

# TRANSACTIONS

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## DIGEST OF REPORTS ON TOPICS OF CURRENT INTEREST

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### RECENT DEVELOPMENTS IN SOCIAL SECURITY IN THE UNITED STATES

MR. ROBERT J. MYERS: An element that can have a very important effect on the future development of the social security program in the United States has recently arisen, namely, the concept of a consolidated budget for the United States government. Previously, the operations of the social security trust funds were outside the budget of the United States government, which thus only reflected the general governmental operations. As a result, any excess of income over outgo for the social security program did not affect the budget balance. Of course, for purposes of economic analysis, the effect of the social security operations has in recent years been considered in combination with the regular budget.

In 1967, a bipartisan commission appointed by President Johnson recommended a number of changes in the content and manner of presentation of the budget. This commission recommended that the budget concept be changed to the consolidated approach of considering the operations of the social security trust funds as being *within* the budget. This was done for the first time for the budget for fiscal year 1970 (the year ending June 30, 1970). For the first time in a number of years, the budget showed a surplus (about \$2 billion), but this was entirely due to a \$7 billion excess of income over outgo for the social security system. In other words, by the former budget concept a deficit of about \$5 billion would have been shown.

Persons who have not been closely in touch with the operations of the social security program in recent years may be surprised that there are currently such sizable excesses of income over outgo, resulting in a considerable growth in the size of the trust funds. During the late 1950's and

early 1960's, the income and outgo were in fairly close balance, and the assets of the trust funds remained relatively low. For example, in fiscal year 1966, income and outgo under the three payroll-tax-supported programs (OASI, DI, and HI) were in almost exact balance. In the next three fiscal years, however, income exceeded outgo by roughly \$4 billion each year. Such excess of income over outgo is, under present law, expected to increase significantly in the future from the previously mentioned \$7 billion for the fiscal year 1970 to as much as \$14 billion for fiscal year 1973.

These sizable excesses of income over outgo, which mean increases in the trust fund assets, have been viewed with considerable enthusiasm by economic planners, since they tend to "cool off the economy" by syphoning-off purchasing power—and thus have the same effect as would increases in income taxes and other taxes, which might be difficult to obtain in a direct manner. Furthermore, with a consolidated-budget approach, such excesses of income over outgo in the social security system make the over-all budget picture appear more favorable.

The consolidated-budget approach can have serious effects on the development of the social security program. Specifically, proposed amendments may tend to be considered more for their short-range fiscal effects, as they will have an impact on the previously established budget, rather than for their long-range effects. This would seem to be an unfortunate situation, if it should occur, since, unlike many other types of legislative actions, changes in a long-range, insurance-type program are usually of permanent significance.

Specifically, the emphasis might be laid only on the fiscal effects for the immediate future. Effective dates for legislative changes might be established solely for the effect that will be produced on the current or next year's budget rather than for what would seem to be proper on policy or administrative grounds. Too, changes might be made that have significant long-range cost aspects but an effective date deferred for some period into the future would be established, and thus the short-range budget planners would feel no concern over the matter because it did not affect the budget with which they were working.

Next, let us consider certain social security proposals that have been made recently. Just before leaving office, President Johnson made certain recommendations. On the benefit side he proposed an across-the-board increase of 10 per cent, with the minimum primary insurance amount being increased from \$55 to \$80 (and to \$100 for persons with twenty years of coverage). He also proposed (1) that the earnings or retirement test be changed, to keep it up to date with earnings trends and

to make it somewhat more flexible—that is, to raise the annual exempt amount from \$1,680 to \$1,800, to continue to have the “\$1 for \$2” reduction band apply to the next \$1,200 of earnings, and then to have a “\$3 for \$4” band (instead of a “\$1 for \$1” band); (2) that the definition of disability should be liberalized so that the waiting period would be reduced from six months to three months, with elimination of the requirement that the disability should be expected to last for twelve months; and (3) that Medicare benefits should be provided for all disabled beneficiaries (although the latter proposal was not too clearly stated). The effective dates for these benefit changes were deferred into the future and, on the whole, beyond fiscal year 1970, so that little short-term benefit effect arose.

