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PENSION TRUSTS

A. What are the advantages and disadvantages, from the viewpoint of a smaller company, of entering the field of small pension plans?
B. What considerations are involved in arriving at a discussion as to whether a smaller company entering this field should offer group annuities?
C. To what extent are special premium rates, plans of agents' compensation, and policy forms necessary for a smaller company to compete successfully for individual policy pension plans?

Toronto Regional Meeting

MR. WAID J. DAVIDSON, JR.: I suggest the following advantages and disadvantages:*

Advantages. The opportunity to expand your Company's area of operations, increase the average premium per $1,000, increase agents' earnings and place persistent policies in force on permanent plans; the opportunity to provide contacts for your agents to sell life, group, and Accident and Health policies; the means to attract brokers and to handle all their pension and life business; the benefit resulting from the favorable tax treatment under current United States tax laws for reserves for qualified pension plans.

Disadvantages. Additional costs to develop pension business, train agents and salaried personnel and to prepare rates and promotional material; the necessity of offering some type of guaranteed issue and this is especially complicated on nonparticipating; special dividends because of favorable tax treatment and guaranteed issue costs; special policy forms and special accounting; the danger of loss on annuity guarantees, especially on the split funded ordinary life type of contract; the danger of lapse by case, especially if there is a change in the Internal Revenue code; the problems involved if a plan grows to a size where a group annuity or a self-insured plan is desired.

On section B, I believe that a small company should not enter the group annuity field except as a means of holding the auxiliary fund on split-funded individual policy pension trusts. It is impractical to expect to write much group annuity business since the national volume of new sales is relatively small. Quotations are time consuming and the ratio of

* Some of these advantages and disadvantages were also given by MESSRS. COOPER, ECKERSLEY, and McINTOSH.

cases closed to cases quoted is quite low. Group annuities are of little value to the field force because sales are usually made through special representatives. Home office technical talent is also needed for making quotations and for periodic valuations of cases placed. Because of competitive factors in this business, I believe it is impossible to make a profit and difficult to break even.

On section C, I consider that some differential is justifiable in premiums or dividends or both, because of factors such as the Income Tax differential, special underwriting considerations and the different lapse and expense rates inherent in pension trust business. I believe the client, rather than the agent, should pay the cost, so that the differential should be in premiums and not in commissions. A special policy form is needed where split-funded ordinary life contracts are used, otherwise we will be exposed to antiselection at retirement. For other plans, I favor the use of regular policy forms and regular cash values in order to hold down expenses.

MR. MITCHELL DEZUBE: My Company, the Manhattan Life, has been in the small pension plan field for ten years but many of the advantages and disadvantages of entering this field are similar to those involved in remaining in it. The principal advantage currently is that the sale of pension plans gives rise to sizable premiums, including conversion fund deposits, and in view of current high interest rates there is a keen desire to acquire as much pension business as possible. We have found that certain agents who were only mildly successful in individual sales have almost a "calling" for pension plan sales. We have been able to promote this type of sale using individual policies without involved home office procedures.

One disadvantage is the tendency on the part of some agents to neglect their individual sales while trying to sell pension plans. Because of the considerable time it takes to develop and sell a pension plan, this tendency results in periods of abnormally low production for such agents. Another disadvantage is the continual demand from the field force for more and more service from the home office, thus requiring more trained home office personnel. Termination of a case may result from a merger with or purchase by a similar business. The persistency of our pension cases has been poor recently and is a source of concern and disappointment to us.

On section B, we have decided to enter the group annuity field to give our agents an alternative basis for sales and to assist in conserving those existing cases which have grown to a considerable size. We are now trying to resolve the questions of the types of group annuities to be offered and the amount of servicing and additional home office personnel which will be needed. On section C, until recently we did not believe it necessary to devise special scales to compete successfully. Because of increased competition in the last year or so, we are studying the necessity of redesigning our policies to stress higher early cash values and a compensation scale that is more consistent with the continuing service required.

MR. DEREK ECKERSLEY: In Canada, the federal government is considering the replacement of the present noncontributory Old Age Security Plan by a contributory plan. Also, the Taxation Division have recently relaxed the eligibility rules under which contributions to private pension plans qualify for tax relief. Some provincial governments, particularly Ontario, are studying portability of pension equities. The publicity resulting from these activities has focused attention on pensions.

