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Persistency

A. What has been the recent experience of companies as to
   (i) first year lapses,
   (ii) surrenders at policy durations with appreciable cash values,
   (iii) total voluntary terminations?
B. What factors contribute to the current level of lapses and surrenders? Has there been a change in recent months?

Philadelphia Regional Meeting

DR. GEORGE CHERLIN: At Mutual Benefit Life first year lapse rates for first policy years ending in the five calendar years 1956–1960 are all higher than similar rates for first policy years ending in the years 1951 through 1955. We note that at the time of changing our premium rates to pricing by size there was an increase in the voluntary termination rates for each of the first ten policy years for a period of a year or two. This suggests that the theory of pricing by size has to be applied carefully to avoid an undesirable volume of replacements.

Recent experience running through January 1962 indicates no significant change from a year ago and two years ago in the volume of surrenders at policy durations with appreciable cash values or in the volume of total voluntary terminations, but there has been a noticeable change from the lower levels of ten years ago.

We are coming to the opinion that replacement is far more extensive than we formerly realized. Probably many terminations which seem to our company to be outright elimination of coverage are replacements with business placed in another company without the facts coming to light.

MR. CHRISTOPHER H. WAIN: The over-all Ordinary lapse rates of the Prudential in 1961 were about two thirds greater than they were in 1955 and about 5% greater than they were in 1960. Review of lapse experience in recent months, however, indicates that our lapse rates reached a peak last summer and have been improving since. The change is most marked in the results for the first two policy years, which show an improvement of better than 1% in our Regular Ordinary business and 2% for Debit business. Renewal lapse rates also show improvement, but much smaller. Perhaps most significant, although our sales of individual insurance for the first two months of this year were $50,000,000 less than those of 1961, we actually had a greater increase in insurance in force. We believe that this improvement is due to the following major measures that were introduced late in 1961.

1. In our Debit business, we introduced a system under which in effect total earnings are substantially affected by the agent's renewal lapse rate. In

addition to the basic new business commission we make a supplementary payment that is lower for a man with a lapse rate above company average and higher if his rate is better than average. The difference in these additional payments can easily be one third of new business commissions earned.

2. We installed throughout the company a simple rule reducing the first year commissions on policies that are replacing other Prudential business. In general, first year commissions are granted only on increases in the premium income.

MR. WILLIAM J. NOVEMBER: As Dr. Cherlin pointed out for his company, there has been no significant change in the rate of surrenders at the Equitable Society during the past three years, but there has been a noticeable change from ten years ago.

Based on valuation in-force data, the percentage increases in voluntary termination rates from 1950 to 1960 for premium-paying policies at the Equitable Society were as follows:

Mean Durations	Percentage Increase
1 & 2	18%
3 to 5	35
6 to 10	70
11 to 15	117
16 to 20	120
21 to 25	50
26 and later	About 30

We have experienced the highest relative increase in terminations at policy durations at which cash values are significant in amount and may therefore be more susceptible to replacement propositions. As to the sharp drop-off in the percentage increases after twenty years, the policyholder may have reached an age when he has no interest in new insurance or is uninsurable, or he may find his dividends an incentive to keep his old policy.

It should be pointed out that while the percentage increases are high at the 11th to 20th durations, the absolute termination rates were still good, as the 1950 base for those durations was only a 1% to 2% termination rate. For earlier durations the smaller percentage increases were equivalent to larger absolute increases.

MR. EUGENE W. BATES: Since it is generally felt that the persistency of Industrial business is more responsive to the vicissitudes of the economy than Ordinary business, we have for comparison reviewed the first year lapse experience at Western and Southern for this line of business as well as for Ordinary, excluding Monthly Debit Ordinary. Table 1 shows the trend from 1950 to 1961. The Ordinary rate is the rate of nonrenewal in the second policy year.