As to the financing of the changes proposed by President Johnson, curiously, complete information was not publicly stated. Part of the cost of the OASDI changes would be met from the current favorable actuarial balance of the program. Part would be met by increasing the maximum taxable earnings base to \$9,000 in 1970, \$12,600 in 1973, and \$15,000 in 1976 and by moving up the increase in the contribution rate scheduled for 1971 to 1970 (so that there would be about the same excess of income over outgo in fiscal year 1970 as under present law). Even with all these increased financing sources, the proposal was inadequately financed insofar as OASDI is concerned, and an additional combined employer-employee contribution rate of 0.3 per cent would need to be added to the present contribution schedule for all future years. The changes in the HI program, and its existing unfavorable actuarial balance, would have been adequately financed by the increases proposed in the earnings base and by an increase in, and speeding-up of, the contribution schedule after 1972—to a combined employer-employee rate of 1.5 per cent for 1973–75 and 2.0 per cent thereafter. This would result in a combined employer-employee rate for OASDI and HI together of 12.0 per cent in 1976 and after (as compared with 11.4 per cent in 1976–79, 11.6 per cent in 1980–86, and 11.8 per cent in 1987 and after under present law).

In a rather unique manner, about the same time that President Johnson was making his proposals, his Secretary of Health, Education, and Welfare, Wilbur J. Cohen, was making much more extensive recommendations for expanding the social security program. These proposed expansions would greatly dismay those who believe in the time-honored principle of social security's being solely a floor of protection in the economic security area. Included in his proposals were such items as (1) a 50 per cent benefit increase with a \$100 minimum; (2) an earnings base of \$15,000

for workers and complete removal of such base insofar as employer contributions are concerned; (3) a combination of the Supplementary Medical Insurance program with the Hospital Insurance program, so that both would be financed on a payroll-tax basis with equal matching government contributions; (4) the addition of out-of-hospital drug benefits to the Medicare program; (5) liberalization of disability benefits, as in the Johnson proposal; (6) extension of the Medicare program to all disabled beneficiaries; (7) development of a "Kiddicare" program providing, on an insurance basis, for prenatal, obstetrical, and postnatal care; and (8) extensive government contributions to meet the cost of the expanded program.

President Nixon has recently proposed two OASDI benefit changes—a 7 per cent benefit increase with no specific increase in the minimum (other than what would arise from the 7 per cent change) and a somewhat greater liberalization of the earnings test than President Johnson proposed, namely, to raise the annual exempt amount from \$1,680 to \$1,800 and to have the "\$1 for \$2" reduction band apply without limit (rather than merely to the first \$1,200 above the annual exempt amount). The method by which these changes would be financed has not yet been announced, but obviously a very large part of the cost can be met by the existing favorable actuarial balance under the OASDI system.

Finally, a statutory advisory council on social security is to be named shortly. If past precedent is followed, there will be at least one actuary appointed. This council will have the very important task of reviewing all aspects of the social security program and of making recommendations for changes. Of particular importance will be the questions of the relative size and importance of the program (as brought up by the significant expansions recommended by Mr. Cohen) and of the future financing principles to be followed (in view of the very large excesses of income over outgo that are anticipated in the next few years under present law and in view of the consolidated-budget concept).

## THE FOURTH PACIFIC INSURANCE CONFERENCE

**MR. ERNEST J. MOORHEAD:** The Pacific Insurance Conference is an organization formed several years ago to promote the interchange of life insurance ideas among the countries that rim the Pacific Ocean. Its fourth biennial meeting was held in Sydney, Australia, April 13-18, 1969. The one hundred and twenty delegates from twelve countries included fourteen delegates from the United States and one from Canada.

The Conference Committee, headed by a professional brother of ours (H. V. Napier, F.I.A.), surmounted with conspicuous success the problems of exchanging opinions and facts among a polyglot group. Each of the five main subjects of the Conference was introduced in advance by a series of papers written by delegates from several countries. The authors or their substitutes formed a panel to answer questions and to elaborate upon the information given in the papers. This is a format that might well be useful for meetings within a single country.

In the belief that some Society members, particularly those who may have occasion to visit countries across the Pacific, may benefit from advance reading of some of the papers, I have prepared the following chart showing the originating countries of the papers covering the various subjects.

