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TASK FORCE ON MUTUAL LIFE CONVERSION

The Society of Actuaries Task Force on Mutual Life Insurance Company Conversion has recently submitted its final report. Appointed in July 1984 with Harry Garber as Chairperson, this Task Force has met monthly, and has established committees that have had additional meetings. The purposes of this Task Force are "to examine the actuarial issues involved in converting a mutual life insurance company to the stock form of ownership and to produce a record of the examination." The recently completed report is the record called for by the Task Force's charge.

The report itself includes 28 typewritten pages, attached to which are six appendices adding another 100 pages. One must be impressed by the amount of good thought and constructive effort that this voluminous report represents.

By way of background, it may be noted that when the Task Force was formed, some three years ago, it appeared that several of the large multi-line mutual life companies had become interested in the possibility of conversion to the stock form. The driving force behind that interest was the feeling that a mutual life company might be at a disadvantage in accumulating sufficient capital to permit it to enter, to expand, and to compete in its selected markets, and to maintain, securely, its ability to meet its obligations to policyholders.

During the life of the Task Force the Union Mutual conversion took place. Many of the concepts reflected in that conversion have been helpful to the Task Force in the development of its report. That the interest in mutual life conversion has to some degree died down does not detract from this important document. Many of the actuarial principles

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BOOK REVIEW

B. Michael Pritchett, *Financing Growth: A Financial History of American Life Insurance Through 1900*, pp. 90, S.S. Huebner Foundation for Insurance Education, Wharton School, University of Pennsylvania.

Reviewed by Anthony B. Richter

Life insurance companies, some with hundreds of officers, have come a long way since the early days of the industry when a typical new company would have only three: President, Cashier and Actuary. Those early days are examined in some detail in *Financing Growth* by B. Michael Pritchett of Brigham Young University, an examination of the investment role played by life insurance companies prior to 1900.

By necessity, the book is in some respects a history of the early days of the industry itself, and a colorful history it was. The first company to issue policies was a branch of an English company with the incredible name of The Corporation for the Relief of Poor and Distressed Presbyterian Ministers and of the Poor and Distressed Widows and Children of Presbyterian Ministers. It issued its first policy on May 22, 1761 and, under the name of the Presbyterian Ministers Fund, is still operating from its office in Rittenhouse Square in Philadelphia.

Although several other companies entered the business in the following decades, the industry did not begin to flourish until the "mutual era", which began with New England Mutual (1835) and which soon included The Mutual Life Insurance Company of New York, New York Life, Connecticut Mutual, Penn Mutual and Mutual Benefit.

Active person-to-person solicitation began with the mutual companies.

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LIFE INSURANCE RESERVES AND THE AICPA EXPOSURE DRAFT ON AUDITING ACCOUNTING ESTIMATES

By Jonathan S. Carr

Auditing accounting estimates is the main job of an actuary taking part in the audit of a life insurance company. Accounting estimates are also the prime concern of a company's valuation actuary. Why? Because life insurance benefit reserves and Deferred Acquisition Expense (DAC) are "accounting estimates" under the definition given in the exposure draft of a proposed Statement on Auditing Standards issued by the AICPA's Auditing Standards Board entitled "Auditing Accounting Estimates."

According to the draft, an accounting estimate "is an approximation of a financial statement element, item, or account in the absence of an exact measurement." The absence of an exact measurement arises from two sources:

"a. Exact measurement of some amounts or the valuation of some accounts is uncertain pending the outcome of future events.

"b. Relevant data concerning events that have already occurred cannot be accumulated on a timely, cost-effective basis."

Not many accounting estimates are more "uncertain pending the outcome of future events" than benefit reserves and DAC, which depend crucially on projected interest, withdrawal, and mortality. Also point (b) above applies to benefit reserves and DAC; in-force models are an example of an approximation of "events that have already occurred."

The draft should not have a major impact on current practice for internal control for and auditing of accounting

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UNIFICATION

Once again the actuarial profession is studying the possibility of reorganization. Once again the driving force is the issue of unification. That such a small profession is fragmented into as many as *six* sometimes-competing organizations is surely a bar to efficiency and effectiveness.

Those who have been down this road before will remember both the successful attempts of the past and those that failed. The outstanding success was the merger of the Actuarial Society of America and the American Institute of Actuaries; but that occurred nearly four decades ago. No less than four other North American actuarial organizations have shown up since. The outstanding failure was that of one decade ago, when a series of committees considered several unification proposals, but none came to pass.

