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REPORTS ON TOPICS OF CURRENT INTEREST

New York Regional Meeting

AMERICAN ACADEMY OF ACTUARIES

Last year we reported to you that a bill to provide a federal charter for the American Academy of Actuaries was introduced in the Senate by Senator Dodd of Connecticut and was passed there quite promptly. A similar bill was introduced in the House by Congressman Boggs of Louisiana, but by that time it was rather late in the session. Congress adjourned before the bill was passed.

On January 12, 1965, Congressman Boggs of Louisiana again introduced in the House a bill to provide for an American Academy of Actuaries. With a few minor changes and corrections, he reintroduced the bill on February 8, 1965, and it is H.R. 4470.

The House bill has been referred to the House Judiciary Committee. It will be considered by a subcommittee, and efforts have been made to have influential people contact the nine subcommittee members. Congressman Rogers of Colorado is chairman of this subcommittee.

Meanwhile, Senator Dodd of Connecticut introduced the bill in the Senate (S. 1154) on February 17, 1965. There were twenty-six cosponsors. The bill was referred to the Senate Judiciary Committee. Senator Dodd and several of the cosponsors are members of this Committee. Every effort has been and is being made to contact the other members of the Committee.

We are confident that the Senate will pass the bill rather promptly. It is probable that the House Judiciary Committee will require hearings, but we are hopeful that action in the House will not be unduly delayed.

Last fall when the House failed to pass the bill, the question arose as to whether it would be advisable, in order to save time, to attempt to get a charter in a state or in the District of Columbia. This question was discussed by the Joint Committee on Accreditation. It was decided that there were real advantages in having a federal charter from the standpoint of general prestige and recognition and seeking accreditation in the various states. If for some reason Congress should again fail to pass the bill this year, we would still have the alternative of getting a charter in a state or in the District of Columbia, and, if this should be

found necessary, we understand that such a charter could be obtained rather quickly.

If Congress passes the Academy bill within the next few weeks, it may still be possible this year to initiate some legislation on accreditation in a few of the states. In any event, efforts are being made in a number of states to conduct some research on the legal problems which may be encountered in obtaining legislation for certification of actuaries or administrative orders for accreditation of actuaries.

HENRY F. ROOD

ACCREDITATION—CANADIAN DEVELOPMENTS

Developments in Canada have been reported to the Society by Mr. J. E. Morrison (see page D8, Vol. XVI) and by Mr. N. E. Henricks on my behalf at the Annual Meeting in November 1964. As a new actuarial organization has now been formed in Canada, it would appear to be an appropriate time to summarize developments to date:

1. Until March 1965 all, or nearly all, practicing actuaries in Canada were members of the Canadian Association of Actuaries. The majority of these were Fellows or Associates of the Society of Actuaries.
2. In March 1965 the Parliament of Canada, by private bill, incorporated a new organization, the Canadian Institute of Actuaries. The initial membership in the Canadian Institute of Actuaries is identical to the membership of the Canadian Association of Actuaries which organization was automatically dissolved upon the incorporation of the Institute.
3. Future new members of the Institute will be limited to Fellows of the Society of Actuaries, the Casualty Actuarial Society, the Institute of Actuaries (Great Britain), the Faculty of Actuaries in Scotland, and those who have established to the satisfaction of the Council of the C.I.A. that they have passed examinations of an actuarial organization equivalent to the exams required of a Fellow in one of the four actuarial organizations I have just named. Persons becoming Associates in the future are not eligible for membership in the C.I.A. but may enrol as "Students."
4. At the present time many members of the Canadian Institute are only Associates of the Society and for that reason we have established a designation "Fellow of the Canadian Institute of Actuaries." The Fellow in the Canadian Institute of Actuaries is a person who is a Fellow of one of the other four actuarial organizations or a person who is an Associate with ten years' actuarial experience of a nature approved by the Council of the Institute.
5. *Canadian Residence Requirement*
   For the Canadian Institute to be a basis for accreditation and licensing we feel that its membership must consist predominantly of Canadian residents. Accordingly, the by-laws of the Institute require that new members be Fellows who are residents of Canada or who establish to the satisfaction of the Council that their responsibilities require them to furnish actuarial advice in Canada or sign an actuarial certificate required by Canadian statute or regulation. We hope that present members of the Institute who are not residents of Canada will drop their membership and become "Correspondents."