The marked increase in the Ordinary rate in 1957 is due to the introduction of Ordinary business on a monthly mode in that year. From 1957 to 1961 the Industrial rate, in contrast to the Ordinary, has shown a substantial increase, from 12.8% to 22.7%. The Industrial trend may be

TABLE 1

Issues of	Ordinary Rate of Nonrenewal in 2nd Policy Year	Year of Lapse	Industrial 1st Year Lapse Rate
1950......	9.3%	1950......	11.4%
1951......	10.4	1951......	10.6
1952......	10.9	1952......	11.6
1953......	14.4	1953......	11.2
1954......	12.7	1954......	12.6
1955......	12.5	1955......	11.1
1956......	13.1	1956......	11.9
1957......	18.2	1957......	12.8
1958......	18.2	1958......	16.3
1959......	18.0	1959......	18.1
1960......	19.2	1960......	20.6
		1961......	22.7

TABLE 2

LAPSES ON POLICIES PAID 6 MONTHS OR LESS

Issues of	Ordinary	M.D.O.
Jan.–June '59....	10.4%	16.2%
July–Dec. '59....	12.1	19.0
Jan.–June '60....	11.7	18.8
July–Dec. '60....	12.9	19.7
Jan.–June '61....	11.2	17.1

somewhat explained by the increasing tendency for the better Industrial persistency risks to purchase M.D.O. and Ordinary insurance, leaving the less desirable persistency risks in the Industrial line. The effects of 1954 recession are apparent. The effect on Ordinary in that year (1953 issues) was more severe than on Industrial. Since 1954 there has been an increase in first year lapse rates through good and bad times.

In an effort to obtain more current experience, we computed the lapse rates for Ordinary and Monthly Debit Ordinary policies exposed to six months of lapse risk. Table 2 shows the result.

The trends are similar here. The latest issues studied (Jan.-June, 1961) show an improved persistency concurrent with the latest improvement in the economy.

Ratios of surrenders and total voluntary terminations to mean insurance in force are shown in Table 3.

The ratios have increased each year. The increase in surrender percentage in 1961 was nearly twice that of 1960, but the increase in Industrial surrender percentage was one third less. The opposite was true in total voluntary terminations, with the rate of increase declining for Ordinary and rising for Industrial.

TABLE 3

RATIO OF TERMINATIONS TO MEAN INSURANCE IN FORCE

	SURRENDERS				TOTAL TERMINATIONS			
	M.D.O. & Ord.	Δ	Ind.	Δ	M.D.O. & Ord.	Δ	Ind.	Δ
1959....	1.977%		4.100%		6.155%		12.087%	
		.136%		.809%		1.169%		.879%
1960....	2.113		4.909		7.324		12.966	
		.231		.546		.477		2.012
1961....	2.344		5.455		7.801		14.978	

I believe that this pattern indicates the greater sensitivity of the Industrial business to the economic cycle. In 1960, economic conditions were depressed and Industrial surrenders increased. In 1961, business conditions improved and, although total lapses were up even more, the increase in Industrial surrenders was slowed down.

Another factor affecting the rate of Ordinary surrenders is the availability and use of the policy loan. The inclusion of policy loans increases the 1959, 1960 and 1961 Ordinary surrender rates to 2.098%, 2.262% and 2.506%, respectively.

Some of the factors which contribute to the current level of lapses and surrenders include (1) the tendency in Ordinary to more frequent modes of premium payment, with the preauthorized check being the only rein on a runaway monthly mode lapse, (2) the glitter of mutual funds, (3) a general postwar aura of the temporary nature of everything and (4) the de-emphasis of conservation in agents' compensation during the past five years.

In the past 14 months, through February 1962, Industrial surrender rates at Western and Southern have shown a definitely improving trend, but the Ordinary trend is much less clear. We have only to look at our asset share calculations to see the case for improvement in persistency in the early policy years. If the insurance industry is to retain its place in the competition for investable funds, it must find ways and means to improve the persistency of its business.

MR. VICTOR E. HENNINGSEN: The Commissioner of another state recently asked me to act as referee on a replacement transaction which, of course, did not involve our company. The agent of the replacing company argued that the cash value of the replaced policy should be considered a side fund earning interest to reduce the cost of the new policy. Now, if that is a valid approach, I could only conclude that the higher the cash value and the older the policy, the higher the interest earnings would be and therefore the better the reason for replacement.