In the Dominion Life, we consider that there is a big potential market for pensions, particularly in the small pension field. We think it is timely to attempt to tap this market, otherwise potential pension dollars will be lost to other investment outlets.

We entered the small pension field ten years ago by using the facilities of our group department to market a group retirement annuity plan. We find that this plan is easily understood by our field force and that they require minimum assistance from our salaried group representatives. Also, head office administration is quite simple.

Some of our more knowledgeable agents have written pension trust plans without head office assistance. We are now considering the expansion of our pension trust sales. Our group retirement annuity staff would require little additional training to handle pension trust business. We will probably use special policy forms, special premiums or dividends, lower commissions and provide for auxiliary funding and guaranteed issue. While these features are desirable, I do not consider them essential for at least partial success. In fact, the market is such that a small company may find it advantageous to enter it without providing these features.

Most group annuity business channels through consultants and is highly competitive. The competition is not only with other life companies but also with other funding mediums. Therefore, it is essential to have competitive rates based on actuarial assumptions which are not conservative and which may result in a considerable valuation strain. I believe that in order to attract a substantial volume of business it is essential to sell deposit administration contracts as well as the traditional deferred annuities and to move to the new money approach and also to offer equity funding. To do so would require a specialized head office department and salaried assistance in the field.

MR. H. IAN McINTOSH: On section B, it was possible in Canada ten years ago for a smaller company to enter the small pension plan field through the sale of the individual policy pension trust. I do not believe that this can be done successfully today. Companies already in the pension trust field have been forced to rewrite their pension cases as group annuities or lose their business to their competitors. Present high interest rates are undoubtedly a major factor in this change. A projection of pensions based on a continuance of current rates completely dwarfs the guaranteed pensions provided through conventional pension trust contracts.

On section C, I do not believe that, in Canada, any combination of special premiums, policy forms or plans of agents' compensation can enable a smaller company issuing individual policy plans to compete successfully with current group annuity plans.

MR. SIDNEY H. COOPER: At first sight the individual policy pension trust arrangement has obvious attractions. Premiums, commissions and policy contracts are familiar to the agent. The facilities of the underwriting, policy issue, premium collection and valuation departments can be used to process the business. In practice, however, the business creates a number of special problems. There is a considerable amount of documentation. There are special tax problems at the time the case is sold, particularly if there are past service payments and in connection with withdrawals. Although you may try to standardize your forms to reduce the cost, my experience has been that small employers are more likely to want special consideration and special "gimmicks." In the absence of a home office pension trust department, a considerable amount of administrative work will have to be undertaken by your agents and branch office staffs. A successful pension trust plan requires general administration as a plan, quite apart from routine policy issue.

If we do enter the pension trust field, what will be the basis of our premiums, commissions and surrender values? Immediately, we will be confronted with the philosophy that a wholesale rate should be used. We must consider whether or not our pension trust procedures result in any real saving in expenses. Surrenders and changes occurring on termination of employment involve not only extra work but also special knowledge and training. We may expect some savings in billing and collection, but with mechanized systems this saving may be small. Our services will not be limited to the routine issue of policies and we cannot ignore the other expenses of general administration of the plan. Perhaps the main economy is in the area of acquisition expense. A similar volume of Ordinary business might require the financing and training of additional agents. On the other hand, we may be diverting the attention of successful agents from Ordinary production.

Surrender charges and termination values are a cause of dissatisfaction. Where do we go for savings to justify reduced rates and the better surrender values expected in a market which is becoming increasingly informed of other available types of funding? We can obtain some relief by reducing or adjusting commissions, but we probably cannot afford to make either premiums or surrender values as attractive as the public expects.

At this point we will want to consider the possibility of using a master policy and group underwriting. If we adopt this approach, we will have discarded all the features which make this type of business attractive in the first place. Having gone this far, should we go into group annuities? Among other problems, we should consider how such action will affect the balance between participating and nonparticipating business and between insurance and annuities. We should also consider the long-term nature of the liabilities and the risk involved in the rate guarantees we are giving. We may hope to limit the guarantees given in respect of future premiums but, if we do, we must adopt favorable terms on a new money basis for current premiums. Alternatively, we must adopt a generous experience rating procedure.