The standards for Fellowship in the Canadian Institute of Actuaries have been designed to be acceptable to federal and provincial super-

visory authorities. Although we have not yet formally approached any government officials, we hope that some of the laws and regulations will be quickly amended to designate a qualified actuary as one who is a Fellow of the Canadian Institute of Actuaries.

The Committee on Qualification and Accreditation of Actuaries of the Canadian Institute of Actuaries is just now turning its attention to the question of provincial certification or licensing. It is therefore too early to give any indication of how successful we may be or what specific legislation we will recommend. It is apparent that in this area we are trailing our American colleagues, but I am sure that the work which has been done in the United States will be very helpful to us in our deliberations.

I would like to conclude these few remarks with an observation that Canadian actuaries value their membership in the Society of Actuaries and plan to continue it. It may be that at some time Canadian actuaries will feel the need to have some exams relate specifically to the practices and the laws in Canada, but I hope that any developments along these lines will be with the close cooperation and approval of the Society.

E. SYDNEY JACKSON

COMMITTEE TO STUDY PENSION PLAN PROBLEMS

At the last meeting of the Board in 1964, the President was authorized to appoint a special committee on pensions. This committee was selected by Mr. Henningsen to include both consulting actuaries active in the pension field and company actuaries with special interest in group annuities and insured trusts. Broad geographic representation was also achieved. The members of the committee are:

Henry E. Blagden
John K. Dyer, Jr.
Walter L. Grace
Frank L. Griffin, Jr.
Wendell A. Milliman
Joseph Musher
Ray M. Peterson
George V. Stennes
Charles L. Trowbridge
William K. White
John H. Miller, *Chairman*

The committee has been asked to consider, first, "the role and responsibilities of actuaries in explaining and publicizing the actuarial principles and practices necessary to insure sound operation of pension funds in the public interest."

In carrying out this first assignment, we are encouraging the writing of books, articles, and papers which will be helpful to the public, particularly employers, labor union officials, legislators, government administrators, and pension fund trustees, in gaining an understanding of the basic principles underlying the sound operation and financing of pension funds, and the practices by which these principles can be made effective. Through the Pension Research Council and the individual work of actuaries and other students of pensions, there has been created quite a bookshelf of literature on pensions, but, respecting the criteria governing the choice of funding methods and cost methods appropriate in individual circumstances, we feel that there is a significant void.

The papers on funding written by Mr. Trowbridge are classics of actuarial literature and invaluable to the reader with the prerequisite technical understanding. Similar information directed to a nontechnical readership is needed. I am happy to say that one of the members of the Society is presently engaged in writing a book which, we expect, will go a long way toward filling this requirement. We hope that other actuaries will find the time and inspiration to remove the bushel from their lamp and let their light shine out where it is most needed.

To further the study of these principles and practices, two subcom-

mittees have been formed—one to deal with assumptions underlying the determination of costs and liabilities and the other to make a study of cost and funding methods. Obviously there is a great deal of interrelation between these two subjects, hence the respective groups will work closely together. The purpose of these studies is to illustrate, through mathematical models, or by other means, the consequences of changes in actual experience or plan specifications, the interrelation of the various contingencies, and the incidence of recognized costs under different funding methods. There is certainly no intent to propose the use of any specific assumptions or methods, or to suggest standards or norms.

A third subcommittee will address itself to the question of vesting and portability of benefits, considering the actuarial implications and aspects, the practical issues faced by the employer, and the administrative problems in the payment of pension benefits.

A fourth subcommittee is concerning itself with a study of various proposals that have been made involving governmental guarantees. The success or apparent success of such programs as FDIC and FHA may have led to the superficial conclusion that guarantees by government could also serve a useful purpose in the field of pensions. After delineating the various hazards to which security of pensions is vulnerable, consideration can be given to the propriety and feasibility of measures which would require the tax-paying public to underwrite any of these risks.

The second assignment given to the new committee is to study the "obligation or responsibility of the Society in respect to these problems." We are all aware that our constitution states that "no resolution expressive of opinion shall be entertained at any meeting of the Society of Actuaries." I do not believe that this provision has ever been interpreted as to its applicability to a public expression of actuarial opinion endorsed by our Board of Governors, and presented in such manner, for example, as has been employed by the Institute and Faculty in voicing principles that should govern the making of commitments to future generations under national pension plans. The committee, of course, will make its reports directly to the Board of Governors and any distribution of such reports will be made only on the Board's instructions.

