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*Financed Insurance*

A. What lapse experience has developed on business financed at or near issue through either policy or bank loans?
B. Is the amount of such financed business increasing or decreasing and, if so, why? What measures have been taken to limit the amount of such business and what are their merits and demerits?
C. To what extent is the exercise of the Fifth Dividend Option in practice being confined to policyholders interested in minimum deposit policies, and why?

MR. ROBERT MACLENNAN: National Life does not have lapse rates for financed business by itself, but for the past 3 years we have developed lapse rates for those plans on which the largest amount of financed insurance was written. On 10 payment life, the studies indicate an almost nonexistent lapse rate in the first year, a low rate in the second year, and higher than Company average thereafter. The lapse rate is especially noticeable in the 5th year, where a rate of approximately 10% has been common for the past 3 years.

The high early cash value life to 95 showed a lapse rate of about 6% for each of the first three durations. This was replaced in 1959 with a very high cash value life to 95 with redistributed commissions, which showed a first year lapse rate of 7.3%. A high early cash value limited payment endowment at 95 showed first and second year lapse rates of 18.4% and 9.5% for issues of 1958, and a first year rate of 6.4% for 1959 issues. None of these specials have been available since mid-1959 and it appears that this business has shifted to ordinary life, which showed a satisfactory first year lapse rate of 6.7% on 1959 issues.

MR. JERRY L. BROCKETT: Northwestern National markets a whole life policy providing the face plus the cash value as a death benefit if death occurs prior to age 65 or the 10th anniversary. We also market a "face amount only" ordinary life. Each of these has a moderate first year cash value. On each of these plans the first year commission is reduced 10% of the premium and the sixth year commission is increased 12% of the premium.

Study of these plans revealed that 79% of the "face plus cash value" policies had policy loans, and probably a portion of the remaining 21% were used as bank loan collateral. Only 42% of the "face only" policies had policy loans.

The "face plus cash value" policies showed 1st, 2nd and 3rd year lapse rates of 13.4%, 12.4% and 15.4% by number and 10.9%, 8.7% and 17.4% by amount. The corresponding rates for the "face only" policies were 6.7%, 5.8% and 4.1% by number and 6.6%, 5.2% and 4.9% by amount.

We can only conclude that financed life insurance has very different lapse rates than nonfinanced.

MR. ROBERT C. TOOKEY: In the public accounting firm, Peat, Marwick, Mitchell, & Co., we have studied the lapse rates for several companies' experiences under the high cash value minimum deposit business. Nearly all policies had full policy loans. Variation was very great, as shown by the following table (based mainly on 1958 issues):

| Company: | A | B | C | D |
|---|---|---|---|---|
| First Year Lapse Rate (by Amount) | 84.7% | 70.8% | 62.5% | 51.9% |

| E | F | G | H | I | J |
|---|---|---|---|---|---|
| 35.4% | 32.9% | 16.0% | 11.0% | 8.0% | 2.0% |

Analyzing each company's individual situation, it is clear that lapse rates tend to vary in proportion to the first year commission paid and inversely with the strictness of underwriting requirements regarding applicants' annual income, and the degree of agency control. Companies A through D paid total first year commission rates of 40%, while the other companies paid lower commissions and maintained a higher degree of agency control. Company I was particularly restrictive in its underwriting. Company J pays a level 15% commission for 10 years and grants the writing agent a stock option based on premium volume on business which persists into the 6th year. Almost negligible lapsation during the first 5 years is expected. Company H's minimum deposit plan requires a one-year renewable term premium the first year, and the ordinary life premium at the attained age starting the second year. Lapse rates for second and subsequent years have been about the same as the first year, duplicating the persistency expected under annually renewable term insurance.

Financed business doesn't exhibit a normal lapse pattern; renewal lapse rates do not always fall off sharply from those of the first year, but appear to be rather constant in many cases.

MR. ANDREW C. WEBSTER: It seems to me that underwriting this business is the most important factor that affects the lapse rate. Mutual of New York underwrites very strictly financially, not selling our special high cash value policy to anybody with an income of less than $15,000 per year, and our first year lapse rates are favorable, but not any better than the lapse rates for $25,000 and up on the ordinary life plan. We cut out monthly and quarterly premiums because of very poor lapse rates on this mode of payment.

MR. ROBERT T. JACKSON: Phoenix Mutual has a large volume of financed business on the books, and our first year lapse rate (*i.e.*, those

policies failing to pay the second annual premium) has been around 10.4%. It has dropped somewhat in the last year because of more severe underwriting. The second year lapse rate has been roughly $4\frac{1}{2}\%$, and the third and fourth years around 6%. Thus, even a fairly satisfactory first year lapse rate on financed business appears to be no guarantee that the business will show good persistency in the long run.