If we adopt the investment generation approach for premiums, with a discount based on current investment conditions, we shall be faced with the problem of valuation strain, although in Canada this problem has been reduced somewhat by the relaxation of the statutory valuation requirements for annuities. We must also consider the necessity for a special investment policy geared to support the long-term guarantees we are giving in respect of current premiums. It will be necessary to exclude these special investments in calculating the over-all yield on our funds when this is considered in relation to our other liabilities, and we should consider whether the assets relating to this business should be earmarked internally or whether a separate fund should be set up for this business.

MR. ANDREW U. LYBURN: I believe the main advantage of entering the field of small pension plans is the provision of contacts for agents. Most small businesses are privately owned and substantial business insurance can often be sold to the owners. On the other hand, it is difficult to provide the service required at reasonable cost. The amount and quality of service will depend on the type of agency organization, so that commission and supervision must be considered. First year commission must be generous to reward the agent for the time it takes to install the plan. Premiums need to be more competitive than Ordinary rates and if first year commission is substantial, then renewal commission rates will have to be very low. Withdrawal values must be reasonable and such can only be achieved at the expense of commission. The problem of service becomes acute with agency turnover and it seems imperative that commissions should not vest but be transferable. In practice, the carrier may have to rely on a salaried supervisor to service the plan after the agent terminates, thus adding to the carrier's expenses.

On section B, I think some of these disadvantages can be overcome by the use of group plans underwritten by master contracts. I suggest that for groups of at least 10 lives, it is probably cheaper initially to issue one master contract than to issue individual contracts and it is easier to handle increments, decrements and new entrants. The resulting saving in expense leads to lower surrender charges and a more competitive position.

Group contracts can be on a single premium basis with considerable variation in rate guarantees, whereas annual premium contracts require long-term rate guarantees. In Canada at the present time, annual premium rates are hardly competitive. It is difficult to convince employers that a long-term guarantee of rates for the level of benefits obtained in, say, the first 5 years, assuming perhaps $3\frac{3}{4}\%$ interest, is of equal value to a short-term guarantee of single premium rates assuming 5% or higher for a limited period and reducing thereafter.

On small plans, it is necessary to standardize policies to keep down expenses in order to be competitive. On larger plans it is necessary to be more flexible. There is a level at which it becomes advisable to establish home office and field service organizations. At this level, lower commissions can be paid to the agent and the savings used to provide specialized service by salaried supervisors. The agent is thus relieved of the detail work and can devote his time to writing new business. The agent should assist with the initial enrolment with a view to selling personal insurance.

Group contracts have advantages over ordinary policies for handling options such as early retirement, late retirement, joint and survivorship and notched pensions. Group contracts also lend themselves to changes in benefits or rates by a simple endorsement. Unlike individual policies assigned to trustees, there is no need to have trustees. In fact the advantages of group plans over individual plans are so great that one Canadian company has abandoned the use of individual policies for new plans and is attempting to change its individual policy plans to group contracts. This change in approach was due in part to a change in the agency system. Group plans are now completely installed and serviced by a salaried inspector.

On section C, I believe that success in the pension field on either a group or an individual policy basis certainly requires special premium rates, policy forms and plans of agents' compensation. It is not worth while competing for pension business unless a considerable and sustained effort is going to be made.

Los Angeles Regional Meeting

MR. HARRY M. SARASON: The small pension trust field has reached a very profitable stage for companies that are qualified to enter into it. The pioneering work has been done by the larger companies but they haven't cultivated all of the prospects for this business. It offers one of the best areas for development by a company which is anxious for new business. The group annuity field is more difficult.

I am assuming that the small pension area refers to cases involving 25 lives or less. Marketing these small pension plans requires a special kind of operation. It is essential that a company entering this field develop one or more new plans with high cash values and with somewhat lower than usual commissions. It is also essential for someone in the company to know or learn a great deal about tax laws and regulations relating to profit sharing plans. It is also well for management in the company to be steeled to spending considerable money and having much time elapse before results are obtained in the pension field. Management should also be aware that in this field there may be substantial terminations and changes in existing business.