Whatever restraints there may be on expression of opinion by the Society, there are some who feel that, in view of the tremendous dependence of millions of our citizens on private pension plans, the Society must continually concern itself with the actuarial aspects of these plans and must ask itself the question: Do actuaries collectively, as members of a professional organization, have a responsibility to the public going

beyond their already acknowledged responsibility for the competence and the professional conduct of individual members?

The committee is, of course, keenly interested in the recently released report to the President on Private Employee Retirement Plans by the President's Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs. For those who have not had an opportunity to read the report or an adequate summary, I will mention a few highlights, relying for this on the excellent analysis by Professor Dan M. McGill, published in the March 1965 issue of *Trusts and Estates*. The report pinpoints the following "four aspects of private pensions that seem to justify some inquiries on the part of the federal government": (1) The recognition of the importance of this source of old-age economic security, with about 25 million employees covered by private plans, i.e., about one-half of the employees in private nonagricultural establishments. (2) The importance of private pension plans as a source of savings, representing as they do between six and seven billion dollars yearly; the importance of these savings as a source of economic growth; and the implications of the fact about one-third of the new money is going into common stocks. (3) The impact of private pension plans on the utilization of manpower, with particular reference to effects on labor mobility, employment of older workers, and encouragement of early retirement. (4) Considerations of national policy with respect to the tax treatment of pension plans and pension benefits.

The report should have our careful study and discerning consideration. There is and will be disagreement with many of the recommendations made in the report, but we can all agree with the concluding statement in Secretary Wirtz' letter of transmittal, ". . . that broad public discussion of the report can contribute to a better understanding of the nature and character of private retirement programs."

The formation of this special committee on pensions represents simply another expression of the Society's concern with and interest in pension plans as exemplified over the years by the presentation and discussion of relevant papers, by informal discussions and panel discussions, notably the one which took place at our Annual Meeting at Atlantic City in 1963. The members of the Committee hope that through their efforts and by stimulating the interest of others they will be able to contribute to the broadening of knowledge and understanding, by all concerned with pension plans, of the fundamental principles and issues involved.

JOHN H. MILLER

THE MEDICARE BILL

The Medicare Bill, H.R. 6675, as you all know, has passed the House of Representatives. The Medicare portion of the bill, involves three separate programs and has been called a three-layer cake, although it is an unappetizing dish looked at from the viewpoint of private health insurance.

The part which probably should be called the middle layer provides hospital and nursing-home benefits for all over 65, paid for by a payroll tax on those paying social security taxes. This is essentially the provisions of the King-Anderson Bill, H.R. 1, which was introduced at the beginning of the congressional session. The lower layer of the cake is an expansion of the Kerr-Mills Program for benefits to the aged who are medically indigent.

The top layer, which was added by the Ways and Means Committee and which surprised a good many people, provides medical services and also hospital services in mental hospitals. It is essentially what could be called a comprehensive major medical program with exclusion of the benefits provided by the King-Anderson part of the bill. This is voluntary for those over 65, and the coverage is to be paid for by those who elect to receive the benefits. The charge is to be $3.00 per month per individual, and an equal amount is to be supplied by the government from general revenue.

Both the top layer and the hospital and nursing-home benefit layer provide for claim payments by state or private agencies, and in the case of the top layer this could include life insurance companies. There is doubt that the life insurance companies will elect to try to take advantage of this possibility of claim administration. Theoretically at least, life insurance companies could take part in the claim administration of the hospital and nursing-home benefits. However, the provisions there are so drafted that it is extremely likely that Blue Cross will become the administrator, at least in many areas.

The third layer of medical benefits reflects the criticisms made of the King-Anderson Bill. The King-Anderson Bill was criticized from all possible standpoints, and two other bills were introduced in the Congress calling for different approaches—the Byrnes Bill and the Tower-Herlong Bill. Some of the provisions of these bills were written into the third layer.

The King-Anderson Bill was criticized because it was compulsory, because it used Social Security financing, and because it provided only hospital and nursing-home benefits and failed to provide medical benefits. The third layer takes account of all these criticisms. It is voluntary, is financed from general revenue, and it provides the medical benefits which the King-Anderson Bill lacked.

The critics, which included the insurance companies, of course, hardly suspected this result. The bill is now before the Senate. The medical benefits layer and other provisions will be strongly opposed in the Senate, but as to whether the opposition will be successful, the question is greatly in doubt.

The bill poses serious questions for private health insurers. The first programs that come to mind are the various state-65 plans and other programs for mass enrollment benefits for those over 65. However, it also poses questions for all other health insurance sold to those below 65.

