SOCIETY OF ACTUARIES

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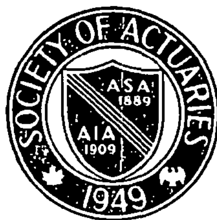

The Actuary

The Newsletter of the Society of Actuaries

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ACTUARIES CLUB OF TORONTO

by J. Ross Gray

It is interesting to see matters come full-cycle, and this time it is the oldest (I believe) Actuaries Club becoming the youngest. Perhaps there is a lesson to be learned, that when things become too large and formalized, they no longer fulfill all the needs of their members.

Seventy-four years ago steps were taken to provide opportunity for informal meetings and discussions among Toronto actuaries. The inaugural meeting of The Actuaries Club was held on 12 February 1907. The original membership seems to all have been from Toronto, but members were added from London and Waterloo, and a few from Winnipeg, Montreal, and Halifax, and probably elsewhere.

Expansion in numbers occurred, and it was felt that we should take ourselves more seriously, so in October 1946 the Canadian Association of Actuaries replaced The Actuaries Club. Members of the Actuaries Club of Winnipeg were automatically included also. There was no suggestion that the membership be limited to Toronto, or even to Canada, the only requirement being that one be a Fellow or Associate of one of the established actuarial bodies.

As part of the effort to obtain accreditation, the Association was replaced in March 1965 by the Canadian Institute of Actuaries, which covers all of Canada and permits membership from abroad. It has now grown to a total Membership of 684, plus 153 Students and 53 Correspondents, as at 8 October 1970.

To this writer, the Canadian Institute is now showing the problems that also beset the Society of Actuaries. It is too big, one does not get to know new members, one is losing touch with old members, its meetings are tending toward

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CERTUM EX INCERTIS

Institute of Actuaries Students' Society, *Actuaries and Financial Planning*, Butterworth, London, 149pp., £ 1.50.

by Ardian Gill

"The actuary is an enigmatic figure. It is believed that he is highly paid . . ." A book that begins this well has a large promise to keep. And it succeeds. *Actuaries and Financial Planning* is not devoted to the best use of that fat pay check. Rather, "this book aims to give an account of what the modern actuary does, and the way in which his work has developed from restricted beginnings to an essential part of the world of financial planning." The work of a group of young British actuaries, this pleasant little book is directed primarily to non-actuaries in the financial world.

It begins with the origins and development of the profession, explains the essential nature of the actuary's work, describes how insurance institutions evolved and relates the role of actuaries in life insurance, consulting, government, investments and other fields. Although seven authors contributed to the book, the writing is even and generally entertaining. We learn that the first known form of life insurance appeared in Lanuvium in 136 A. D. For an initial premium of 100 sesterces and a flagon of wine and five asses annually, one could assure himself a decent burial. (Do "cover" and "coverage" derive from the act of burial?) We are told that the reason an "actuary is an enigmatic figure" is that the tools of his trade (probability and compound interest) are unfamiliar to the world at large, whereas an architect, say, does not have to detail the use of bricks and mortar when talking to a layman about his profession.

Nathan Detroit's "permanent floating crap game" is used to help explain mathematical expectation; Hamlet and

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NEW YORK EXPENSE LIMITS

by John K. Booth

On September 24, 1970, the New York Actuaries Club sponsored a panel discussion on the need for revision of the New York Expense Limitation Law, Section 213, in the light of its history and purpose. Abraham Hazelcorn acted as moderator of the panel composed of Milton J. Goldberg, Jacob S. Landis, Daniel J. Lyons, and Anna M. Rappaport. The views expressed by the panelists are their own and do not necessarily reflect the views of the organizations with which they are associated.

Daniel J. Lyons

Mr. Lyons opened the discussion by summarizing the history and purpose of the New York Expense Limitation Law. The original version of Section 213 was enacted in 1906 following the Armstrong Investigation and was designed to curb the expenditure of unreasonable sums for new business. The law limits first-year commissions, other field expenses, and total company expenses and in addition includes specific limitations on renewal commission rates and collection fees. Companies are prohibited from paying either bonuses or additional commissions or compensation based on volume of new business. There is a further prohibition against making loans or advances except against first year compensation. The law makes special provision for the payment of limited training allowances to new agents and subsidies to new general agents. Subject to the approval of the Superintendent of Insurance, a company is permitted to adopt a plan of compensation other than commissions, provided appropriate charges are made against the first-year and field expense limits as required by Section 213. Some companies have used this section to develop salary plans for agents.