Subject	Australia	Canada	Hong Kong	Indonesia	Japan	Malaysia	New Zealand	Philippines	Taiwan	United States
Subject 1: Different Characteristics*	1	1	.....	.....	3	.....	1	1	1	2
Subject 2: A Look at the Life Insurance Industry	4	.....	.....	.....	1	.....	.....	.....	.....	2
Subject 3: Unit Managers†	4	1	.....	.....	.....	.....	.....	1	.....	2
Subject 4: Taking Life Insurance to the Public	3	.....	.....	.....	1	.....	.....	.....	.....	2
Subject 5: Future Development‡	1	1	1	1	.....	1	.....	.....	1	.....

\* Complete subject title is "Different Characteristics of the Life Insurance Industry in Pacific Rim Countries and the Basic Reasons for These Differences: Glossary of the Most Common Life Insurance Terms Used."

† Complete subject title is "Selection, Training, Control, Motivation, and Remuneration of Unit Managers in the New Business Field."

‡ Complete subject title is "Future Development of the Life Insurance Industry in the Pacific Rim Countries where the Industry Is Perhaps Less Advanced than in Others."

Subject 2, "A Look at the Life Insurance Industry," is perhaps of particular interest. The authors were requested to give their views on seven criticisms of life insurance that are being heard in the various countries, directed, respectively, at management, agency operations, expenses, in-

vestments, and dividend distribution. The authors, among whom were Robert C. Tookey and Professor Robert I. Mehr, rose successfully to the challenge to recognize shortcomings while vigorously defending against criticisms based upon misunderstanding or flimsy grounds.

All in all, it was an excellent Conference, well organized and purposeful.

This particular delegate welcomed also two exceptionally fine opportunities to meet with actuaries on the other side of the world. I attended a meeting of the New Zealand Actuarial Club in Wellington at the invitation of its chairman, Mr. S. J. R. Chatten, and a luncheon meeting of Sydney actuaries for whom the invitation was extended by Mr. C. J. Stevens, a vice-president of the Institute of Actuaries of Australia and New Zealand. The cordiality of all these gentlemen and their interest in actuarial affairs on this side of the water made both these visits extremely pleasant.

## CURRENT LEGISLATIVE DEVELOPMENTS

MR. GEORGE H. DAVIS: Since there are a new administration and a new Congress in Washington, legislative developments there have thus far during 1969 proceeded slowly. Bills to regulate employer pension plans introduced and given consideration last year failed to pass. So far only one of them has been reintroduced this year. It is the same as one that had strong support last year and would establish minimum standards for vesting and funding and would set up a pension benefit insurance corporation to insure payment of benefits. Other bills will probably be introduced, and passage of some legislation in the field seems a likely ultimate possibility; but any action on these bills in the near future seems unlikely. There seems to be some feeling among the Congressmen most concerned with this subject that further study by Congress of the problems involved is needed.

Another bill in Congress which seems important has been introduced by Senator Proxmire; it would require regulation of premiums for credit life and credit health insurance by the Federal Reserve Board. In fixing the standard for rate regulation, loss ratios comparable to those for group life and group health insurance among other factors are to be considered. Therefore, if passed and put into effect, rates for much credit insurance might be substantially affected.

Mr. Mills, chairman of the House Ways and Means Committee, has introduced a bill to provide for the deduction of interest on special group life and health reserves held for the purpose of funding benefits on retired lives or for premium stabilization. Mr. Mills's statement has said that the purpose of the bill is merely to clarify the law and to make it say clearly what Congress had originally intended. The bill is retroactive to the effective date of the 1959 life insurance company Federal Income Act.

Probably the most important recent developments in connection with federal income tax on life insurance companies have come in the courts. The Supreme Court has denied certiorari in the Franklin Life case, which lets stand the court of appeals decision that loading must be included in deferred and uncollected premiums both for determining gain from operations under Phase II and for the determination of assets under Phase I. The Franklin Life also decided that interest paid in advance on policy loans must be regarded as earned when paid. These same issues were also involved in the Jefferson Standard case, and the court of appeals in this

case has recently affirmed a district court decision, which was the same on these issues as that of the court of appeals in the Franklin Life case.

It appears that this Congress is going to show considerable interest in measures intended to protect the consumer. Among the consumers alleged to need protection is the life insurance policyholder or prospective policyholder. It is evident that this area of consumer protection will include the area of life insurance costs.

