



SOCIETY OF ACTUARIES

Article from:

The Actuary

September 1980– Volume 14, No. 7



The Actuary

The Newsletter of the Society of Actuaries

VOLUME 14, No. 7

SEPTEMBER, 1980

TESTS OF A BUSINESS LIFE INSURANCE PROPOSAL

by *Ellis D. Flinn*

In this era of high interest rates, business life insurance funded by individual level-premium life policies has become popular, even to the point of undertaking to compete with group insurance plans.

It is easy and tempting to do what amounts to conjuring with facts and figures so as to show what good value these individual policy plans offer. But a proposal that fails to take all relevant points accurately into account may end up by conveying the false impression that the insurance doesn't cost anything.

We are seeing ordinary life insurance recommended for funding all sorts of benefit programs. It fills the role of chicken soup; it seems to be the answer, regardless of the question.

Uses of Business Life Insurance Frequently Encountered

Industrial firms often feel that in these days of high taxes and high cost of living, they want to do more to help their key executives meet their financial obligations. Amid substantial competition for good executives, companies are trying to find an edge over their competitors. Hence companies have turned to the use of ordinary life insurance, one of whose merits is that it can be used in selected situations, steering clear of the restrictions placed on group insurance and on tax-qualified benefits.

Companies purchase ordinary life insurance on their executives to supplement existing life, disability and retirement programs and to help solve estate tax problems. The cost of these supplemental benefits can be kept low by providing them to only a select number of, rather than to all, employees. Amounts

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SPREADING WORD ON CAREER OPPORTUNITIES

by *Linda M. Delgadillo,*
Communications Manager

Some readers may not know of the employment listing service the Society operates for its members. For a \$5 fee, a member can subscribe to an Employment Career Bulletin that lists current actuarial opportunities. The subscription list is confidential; only the Society office has access to it. A subscription runs for six months and is renewable each January and July.

The service works thus: Companies that have job openings for actuaries list these positions in the Bulletin through the Society office. To do so, a company sends us a Position Listing Form for each opening. This form gives the employer's name and address; who is to receive enquiries about the position; a job description; to whom the employee would report; education and experience requirements; and salary range. A \$75 fee is charged for each job description we accept.

Whenever a new job listing arrives, we send the Career Bulletin to all subscribers. It is then up to the subscriber, if interested, to write, phone or visit the employer.

Employers may like to know that for \$75 they reach up to 200 actuaries who are interested enough to have paid their fee within the last six months. And subscribers are likely to receive about one listing a month for their \$5. We believe that if more employers and actuaries can know about this service, such as through this article, both those circulations will grow. If you want to subscribe, send the \$5 fee along with your name, your address (which may differ from that used for Society mailings), and date you wish the service to start to: Society of Actuaries, Box 91901, Chicago, IL 60693. □

HEALTH MAINTENANCE ORGANIZATIONS

by *John C. Turner and*
Michael J. Peninger

John K. Kittredge's review of *HMO's and the Politics of Health System Reform* (May issue) comments that readers will "have to turn to other sources" to learn about Health Maintenance Organizations (HMO's). This article undertakes to describe, in a limited way, HMO's and the progress they are making.

The concept of prepaid medical care in the U.S.A. is not new. Several groups, notably the Kaiser-Permanente plans in California have been operating for many years. For the most part, though, the HMO movement is still in its first decade.

What Is An HMO?

HMO's are organized delivery systems of comprehensive health care services (hospital and outpatient) to a voluntarily enrolled population in return for a fixed prepayment from each member. Traditional health insurance by contrast reimburses for a portion of expenses of treating sickness or injury as the policy specifies.

Because HMO's are at risk for services provided, they must emphasize efficient management and tight controls on use of services. Also they encourage minor treatments, traditionally given in the hospital, to be performed on a less expensive outpatient basis.

A typical subscription rate might be \$35 to \$45 per month for single coverage and \$95 to \$125 monthly for family coverage, a substantial portion of this being paid by the employer as for conventional health insurance. Individual

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Business Life Insurance Proposal

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of life insurance range from modest supplemental benefits to substantial sums designed to create estates for the executives.

