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Premium Gradations

A. Has the actual experience borne out the estimates of expense savings in graded premiums? Has it been found necessary to increase policy fees, change the bands of insurance, or change the premium differentials between bands to cover the current or anticipated expense levels?

B. What are the relative merits of policy fee and graded premium methods under today's conditions? Have any companies changed from one method to the other, and if so, what difficulties were encountered?

C. Under graded premium systems, has there been evidence of an upward trend in the expense rates within size bands now that the individual bands do not have the benefit of rising average sizes of policy to offset increasing costs? If so, how is this being taken into account in the determination of dividend scales?

Philadelphia Regional Meeting

MR. ALVIN B. NELSEN: The increased level of expense rates makes it possible to support greater premium differentials now than at the time of the adoption of the Equitable Society's graded premium system as of January 1, 1959. The distribution of business by size band and the average size policy within each band are nearly as anticipated in the premium system; 1961 issues indicate the following:

Size Class	Percentage Class	Average Size Basic Policy
Less than $2,000	1.7%	$ 1,050
$ 2,000 but less than $ 5,000	6.8	2,500
$ 5,000 but less than $10,000	18.9	5,600
$10,000 and over	72.6	14,700

With the increase in expense rates, the Society on January 1, 1962 discontinued issuing policies for less than $2,000, except in a few areas such as pension trust purchases and group conversions.

We adopted a band system of grading premiums rather than a policy fee system, for the following reasons:

1. The band system would encourage applicants to seek the lower costs in the next higher band and thereby encourage upgrading of amounts.
2. The band system required the least change in existing systems of operations.
3. A band approach was indicated by our adoption of nonforfeiture values for policies of less than $10,000 different from those for policies of $10,000 and over.

Thus far we have been satisfied with our use of the band system. For policies of very large face amounts the policy fee system does have advantages; this problem can be largely solved by the introduction of an additional higher sized band.

We have separate dividend classes for policies of less than $10,000 as contrasted with policies for $10,000 or more. Since the increase in expense rates justifies greater premium differentials, we are glad that we have separate dividend classes which make it possible to maintain greater equity. Fortunately, we have been in an era of increased interest returns which in general have more than offset any increases in unit expense rates.

MR. B. FRANKLIN BLAIR: I feel that using a policy fee is one method of grading premiums by size and that, therefore, the first question in section B might more properly be worded: "What are the relative merits of policy fee and band methods of grading premiums under today's conditions?"

Provident Mutual uses a modified policy fee method. Last year we summarized the methods used by 79 companies to vary costs by size of policy with the following results:

Method of Varying Costs by Size of Policy	Number of Companies		
	Mutual	Stock	Total
Policy Fee:			
Flat Fee	5	14	19
Modified Fee	3	12	15
Subtotal	8	26	34
Band Method	29	15	44
Total	37	41	78

The table includes two mutual companies under the band method and one stock company under the modified fee method which vary the costs by means of dividend adjustments instead of premium variation. It excludes one stock company that has 15 premium bands.

The policy fee method has the following advantages:

1. A flat extra collection charge per premium may be made on instalment premiums without complicating the calculation of premiums. Six stock companies and two mutual companies in the study use this procedure. It clearly seems more equitable than covering the costs of extra collections by means of a percentage of the premium.
2. Arbitrary divisions into bands, as well as any discontinuities at the edges of the bands, are avoided.

3. The flat policy fee method is easier to extend to policies with unlevel benefits, such as double protection and decreasing term plans.
4. A continuously decreasing cost per thousand dollars occurs as the amount increases. Under the band method the cost per thousand dollars decreases no further after the minimum amount for the top band.

Advocates of the band method frequently raise the following objections to the policy fee method:

1. The psychological sales advantage of subtracting a discount on a large policy is lost.
2. Preparation of sales proposals is more complicated in certain respects than under the band method.

Several companies have shown in actual practice that the first of these two objections can be overcome by including the policy fee in a basic premium and quoting a quantity discount to be subtracted. In regard to the second objection, we have not encountered any serious complications at Provident Mutual; we feel that fear of such complications should not deter any company, either mutual or stock, from adopting the policy fee method.