One development in Washington of particular interest to actuaries arises out of an effort to implement a provision of the Housing and Urban Development Act of 1968. This provision directed the Secretary of Housing and Urban Development "to develop a plan for the establishment at the earliest practicable date of an insurance program to help homeowners in meeting mortgage payments in times of personal economic adversity." Such factors as death, disability, illness, and unemployment are referred to as factors which should be covered by the program. The H.U.D. Department formed a technical assistance group to make a feasibility study under this provision. This group, which has made its report, had Morton D. Miller as chairman and included several other members of the Society. What will be the outcome of this effort remains to be seen.

Nearly all the state legislatures are in session during the first half of 1969, a few sessions having already adjourned. Revenue problems are troubling many states, and there have been a number of proposals for increases in premium tax and also proposals for other taxes on life insurance companies. No bill for a significant increase in tax has yet passed in any state, but an administration proposal for an increase in the premium tax rate from 2 to 3 per cent is still receiving consideration in North Carolina, although there seems reason to hope that it will not be passed. There is also strong administration support for increased taxes in Connecticut.

The proposal in Connecticut is to substitute for the present premium tax of  $1\frac{3}{4}$  per cent on life insurance and 2 per cent on health insurance a sales tax of 5 per cent on premiums. This sales tax would be levied on the policyholder rather than on the company. In addition to the substantial increase in the cost of insurance, this tax would involve serious collection problems, and there are indications that the complications of it may be sufficient to cause the legislature to disapprove it. However, a companion measure poses an even more serious threat for Connecticut domestic companies. It would increase the present  $\frac{1}{2}$  per cent tax they pay on income from interest and dividends to 6 per cent. It is evident that defeat of this bill will be difficult, although the 6 per cent rate might be reduced if it is finally passed.



There are also tax problems in New York, where a bill passed last year raised the premium tax by  $\frac{1}{4}$  per cent on domestic companies and was scheduled to make the same increase effective for foreign companies on July 1, 1969. The effect of retaliatory taxes in other states would have caused this increase to create a burden substantially larger for domestic companies than for foreign companies. A bill is expected to be enacted which will delay until July 1, 1971, the increase in the tax on foreign companies and will substitute for it in the intervening period an additional tax on domestic companies, which applies only to companies with less than 40 per cent of their business in the state of New York, thus restricting it to those that are subject to serious retaliatory taxes. It is hoped that it will be possible to develop a more satisfactory permanent solution of the problem before 1971.

New York and Massachusetts are the only states which limit the policy loan interest rate to 5 per cent. In 1968 an insurance department bill in New York to substitute for the 5 per cent limit a flexible rate depending upon the rate earned on new investments failed to pass. This year bills were introduced in both states which would simply increase the limit from 5 to 6 per cent. The bill introduced in New York, however, has been defeated, and it is unlikely that the Massachusetts bill can be passed in view of the failure in New York.

A bill providing some regulation of holding companies with insurance subsidiaries has passed in New York and is certain to be signed into law. The bill gives the superintendent of insurance a degree of authority over certain holding company transactions which affect insurance subsidiaries. It also permits insurance companies to carry on certain activities in other areas of financial business, either in the companies themselves or in subsidiaries.

Bills concerned with holding companies are also pending in several other states. Some are concerned with regulation of holding companies and others mainly with delaying or making more difficult the taking-over of insurance companies by holding companies. The National Association of Insurance Commissioners is also engaged in developing a model holding company bill and is currently considering two different drafts of such a bill.

With increased interest in individual variable annuities, there is much activity in the different legislatures in bills dealing with separate accounts and variable annuities. New laws are being proposed, and bills are being considered to broaden existing laws, particularly to make them permit, and establish regulation of, individual variable annuities. There is also activity in this field at the federal level, where effort is being made to ob-

tain more practical SEC regulations, and consideration is being given to various proposals for amendment of laws.

A revision of the Wisconsin Insurance Code is being developed by an Insurance Laws Revision Committee. Those doing the drafting have recently submitted to the committee sections which would establish rate regulation on the property-insurance pattern. The draft, however, extends the regulation to health insurance. As originally proposed, it also extended to life insurance, but this has been eliminated from the current draft.