Tests That A Sound And Adequate Proposal Should Meet

There are sound reasons for a company to purchase ordinary life insurance on its executives, but the proposals used for sales purposes frequently do a poor job of illustrating how these plans work and the real cost of the program. Illustrations often try to portray the plan as a no-cost item. To be sure that business insurance proposals give a true picture of their cost and enable the buyer to reach an intelligent decision, the following tests should be made.

(1) The time value of money must be recognized. And, because the purchase contemplates transferring large sums from the firm to a life insurance company, the firm has a right to know what rate of return is involved in this transfer. I believe that for business insurance proposals rate-of-return information is essential.

(2) Mortality assumptions should be appropriate and consistent with those used in determining the life insurance premiums and dividends. Fallacious calculations, such as those using the life expectancy concept, census data, and the 1958 CSO table, must be avoided.

(3) The likelihood that some lives will prove to be substandard should be taken into account, specially when comparing an individual policy arrangement with a group insurance plan.

(4) All tax aspects, not just the favorable ones, should be fully explained. It is common for agents to stress favorable Section 79 status or estate tax results, but to down-play the widow's ordinary income tax liability.

(5) Cost illustrations should recognize that not all covered executives will stay in the plan until death or retirement.

(6) Comparisons between costs of different funding methods should employ actuarial procedures that properly reflect the yearly benefits.

(7) Deferred compensation benefits should be measured in terms of their after-tax values.

(8) When benefits are related to salary, the proposal should explain how increased benefits will be provided and, if a different premium band or policy form is to be used, the cost of the new plan compared to the original.

(9) Proposals should provide appropriate funding for all benefits offered. For example, plans designed to provide retirement benefits should not use a minimum deposit arrangement.

(10) Disclosure information is useless once the program is approved by management, hence it should be presented as part of the original proposal.

Responsibility of Actuaries

The only people who have sufficient background to appraise these proposals are actuaries. So it is up to us to instruct agents and those who train them and design sales material for them. Statements in proposals that can be made only after actuarial analysis should be certified by qualified actuaries.

Before corrective steps have to be demanded by others, insurance company actuaries had better find out what their agents are doing in presenting business insurance proposals, and get rid of inappropriate procedures whenever these are found. □

Steering Clear of Antitrust Violations

You can reduce the chance of inadvertently getting yourself and the Society into legal difficulties stemming from your Society activities if you will read the Academy's ANTITRUST GUIDE, a 23-page pamphlet written by the Academy's General Counsel, William D. Hager. Our President, Julius Vogel, has sent a copy to each Board member and each committee chairman, and commends it to every active Society member. See the Academy Newsletter, May 1980, for a description of its contents.

You can obtain one free copy (additional copies 50¢ each, prepaid) by writing to Cheryl Long, American Academy of Actuaries, 1835 K Street, N.W., Ste. 515, Washington, DC 20006.

ACCEPTABILITY OF PAPERS FOR THE TRANSACTIONS

by Edward J. Porto, Chmn.,
Committee on Papers

Potential authors of papers for publication in the *Transactions* should take note of the following changes that were made several years ago in the general considerations for acceptable papers:

- (i) The requirement that the subject be "of interest to a substantial proportion of Society members" has been replaced by the less stringent requirement that it be "of professional interest."
- (ii) The requirement that the paper be more suitable for publication in the *Transactions* than in some other publication has been deleted.

These liberalizations first appeared in the 1978 Year Book, but may have escaped many members' notice.

In regard to (i), the Committee on Papers obviously will continue to include interest to members among the factors that determine whether a paper is acceptable; but this factor has been down-graded considerably in importance.

On another matter: Ever since ARCH came into being in 1973 there has been one exception to the long-standing rule that a paper published or widely distributed elsewhere will generally not be accepted for the *Transactions*. Please be assured that a paper built on a previous contribution to ARCH will not be barred from the *Transactions* if otherwise acceptable. □

NEWS FROM LONDON

After 3½ years of work, a Committee to Review the Functioning of Financial Institutions, chaired by former Prime Minister Sir Harold Wilson, published its Report in June. Two F.I.A.'s were prominent in its work: Mr. Gordon V. Bayley, a past president of the Institute, was one of the 18-member committee; Mr. Peter G. Moore, a past Institute vice-president, was a committee consultant, specially for its study of pension funds. An article on the Report is planned for our next issue.

Another Institute past president known to many here, Mr. Ronald S. Skerman, has been awarded the Institute's Gold

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