I told this Commissioner that I would suggest that he ask the replacing company whether it would be a good idea for their agents to replace virtually all their existing business on the basis that the interest on the cash value as a side fund would reduce the cost of insurance at the attained age below that of existing insurance.

MR. ERNEST J. MOORHEAD: Our experience indicates that in studying termination rates it is desirable to examine nonpension business and pension business separately, since their patterns are quite different and the surrender rate of pension business is heavily affected by terminations of single large trusts. In recent years the nonpension business of New England Life has had a surrender rate which, although rising, has remained below 2% of business in force. The corresponding rate on pension business has been running around 6%, and even higher in years when large individual trusts have terminated.

Kansas City Regional Meeting

MR. WILL R. MULLENS: My comments will be directed primarily to recent experience of the Business Men's Assurance with respect to first and second year lapses and factors contributing to the current level of lapses.

Our philosophy has been growth through writing as much business as our financial position will permit. With such emphasis on growth, there will be a certain percentage of our new policyholders whose conviction of the need for our product is minimal. Our first year lapse rate reflects this percentage. Since 1953 our true first year lapse rate has varied from 32.5% for 1953 issues to a low of 30.9% for 1957 issues and a high of 37.8% for

1959 issues, our last full year of experience. Second year lapse rates were at a low of 9.7% in 1958 and a high of 12.8% in 1955.

We also calculate an approximate 2 year lapse ratio similar to the LIAMA ratio. Between 1958 and 1961 this ratio has increased from 40.5% to 46.7%. From this result we expect our true first year lapse rate to increase for issues of 1960 and 1961.

Another significant factor in our case is the increase in the percentage of monthly business from 40.7% in 1950 to 74.0% in 1961. A recent survey of one month's lapses revealed that 46.7% of the lapses occurred within 6 months of issue and 22.7% within 2 months. Despite these rather high rates, we are partially protected by certain salesmen's compensation penalties.

Surprisingly, end results are not too bad. By analyzing, for ordinary insurance, the ratio of increase in insurance in force to paid-for issues for a group of 22 other companies, we found that our figure of .47 in 1960 and .41 in 1961 puts us in the upper range of the group.

At the risk of being a heretic, I would suggest the following:

1. A high first year lapse ratio goes hand in hand with rapid growth.
2. If initial costs are kept down, sound growth can be achieved despite a high early lapse ratio.
3. Poor persistency in early years may result in better than average persistency in later years.
4. Overzealous efforts to improve persistency may result in failure to achieve growth objectives or may produce other undesired effects on the company operation.

MR. DALE R. GUSTAFSON: To attempt to improve persistency the United Benefit has tried drastic measures, such as refusing to issue business having a persistency rating below a certain level. The result was that new business was reduced without improving persistency.

MR. JOHN W. LINCOLN: I accept the challenge to speak on this subject and believe I can state very briefly what I have to contribute. The Northwestern Mutual has a first year lapse rate of 7.5%, and that is much higher than it has been. In recent years it has been as low as 5%. We don't have any monthly business; I think that probably has something to do with it. However, our rate of growth has not been anything at all like the Business Men's. In fact, it hasn't been anything to crow about. I think it was about .6% last year, or possibly −.6%, I don't quite remember. The point that I want to make is simply that I don't think that failing to grow fast has really hurt us at all, but I think having a low first year lapse rate is doing us a lot of good.

MR. WILLIAM J. NOVEMBER: Any condoning of high lapse rates simply because a company wants to grow is most regrettable to me. A lack of concern for the cost to the policyholder will not do the life insurance industry any good.

MR. CHARLES F. B. RICHARDSON: The latest LIAMA report on lapse rates indicated a tremendous range in these lapse rates both for the larger companies and for the smaller ones. Almost all of the companies with low lapse rates, particularly in the group of larger companies, were general agency companies. The fact is that branch office companies with few exceptions have a form of compensation that does not encourage persistent business. To attempt an improvement in the Berkshire's 21% first year lapse rate we have reduced our new agent financing from 90% of annualized commissions to 60% on quarterly and monthly business.

MR. JOSEPH W. HAHN: The Great Southern at one time financed agents on a percentage of annualized commissions. Financing is now based strictly on earned commissions. In any case there is no formula that will take the place of good agency management.