



SOCIETY OF ACTUARIES

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LAPSE RATES ON OVER-THE-COUNTER LIFE INSURANCE

by Gordon Leavitt

The first year lapse rate on insurance sold over-the-counter by savings banks in New York State is about 37% of the rate from the most recent inter-company LIMRA study; 7.6% compared to 20.4% for the agency business. The second year lapse rate was similarly low: 3.7% in Savings Bank Life Insurance compared to 9.3% in the LIMRA study.

Frequency of premium payment is by far the most important parameter in determining lapse rates, according to the SBLI study. The first year (13 month) lapse rates by premium mode are: 3.1% Annual, 3.7% Semi-annual, 9.0% Quarterly, and 18.4% Monthly. (None of the business is on a pre-authorized check basis, but a small percentage is on a savings account deduction basis).

Lapse rates are notably higher in savings banks that sell SBLI aggressively, (all employ ex-life insurance agents), than in 'passive' banks: 10.1% in six aggressive banks vs. 4.6% in six non-aggressive banks.

Term insurance shows only a slightly higher rate the first year, but significantly higher rates thereafter:

	1st year	2nd year	3rd year	4th year	5th year
Life policies	7.8%	2.5%	2.2%	2.3%	2.3%
5 Year Renewable Term	7.9	5.0	3.4	3.9	6.3
Decreasing Term	6.2	4.6	3.8	4.6	3.2
All policies	7.6	3.7	2.8	3.4	3.6

estimate of tax receipts for fiscal year 1975 was \$2.2 billion, whereas the actual calendar year 1974 figure was \$58.9 billion, or about 27 times greater. Similarly, the initial estimate for benefit payments in FY 1975 was \$2.9 billion, whereas the actual CY 1974 figure was \$58.9 billion, or 20 times greater. The initial estimate of interest receipts for FY 1975 was \$1.3 billion, which was only half as large as the actual CY 1974 receipts of \$2.7 billion. This arises from the change in the level of interest rates, since the fund balances were about the same.

The change in the method of financing was clearly evident from the fact that in 1974 the actual interest receipts represented only about 5% of the benefit payments, whereas in the initial estimates this ratio was about 45%.

In summary then, it is indeed interesting that, because of so many counterbalancing elements, the actuarial cost estimates made for the Social Security system in 1935 produced an estimated ultimate fund balance that has been attained five years earlier than maturity was expected to be reached. Quite obviously, this was a great coincidence.

It is significant to note that the system has still not reached maturity. Such a condition cannot possibly come about for another 75 years or more — because of the demographic situation at least, and also because of the mercurial way that Congress behaves in continually changing the program.

It is also noteworthy that this apparent success in the actuarial cost-estimating procedure comes at a time when the program faces great financial problems, over the short range, and, equally important, over the long range as well. □

Gull's Eye

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the trust funds have exceeded \$46,943 million. What is so magical about this figure?

The actuarial cost estimates made for the original Social Security Act of 1935 predicted that the balance in the fund for the monthly benefits would reach \$46,943 million on June 30, 1980 and presumably would stabilize thereafter at that level.^a So, we have come to this estimated level five years earlier, which at first glance might seem to be a very good vindication of the actuarial cost estimates made four decades ago.

Actually, this is the result of quite a number of counterbalancing factors, such as the considerable inflation (and thus the decrease in the value of the dollar), the extension of coverage, the expansion of the benefit protection, and the change in the financing method from partial-reserve funding to current-cost financing. Nonetheless, it is interesting that all these counterbalancing elements resulted in the actual current size of the

trust funds being so close, in terms of dollars, to the original estimate. Incidentally, the estimate of the size of the fund for June 30, 1975 was \$45,368 million.

The initially estimated ultimate reserve of \$47 billion was a matter of great public debate in the late 1930's. At that time, this was a truly colossal figure and was, in fact, somewhat larger than the national debt then. Serious question was raised about where this huge amount was to be invested. Would wasteful governmental spending have to be done just to create sufficient bonds for trust-fund investment?

But the debts from World War II have taken care of that problem! Under today's conditions, \$47 billion is not very large, relatively speaking — only about 10 percent of the national debt. And the problem facing the current \$47 billion balance in the OASDI trust funds is that it is too small and will be all too soon exhausted unless additional financing is provided!

Although the estimate of the ultimate size of the fund made initially in 1935 was close to what has actually occurred, the same can hardly be said for the estimates of the other components of the financial operations of the system. The

^aSource: Senate Report No. 628, 4th Congress, May 13, 1935.

Actuarial Meetings

- Nov. 19, Seattle Actuarial Club
- Nov. 20-21, Actuaries' Club of the Southwest
- Dec. 4, Baltimore Actuaries Club
- Dec. 4, Boston Actuaries' Club
- Dec. 10, Philadelphia Actuaries Club
- Dec. 11, Actuaries Club of Des Moines
- Dec. 17, Seattle Actuarial Club