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Companies file a special Schedule Q each year showing the relation between their expense limits and expenses, and companies must maintain complete files of vouchers that can be checked at the time of the triennial examination. It may be argued that the extra record keeping associated with the vouchering requirement accomplishes nothing. Because Section 213 is much more restrictive on general agents than on salaried managers, many general agency companies feel it is discriminatory.

A revision of Section 213 in the early 1950's provided that more of the limit for field expenses and for total expenses was to be based on new business than formerly. It was not practical to give full weight to the cost of new business because companies would have difficulties meeting their expense limits in times of deflation when a much lower volume of new business might be written.

Jacob S. Landis

Mr. Landis reviewed the changes in Section 213 since 1956. These include a new allowance of $75,000 decreasing by $7,500 each year, changes related to training allowances to new agents and subsidies to new general agents, lengthening the training period for new agents and liberalizing the calculation of the training allowance limits, and liberalization of the renewal commission schedule.

Subsection 8(f) relating to additional compensation to new general agents divides newly appointed general agents into three categories: (a) those who have served as general agents or agency managers for more than five years with another life insurance company, (b) those who have less than five years of such service, and (c) those who have not had such prior service. General agents in category (a) may not receive any Subsection 8(f) compensation. Those in category (b) may receive such compensation for the balance of five years and those in category (c) may receive Subsection 8(f) compensation for the first ten years of service. The additional compensation plan is phased out at the end of the ten years. A general agent who produces more than 50% of the business of his agency is not eligible for Subsection 8(f) compensation after the fifth year of service. At the present time training allowances to new agents in any calendar year are limited to the greater of a 30% of the first year premiums produced by the trainee agents or (b) 10% of the first six million dollars of a company's first year field expense allowance. Depending on the first year field expense allowance (b) can go as high as one million dollars. After 1972, this limit will drop to 5% of the first year field expense allowance not in excess of $700,000. The purpose of this temporary liberalization is to allow smaller companies to experiment with training allowances as a means of developing a career agency force. This training experiment is subject to controls as to amounts involved and their allocation as between training allowances and first-year field expense limits.

The lengthening of the allowable training period for new agents provides that all premiums written by agents in their first three years of service are recognized for purposes of the inside limit on training allowances regardless of whether or not such agents have switched over to a career agent basis. The fourth training year is treated separately and the law provides that 15% of the premiums written by fourth year trainees actually receiving allowances shall be recognized in computing the inside limit. So far no company has availed itself of the fourth year in the training allowance period.

The additional renewal commission schedule was liberalized in two steps. First the schedule was extended from eight to fourteen years and the portion which must be used for security benefits or, in the absence of security benefits, for commissions after the fifteenth policy year was increased from two-thirds to three-fourths. The following year, the additional renewal commission was increased from 1% to 1½% and the entire additional ½% was available for renewal commissions. This liberalization was approximately offset by a reduction in the collection and service fees allowable after the fifteenth year from 3% to 2%.

Milton J. Goldberg

Mr. Goldberg said that any discussion of agents' compensation limitations should not refer to Section 213 but should emphasize the primary objectives, which are solvency of the company, net costs to policyowners and competitive position. Just because there is a margin in a particular year does not mean that margin necessarily should be spent. The margins are not absolute, but flexible, since they are based on such variable items as plan and age distribution, volume of insurance and premiums paid. While new paid life volume has the effect generally of increasing margins, unusual agent financing subsidies, benefits costs and establishment of new agencies in a particular year could cut margins significantly in that year. Increased expenses due to inflation do not necessarily cause problems since they tend to be offset by increases in the limits resulting from increased premiums and paid life volume. What really hurts margins are rising expense ratios attributable to *inadequate control* of expenses. In order to minimize Section 213 margin problems, a company should strive to acquire substantial increases in paid life volume each year while at the same time exercising rigid control of expenses. Such a course of action would result in a better future for the sales force, policyowners, and the company generally.

Mr. Goldberg suggested that with the current interest in consumer protection, the present time is certainly not ideal for considering any changes in the statute to liberalize commission rates even though he felt that *if* the agent is entitled to higher compensation, he should get it.

New York maximum first-year commission scales are not competitive with non-New York first-year commission scales, but account must be taken also of renewals, service fees and benefits available. Merely increasing the first-year commission limit in New York operating companies would not help, because the non-New York companies could obviously increase their first-year commission limit by the same amount or more. He summarized his feelings by referring to the other 49 states as "The Land of the Free" and New York State as "The Home of the Brave." In answer to the question of whether Section 213 should be amended to allow increased agent compensation, Mr. Goldberg said each company should determine its own policy on this question. If the answer is

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"yes," the company should work through a trade association to make its position known and try to achieve the passage of whatever legislation it feels is appropriate.

