% to 20% of our United States Ordinary business on this plan and currently we write about 13%. We applied rigorous underwriting standards to this business from the beginning, and paid a level 12% commission for 10 years where a broker or agent of another company purchased the plan on his own life or the life of a relative. Our persistency for the first three years has been better than the company average. However, as loans on this business increase, higher lapse rates may be anticipated.

Some years ago we offered the combination of single premium insurance and single premium life annuity mentioned in item (ii), but withdrew it because of the small number of sales. Then, a couple of years ago, we revived the combination but offered the life insurance on the annual premium basis. However, we have sold very little business on the new basis even though we have developed a good deal of sales material on the plan.

MR. EUGENE WISDOM: I think, as a firm believer in fundamentals, that the Society has always done an excellent job of preparing students in the fundamentals and, therefore, I would think that it might be a departure from that program of excellence if the Society undertook to prepare a student for important, but nonactuarial functions.