The fees and charges of hospitals and doctors will undoubtedly be affected by the bill. The bill does not provide for regulation of fees but provides for payment of reasonable charges, and the agencies which administer the claims under the bill will be charged with the responsibility of seeing that only reasonable charges are made by doctors and hospitals.

The provisions of the bill affecting OASDI benefits also will have some effect on private insurance. The most important change is that the total and permanent disability benefits will now become, under the OASDI program, total disability benefits. There will no longer be any requirement of permanence. There is, as you know, a six-month waiting period, and under the bill, payments are to start with the last month of the waiting period, which will have an effect on private insurance providing loss of time benefits.

GEORGE H. DAVIS

FORMATION OF NEW LIFE INSURANCE COMPANIES

The formation of a new stock insurance company in the state of California requires the issuance of a permit for the sale of its stock by the Insurance Commissioner. In order for the Commissioner to issue such a permit he must find that (*a*) the proposed plan of business of the applicant is not unfair, unjust, or inequitable; (*b*) the applicant intends to fairly and honestly transact its business; and (*c*) the securities the applicant proposes to issue and the methods to be used by it are not such as, in his opinion, will work a fraud upon the purchaser thereof, or upon other stockholders or policyholders of the applicant.

The minimum statutory requirement in California as to capitalization is $500,000, that is for combined capital and surplus, if accidental death or premium waiver benefit is to be written. It would be $400,000 if life insurance only is to be written without the supplementary benefits.

However, the departmental position has been that, in order for the finding to be made necessary for the issuance of the stock permit, a demonstration should be made indicating that the applicant would have at least a reasonable chance of success as a business venture. As implementation thereof, biographical sketches are required as to the principal parties involved, i.e., the promoters, officers, and directors. As a minimal matter, the filing should show that the proposed company will be equipped with an experienced home office administrator, an experienced underwriter, and will receive competent actuarial advice. Also an actuarial projection is required based upon realistic assumptions, and certified to by a qualified actuary, to indicate whether the initial capitalization proposed would be adequate for the undertaking. The realistic assumptions used must give effect to the actual policy forms the applicant intends to write, and the premium rates to be adopted, the commissions and other expense contemplated, reinsurance contemplated, the market which the company proposes to reach, federal income taxes, as well as the usual assumptions as to mortality and interest earnings. If participating policies are to be written, a reasonable dividend scale must be projected.

A realistic actuarial projection usually indicates the need for initial capitalization well in excess of the minimum statutory requirement. However, the initial capitalization needed would, of course, be lessened if the company contemplates operation in some special or semicaptive market

in which it can actually write business at an acquisition expense less than rates current in the industry.

The California Insurance Commissioner has indicated some concern with the relation to the problems arising from the sale of stock in new companies to so-called "unsophisticated" investors, as well as the speculative increase in stock prices which has occurred in some of the new life insurance companies. Accordingly, he has requested the staff of the department to put in effect certain principles in passing upon applications for security permits for life insurance companies. These principles were established in November 1964 and later amended in January 1965 to reflect the tentative views of the department, as to the fairness or unfairness of specific aspects of a proposed issue. For the time being these principles will be followed on an experimental basis, and it is contemplated that hearings will be initiated in 1965 to promulgate regulations embodying them, at which time the department will have the benefit of experience with these principles in then deciding upon the exact substance and form of the regulations needed to accomplish objectives without unnecessary burdens or restrictions on the formation of legitimate and sound new ventures.

These principles are applicable to all original issues for new life companies, whether foreign or domestic. The principles referred to are as follows:

1. Complex security structures involving more than one class of stock are disfavored. The issuance of tradable options, rights, and warrants will not be authorized.

2. On initial issue, selling price per share should not be less than $50.

3. The promoters and organizers and all initial officers and directors as a group shall purchase a substantial portion of the original issue for cash on the same terms and conditions as shares are offered to other investors. Ordinarily, such portion of the issue to be purchased by such persons as a group shall be not less than 25 per cent of the first $1,000,000 and not less than 15 per cent of the excess over $1,000,000. Although such persons need not divide such purchase among themselves equally, ordinarily, each should make some substantial investment unless some persuasive reason for not doing so is advanced.

4. The issuance of options to promoters should not be authorized except in connection with an original issue. Such options should be authorized only if: (*a*) The total number of shares covered by such options will not exceed 10 per cent of the number of shares initially sold and issued for cash. (*b*) The exercise price stated in such options is not less than the price at which shares are sold to the public investors, at

the time such options are granted. (*c*) The options are nontransferable, except on death or by operation of law, and are not exercisable more than five years after date of issue. (Issue of such options after the release of the proceeds of cash sale of shares from impound, or the grant of a certificate of authority, whichever is earlier, should not be permitted.)