Anna M. Rappaport

Mrs. Rappaport pointed out that Section 213 has strongly influenced the distribution system for life insurance. This system currently has a number of deficiences. First the interest of the agent often conflicts with that of his client and with that of his company. Second, the agent is not paid to provide service. Third, it is very difficult for an agent to earn a decent living. Consequently, it is very difficult to get new agents into the business. A good distribution system must provide an adequate level of compensation for the field force and at the same time have a reasonable cost in relation to the total money available out of premium income. The compensation system should differentiate between products so that the interest of the client, the agent, and the company, can be met on a consistent basis. It should reward the agent for those duties the company wishes him to perform.

There are a number of questions to be considered by the industry and the regulators in facing the challenges of the future. Is personal insurance selling an economically feasible way to sell relatively small amounts of insurance to individuals? Because the total premium is insufficient to provide the margins needed for adequate compensation of personal selling, the insurance needs of a large segment of our population are being substantially ignored. Any change in the legal limits on agents' compensation should permit reasonable equality between payment for different products that provide alternative solutions to various client needs, thus keeping to a minimum the extent to which the interest of the agent is adverse to that of the client. As life insurance competes for savings dollars with other savings media, an increasingly sophisticated public will be looking more critically at the relative distribution costs of life insurance in deciding whether to choose it over other savings media. Future legislation regulating the distribution system should allow a variety of creative approaches so that better solutions can be found to the challenges of the future.

Discussion

Following the presentations by the four panelists, there was a lively and stimulating discussion of Section 213 by the panelists and from the floor. One of the reasons cited for the fact that no company had taken advantage of the four year training period for new agents allowed by the law was that in most cases it is quite evident after a period of about two years whether or not a trainee will become successful.

Mr. Hazelcorn noted that the sale of equity products with life insurance had whetted life insurance agents' appetites for a "piece of the action." As a result there is a growing trend to acquire and incorporate general agencies so that agents can receive stock in addition to cash compensation.

It was also noted during the discussion that Section 213 had been amended this year so as not to apply to the Canadian business of those companies who had an approved plan for accounting for their Canadian business separately from their United States business. It was suggested from the floor that if the Canadian business of New York companies could be removed from the restrictions of Section 213, perhaps the law should be amended to provide for the removal of all non-New York business from the expense limitations, provided it is properly segregated from the New York business so as to protect New York policyholders. In this way, the New York companies could have the same competitive advantages as the non-New York companies who have established New York affiliates.

Another observation was that it is very difficult to get all the life insurance companies to get together to do something as monumental as change Section 213. This seemed especially true today, because the field forces have become relatively more independent of their home offices as exemplified by the trend toward corporate general agencies, diversification into equity products, and the placement of new business with more than one life insurance company. Under such conditions it will be difficult to get a unified approach to any sort of change in Section 213. □

DEATHS

Beginning with this issue, deaths of members will be reported in *The Actuary* as notices are received by the Society's office.

Harold C. Horne
John T. Hoyt
Clair C. Kirkpatrick
Estella C. King (Mrs.)
John W. Lincoln
John B. St. John

Letters

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Reinvestment Rate

Sir:

John C. Fraser in the January 1971 edition of *The Actuary* has set the foundation for further research into the problem of a reinvestment rate which differs from the investment rate.

If I had $1,000 to invest in a 5% five-year bond, and really believed that the coupon falling due one year hence could be reinvested at 10%, I would wait one year and invest the entire $1,000 at 10%.

Stuart J. Kingston

* * * *

Sir:

I wonder if John C. Fraser's "Interesting Dilemma" in the January, 1971, issue does not result from asking the wrong question. Using his examples, we are presented with a choice of using $1,000 to purchase at par either (a) a 5-year bond with $50 annual coupons or (b) a 10-year bond with $44.13 annual coupons. Bond (a) therefore has a nominal yield of 5%, while bond (b) yields 4.413%.

If we felt that the reinvestment yield rate beginning one year from now would be 10%, then clearly our best choice would be to invest the $1,000 in any type of secure one-year note and reinvest in one year at 10%. Neither of the alternative bond purchases would be wise.

The fact that the 5-year bond yields 5%, while the 10-year bond yields only 4.413%, however, says something important about what the "market" feels the reinvestment rate will be. If i is the reinvestment rate, we have the following

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