My impression is that the amount of financed business written by the industry is as great, or greater, now than it was before Regulation 39. It is more difficult for us to determine what is financed business, since we don't have first year loans available on much of our business and frequently no assignment shows up at issue. Yet we get a policy loan at the first date it is available. Some big producers say that financed business is not going to decrease because purchasers of large amounts of insurance in very high tax brackets will buy only on some basis in which initial outlay is less than the full premium required.

As measures to limit financed business, rationing, underwriting, high minimums, agency training and policyholder campaigns for repayment of loan may all prove helpful. It seems probable, however, that some change in commission incentives relating commissions to the net amount paid would be most effective, although this remedy would seem awkward administratively and would possibly introduce legal problems.

The Phoenix limits the fifth dividend option (except in New York State) to large policies, which are the ones usually financed. For the smaller policy this option would appear to have very limited use as a hedge against inflation, as is often urged, but does provide relatively small amounts of term insurance at very reasonable cost.

MR. MacLENNAN: With respect to sections B and C, National has since 1957 watched the percentage of financed business to total paid for. At first, we actually checked, 3 months after issue, to determine if the policy was assigned or had a policy loan; but, for about 2 years, we have relied on a questionnaire which must be completed by the agent and the applicant if the policy is $15,000 or more. During 1958 about 40% of our paid-for business was financed. By mid-1959 the monthly percentage was up to 60%, but with the withdrawal, at that time, of our high early cash value policies, the percentage dropped to 30% for December 1959. It stayed at this level during 1960, but in 1961 it started to climb again, reaching 45% in April. There has been a slight decline since then.

To limit financed business, we withdrew our high cash value policies in June 1959, and refused to permit first year policy loans on other plans. A few months ago we replaced our fifth dividend option with a more expensive type, making illustrations based on the option less competitive. At-

tempts to educate the field away from financed sales have been, and are being, made, but as long as these sales are easy to close, it is difficult to discourage them. Refusal to issue policies sold on a financed basis would create morale problems in the field, but home office policing of such sales introduces administrative problems. Any sudden change in company philosophy should be avoided, and attempts to reduce financed insurance sales should be of a long-range nature.

Of policies issued during the past several months with the fifth dividend option, 60% by number and 70% by amount have been financed insurance cases. These represent 85% of total financed sales. For ostensibly nonfinanced business, 20% by amount and only 10% by number have the fifth dividend option. For small policies the option is of limited value, but possibly the option is being recommended as a hedge against inflation for the larger nonfinanced cases.

MR. LAURENCE K. SMITH: Mutual Trust made the fifth dividend option available on September 1, 1958, to be used for split dollar cases. By mid-1960, we were receiving an increasing amount of minimum deposit business and a decreasing amount of split dollar business. This trend continued into 1961, principally from business in the New York City area.

We did not want such business and desired to stop its spread to other agencies. On September 1, 1961, we withdrew the fifth dividend option; and we amended the general agents' contracts in the agencies which had been submitting minimum deposit business so that, if a substantial part of the second annual premium is paid by policy loan or the policy is assigned to a financial institution, the commissions and expense allowances payable are the same as would be paid on the longest decreasing term policy. These two steps provided very effective control of minimum deposit business.

MR. CHARLES F. B. RICHARDSON: One of the greatest problems we face today is the challenge thrown out by other forms of savings merchandising about the effect of inflation on future values. The fifth dividend option, in a way, provides an answer to this problem. If you use the option as a hedge against inflation, then, depending on premium level and dividend scale, you will probably find that the protection increases each year between one and two percent, until about the time the insured is due to retire. It seems to us that this was a very cogent argument for the use of the fifth dividend option, irrespective of financed insurance.

MR. ELGIN R. BATHO: Berkshire Life has kept a record of the rate of election of the fifth dividend option since it was introduced in March of

this year. To be eligible for the option, a policy must be for at least $5,000. By number of contracts, the option has been elected on approximately 15% of eligible policies. I am quite sure that this rate of election would be considerably higher if based on amount of insurance. We do not feel that this is as high a rate as we would desire. To date, we have not had a substantial percentage of our new business subject to bank loans or policy loans.

MR. J. STANLEY HILL: Minnesota Mutual doesn't have too much of a financed business problem, largely because of our cash values which aren't high enough to make attractive illustrations. We offer the fifth dividend option primarily for split dollar business, and if it is not obviously split dollar we require a simple statement from the insured that neither the Minnesota Mutual nor any of its agents recommended a plan of financing premiums. The principal disadvantage is that we get a low volume on the option, which is expensive to handle. We have set a $25,000 minimum limit for split dollar and $50,000 minimum for any other use of the fifth dividend option.

MR. WEBSTER: I suggest that the reason financed business is decreasing is that the New York Insurance Department Regulation 39 abolished policy loans in the first year. That cut our business in half. I am not sure that the fifth dividend option is the answer to anything, although I have listened to Mr. Richardson. I think it is one of those things that has a vogue and then dies. If it is used with financed business, I am a little chary of what the lapse rates will be, if you extrapolate the rates already quoted for the first three years.