It is most important that a simple sales presentation be developed for your product and that the company have a few salesmen who are experts in and enthusiastic about the small pension field. Even in the companies most successful in the pension trust field, a few salesmen produce the great bulk of the business. In geographic areas where these pension trust specialists operate, their success has inspired a number of agents to work with them by providing leads and setting up interviews. Based on the experience of companies in the field, the necessary enthusiasm among agents can only be developed by their working with and noting the success of a local man who is an expert in this type of sale.

MR. EVERETT G. BROWN: The Southwestern Life had been well known in the State of Texas for many years and had quite a lot of life insurance, including salary savings plans, in force when the pension business started to become popular. Our agents wanted us to get into the pension business in order to conserve the business we already had in group insurance and in salary savings plans, so we embarked on the pension business. Our pension business has been written on a group basis. We have group permanent, group annuities, and on some of the smaller cases we issue individual contracts, but the rates and values on these contracts are the same as those used for group permanent.

We wrote quite a lot of business and maintained fine relationship with many employers in Texas, and for years we did very well. However, with the advent of self-administration and with the development of large trust departments in most of the banks, we have lost a good deal of this pension business. Most of the cases that we have lost have been large cases. However, as the people promoting self-administration become interested in smaller cases we may lose some of these also.

To appraise the situation over-all, I would say that it has been an advantage for us to go into the pension business. I think we still have an advantage by staying in the business, but we are not writing very much of it now in competition with self-administration plans.

MR. JAMES I. DAVIDSON: At Sunset Life we became interested in the pension field about a year and a half ago. We had been funding pension plans with individual policies for some time but had never given the writing agents any real help. We were receptive to the idea of working more with pensions, because the old business going off the books was high premium business and the new business coming on was rather low premium business. As a result, our investment funds were not increasing as fast as we wished.

We felt the pension area was a growth field. However, it was not a tool for our general agency force. In the main, new business was received from brokers having some experience in pension work or was written through agents who were primarily assisted by a home office representative. We endeavored to select prospects very carefully, concentrating on savings and loan institutions, local banks, and small but profitable manufacturing concerns. We favored prospecting within contact area of our home office.

Not always, but for the most part, obtaining qualified pension leads is a home office function with us and from there on we work through a selected broker with pension experience if possible, otherwise through a general agent with ourselves furnishing direct home office assistance. A commission is always paid, but the rate would vary depending upon the home office assistance expected to be furnished. Based on our rather limited experience, our rate of closing cases has been comparatively quite high and we feel the key for us has been careful qualification and then high concentration of effort.

Any small company attempting an entry into the pension field should, I feel, have a reasonable amount of actuarial help available for assignment, as the promptness and degree of flexibility an actuary may add to carrying out an employer's wishes may be the final factor in closing the sale. With us, the actuarial department has an active continuing interest in each case from the initial calculation, through possibly helping in making the sales presentation, on towards the final issuance and servicing of the case.

Competitive premium rates and cash values were very necessary, we found, but good average size policies and high average premium were a helpful offset.

One more word might be added by me as it relates to any small company considering entry into this field. We profited greatly by obtaining technical advice from a consulting actuary who was primarily active in the pension field. It is necessary to have the benefit of someone with a long working knowledge of the subject. Even with this aid, naturally there is a lot of work to be done in your own actuarial department to get a pension operation under way.

MR. WENDELL A. MILLIMAN: I want to underscore one point which Mr. Davidson made. The small pension field is a field which does require specialists—specialists in the home office to do the job and specialists to sell the business. I have taken the attitude a number of times with small company clients that if they are in a position where they have to come to us for help in preparing the product, then they should not go into this field. The home office should have sufficient spare technical staff so that they can actually take over and do the job, and in addition the company must have the specialized marketing personnel, which may also be home office personnel, to go out and market the product.

A company can be very badly misled as to how much business the experienced pension trust specialist will bring to them when he already has outlets. Usually the man who knows and is selling pension business has satisfactory outlets with other companies. He will come to a new company only if he can find something extra from them in the form of higher commissions or more liberal guarantees, but he is not going to bring you very much business just because he likes you.