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FINANCIAL HAZARDS OF THE CASH VALUE LIFE INSURANCE BUSINESS

Ed. Note: This a a capsule of what may be called "the Angle/Bladen theme." John C. Angle spoke at Hartford in April 1980 (*see the Record for that meeting,* pp. 188-193). *His investment colleague, Ashby Bladen, addressed our Annual Meeting in Montreal last October. Their observations were about mutual life insurance in the United States. The speakers' words are not quoted precisely here, but we believe the message is faithful to the originals. Our readers' views are earnestly solicited.*

The historically successful design of policies with guaranteed cash and loan values implicitly assumes stability in the general price level and in interest rates. Can traditional practices and products be sufficiently modified so we can cope with economic instability? Answer: Only partially, not satisfactorily, and at the cost of exposing ourselves to large, ultimately unacceptable, risks.

What Is Happening Around Us

Interest rates have repeatedly soared far outside the familiar 3% to 6% range, and have precipitated a series of intensifying liquidity crises for life companies.

After inflation and taxes, companies are producing substantial real losses for the savers who own us, and are becoming the most exposed of all financial institutions.

If government bailouts of faltering private companies, soaring government deficits, and rapid growth of illegal businesses, and tax evasions by legitimate businesses, all continue, we may end up with hyperinflation and the destruction of accumulated wealth, in which case there isn't much the companies can do that will benefit our customers. But that result is still highly unlikely; a deflationary crash is far more probable.

The prevailing economic conditions, the life company tax structure and today's competitive climate are spawning life insurance contracts that implicitly assume that those conditions will continue indefinitely. By reducing premiums, adopting modified reserve systems, introducing modern mortality tables, raising the reserve interest rate, and lowering our ratios of surplus to liabilities, we are dangerously reducing our corporate safety margin. Thus we are becoming progressively less conservative just when the risk of serious economic trouble is rapidly rising. And at the same time state insolvency laws are adding to our risk by subjecting us to liabilities of unpredictable size that are beyond our control.

What We Had Better Do

We must vociferously point out the disasters that loom if we don't have financially responsible elected leaders determined to end the inflation.

We must understand that we no longer have any reasonable basis for making any assumptions whatever about the range within which interest rates will fluctuate.

Financing the squeeze by issuing commercial paper is just about the most dangerous thing a life company can do.

Have the Society investigate the explicite margins needed for the risks we face, and see that our provisions for these risks appear in our balance sheets as designated contingency reserves, as our Committee on Valuation and Related Problems recommended in 1979.

Recognizing the possibility that interest rates may again slide into a long-term decline, steer away from making long-term reserve interest guarantees of 4½% or higher.

Consider introducing, as stock life companies have done, non-guaranteed flexible premiums that would vary inversely in some proportion to the return on long-term government bonds.

The Moral Of All This

A satisfactory future depends upon restoring stability, not upon trying to learn how to cope with instability.

Suffering as we are from "institutional rigidity," tinkering with our ailment by altering only the valuation interest rate will not enable us to survive in an era of short-term 20% interest rates, 100% marginal tax rates, policy loan borrowings in excess of cash flow, or an unprecedented long-term interest rate.

E.J.M.

REQUESTING AN EXPRESSION OF INTEREST IN FORMING A HEALTH INSURANCE SECTION WITHIN THE SOCIETY

The twelve undersigned wish to establish a Health Insurance Section under the Society's new arrangement for this form of unit. Any member, whether interested in group or individual health insurance, may join. To obtain permission to proceed, we must show that there is sufficiently widespread member interest.

We believe that such a Section will be of great benefit to actuaries serving this field, as well as to regulators, the industry and the public. The Section's purpose would be to enter into and sustain the following activities:

1. *Meetings and Seminars.* Section members would assume responsibility for, or assist with, planning and conducting sessions on our topics.
2. *Education and Literature.* We would promote actuarial education and prepare literature.
3. *Research.* We would define and conduct actuarial research.
4. *Other Activities.* The Section's broad purpose would be to serve all needs of actuaries in our individual and group fields, consistent with Society objectives and as approved by the Board. We would engage in such additional activities as are agreed will fulfill this purpose, subject to the general rules for Sections.

If you have an interest in becoming a member of the Health Insurance Section, simply complete the postcard enclosed with this issue of *The Actuary* and mail it to the Society Office (DO IT NOW!). If you have questions, phone or write any of the undersigned petitioners. Our addresses and phone numbers are in the *Year Book.*

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