MR. GEORGE E. IMMERWAHR: I feel that the choice between a policy fee system and a band system is very much a question of knowing the psychology and selling habits of your agents.

At Monumental Life we have a policy fee of $7.50 on policies over $3,000 and $2.50 per thousand for policies under $3,000. We have two series of policies, one sold primarily under $3,000 with built-in disability and accidental death benefits and the other sold primarily over $3,000 but without such built-in benefits. In view of the selling habits of our agents, most of whom are debit agents, we have found it necessary, also, to have certain of the latter policies sell for a minimum higher than $3,000. On two plans we have a $10,000 minimum for debit agents and a $3,000 minimum for general agencies; yet on these particular plans the general agencies, who are primarily programmers, sell an average size higher than that of the debit agents with the $10,000 minimum.

Kansas City Regional Meeting

MR. RICHARD H. TALLMAN: A recent expense analysis at Northwestern National suggests that we might wish to raise our present nine dollar policy fee to upwards of ten dollars.

Originally our field force expressed some reluctance in accepting the policy fee system, primarily, I think, because the addition of a factor seems to belie the presence of a discount. However, they have since accepted it very, very well.

MR. JOHN W. LINCOLN: Although we at Northwestern Mutual have had the graded premium method since January 1957, the following considerations suggest a change to the policy fee method:

1. The present and anticipated future pressure from the field for more and higher bands to help compete with the continuous discount available in the fee method and the effect of this on the complexity and space requirements of our rate book.
2. Accomplishment of the "discount" psychology under the fee method by quoting a certain premium per $1,000 for amounts up to a stated point and lesser premiums per $1,000 for amounts in excess of this point and the consequent avoidance of some of the practical difficulties encountered in applying the pure fee approach to very small policies.

Except for the preparation of ledger statements, *i.e.*, net cost illustrations, for our agents, we would expect relatively minor difficulty in changing systems.

MR. WILLIAM M. WHITE, JR.: In 1958 we at Connecticut General adopted the graded premium method for the principal reasons that:

1. Banding would tend to encourage upgrading the size of policies.
2. A discount would be more salable than the addition of a policy fee.

The resulting bands and a recent average size per band are:

Band	Amount	Discount per $1,000	1960 Average Size
1..........	Under $10,000	....	$ 3,920
2..........	$10,000–$24,999	$1.50	12,071
3..........	$25,000 and over	2.00	41,656

Currently we are actively considering changing to the policy fee method because:

1. Actual expenses would be reflected more accurately by policy size.
2. A shift in distribution of business by size would not result in an inadequate provision for expenses.
3. Since, as demonstrated above, policies tend to concentrate at the bottom of the band, the policy fee method should produce lower premiums for most of the band.
4. From the field point of view, the continuous discount available to the larger policies is desirable.

If we adopt the policy fee method, we would charge the same rate for all policies below a given amount, thus permitting an agent to use a "discount" approach if he desires to do so. No serious resistance to a change would be anticipated, although some re-education will be necessary.

MR. JOHN M. BURLEIGH: A problem arises under the graded premium method in the case of the Internal Revenue qualified pension trust plan, where you are prohibited from upgrading the amount as you approach the breaking point at the top of the band. At Connecticut General where the premium charged for the basic plan and waiver of premium benefit exceeds what would be charged for the lowest amount of insurance permitted in the next higher band, we use the latter figure. On preliminary term insurance this results in the same premium being charged for quite a range in amounts.

MR. WILLIAM J. NOVEMBER: The Equitable has a different set of values and a different dividend scale for policies of ten thousand and over as compared with smaller policies. The advantage we see in this in enabling us to maintain equity in the future makes me feel pretty confident we are going to remain on that basis.

MR. JOSEPH W. HAHN: At Great-Southern Life we have what could be considered a combination of the two methods in that our endowment at 90 with a twenty-five thousand dollar minimum has different values than our whole life with a lesser minimum although the base premium and policy fee are the same.