Such options are a form of promotional expense and should be justified as such by a showing of the nature of the services or other consideration justifying the grant of the options. The aggregate of all organizational expenses and promotional expense, including the value of such options (as determined by the Board of Directors) shall not exceed 10 per cent of the total amount actually paid on its capital stock.

5. The persons investing pursuant to paragraph 3 should be required to execute an appropriate agreement with the company for the benefit of the company and all shareholders providing that for the periods hereinafter mentioned from the date of the completion of the original issue or grant of a certificate of authority, whichever is later, they and each of them will not sell, transfer, or encumber except by operation of law any shares acquired by them in satisfaction of the requirement of paragraph 3 above or in exercise of promotional options without the prior written consent of the Commissioner. It will be permissible for each such person to dispose of these amounts of the aggregate of his said shares after elapsation of the following indicated periods: 5 per cent after 1 year; an additional 5 per cent after 2 years; an additional 10 per cent after 3 years; and an additional 20 per cent after four years, and the remainder after five years.

Some reasonable method of preventing transfers in breach of such an agreement should be required (e.g., restrictive legend on certificate).

6. Options to be granted to agents as compensation for production of insurance business should, in addition to meeting other applicable requirements of these principles, be authorized only if they are to be issued pursuant to a reasonable plan described in the application and which contains provisions:

a) Relating the grant of the options to some meaningful criteria of production viewed from the standpoint of the value of the type of business written to the company.

b) Affording some assurance of persistency of the business written as a condition to full vesting of the option right. Ordinarily, the exercise of the option right should be conditioned upon persistency of the policies for which it is credited for at least five years.

c) Providing for the grant of the options at an exercise price or prices bearing a reasonable relationship to the fair market value or market

price (at the time of granting the options) of the outstanding shares of stock or the selling price of any concurrently issued cash shares. The Board should in the case of each application make formal findings by resolution: (1) that the price at which the options are proposed to be issued is under the circumstances fair, just, and equitable to all parties concerned and (2) as to the actual fair market value or market price of the stock at the date of the resolution. The option plan should provide for some method by which the directors are responsible for establishing or approving the exercise prices.

The permit should require that there be filed with the Commissioner quarterly a written notification (copy of the resolution duly certified) of each such finding and price determination by the Board, together with a statement of the bases and justification for the value determination by the Board. If the Commissioner does not object in writing thereto within 30 days after receipt of such notice, options may be granted during the period covered by the resolution at the price so determined by the Board of Directors.

d) The options should require exercise within six months of the date on which they become exercisable.

7. The total number of shares subject to outstanding unexercised option rights of all types, including promotional options, employee incentive options, and agent options, should not at any time exceed 20 per cent of the number of outstanding shares.

These principles, of course, cover only a limited number of the problems presented by stock permit applications. Moreover, it should be emphasized that each application must be evaluated with a view to all elements of the proposed issue to determine whether it meets the statutory test of the finding which must be made under the Insurance Code. No set of policy principles can cover every possible situation which may arise; nor is any particular requirement necessarily applicable to every proposed offering. However, the desirability of the greatest possible degree of uniformity in administration of the Insurance Securities Law suggests that exceptions should be allowed from these principles only where a strong showing of special justification is made in a particular situation.

CHARLES MEHLMAN

MR. ANDREW C. WEBSTER presented the reports on American Academy of Actuaries and Accreditation—Canadian Developments previously presented at the New York Regional Meeting by Henry F. Rood and E. Sydney Jackson, respectively.

MR. BRUCE E. SHEPHERD presented the report on Committee to Study Pension Plan Problems previously presented at the New York Regional Meeting by John H. Miller.

MR. VICTOR E. HENNINGSEN presented a summary of the discussions and considerations regarding the Proposed Rules Governing Valuation of Securities and Mandatory Securities Valuation Reserve which have been under study by a Joint Committee of the American Life Convention and the Life Insurance Association of America.

MR. HENNINGSEN also summarized the memorandum submitted to the Treasury Department by the ALC-LIAA suggesting the immediate need for updating the table of Uniform One-Year Term Premiums set forth in Revenue Ruling 55-747 (PS 58) for determining reportable costs under individual life insurance policies used in pension plans and split dollar plans.