The interest in once again considering unification has grown slowly over the past year. The October editorial in this publication gave rise to considerable discussion, much of which is to be found in "Letters" published in later issues. The May issue carried a story of a new attempt organized through the Council of Presidents; and the Supplement to the May issue included the challenging recommendations of James Anderson. *The Actuarial Review,* the newsletter of the Casualty Actuarial Society, has also devoted recent space to the unification issue. Whether we like it or not, the subject is once more before us.

As suggested by the May letter from Brian Jones, the profession might be well advised not to try to go too far or too fast. Smaller steps in the right direction might well be more successful than a full-blown reorganization. Quite likely a major reordering of the six actuarial bodies in North America will prove to be as difficult as before. Clearly the basic difficulty is getting agreement. We would like to believe that there are no serious "turf" problems, but, more realistically, there are.

It is the personal belief of this retiring Editor that the best chance of significant unification lies in the possibility of merger, formal or de facto, of the profession's life and casualty branches. Other of the actuarial organizations have particular constituencies or special interests, but the Casualty Actuarial Society and the Society of Actuaries have the common purpose of promoting actuarial science through education, examination, and research. All that seems to hold these two organizations apart is the fast-disappearing notion that life and casualty actuaries have different bodies of knowledge. Many of us are convinced that actuarial science has one theoretical underpinning — not two.

Any attempts toward SOA-CAS merger will do well to recognize that the CAS, albeit a smaller and less elaborately organized body than the SOA, has its own pride and its own tradition. It simply will not do for the CAS to become only another Section of the SOA. It will take some good work involving negotiation and compromise to make such a joining possible — but it seems from here that a successful result will be well worth the effort.

C.L.T.

Book Review

(Continued from page 1)

Earlier agents were involved mainly in arranging and buying mortgages on behalf of their companies and transacted sales by the more traditional (and presumably more respectable) method of waiting at their agencies for customers. The missionary zeal with which the newer companies pursued their goal was exemplified by this statement from the president of Berkshire Life to its policyholders.

> "Every policyholder should be a missionary of Life Insurance to aid in extending its benefits to others whose families need the protection. It is earnestly desired that each one will use his exertions to promote the interests and extend the business of the Company. If every member will secure but one other, the business of the Company would be rapidly increased, and the benefits of Life Insurance become widely spread."

In these years of rapid growth, there was a tremendous demand for agents, who were often the objects of bidding wars between the companies. The author quotes one incident in the 1860s in which "New York Life received notice one morning that their entire Manhattan office consisting of a general agent and over two hundred agents had gone over to Equitable".

There is a brief section on Henry Hyde of the Equitable and the tontine system which he introduced in 1867, under which the cash values of lapsed policies stayed in the tontine and were paid to the survivors of the tontine period (10, 15 or 20 years). The system did not last long since, as the author notes, it was "not in the spirit of the emerging forfeiture laws". Before these laws, if the insured did not have the premium in the agent's hands by the due date, the contract could be (and often was) terminated. Cash values reverted to the company, regardless of the number of premiums paid. The company was not required to notify the insured of the approaching due date. (The promise of the share cash values on lapsed policies was one of the allures of the tontine.)

In spite of the obvious failings of the tontine system, the author notes that it

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Book Review

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made "faithful, regular savers of those who were not predisposed to such behavior", and thus contributed to making the industry a supplier of capital.

The author forcefully shows, both with text and with tables, the devastating effect of the protracted depression of the 1870s on the life insurance business. In 1870, the number of legal reserve life insurance companies was 135; by 1880, it was down to 69 (many of the companies that failed during this period were absorbed by others). Company failures were rampant, and state regulators (yes, even then they were a factor) and the press were not reluctant to criticize the management of the fallen companies. As the author states: "Men and firms lauded as statesmen and giants in one year were castigated as crooks and frauds in the next, with no factual change except the press of events and bankruptcy laying open their books to public scrutiny and hindsight."

The author notes how state regulation sometimes worked to the detriment of the companies whose financial solvency it was their duty to protect. State regulation emphatically encouraged investment in real estate; one large company's charter provided that it invest only in real estate or related assets except as otherwise specifically permitted in the charter. But real estate performed more poorly than many other types of investment, and in the 1870s, the companies found themselves saddled with real properties with severely depressed values, many of which were acquired by foreclosing on mortgages.

In this book, which contains 29 tables and 13 graphs, the author has sought to examine three hypotheses:

> "(1) life insurers mobilized a substantial pool of capital from a broad policyholder base, (2) insurers supplied critical infusions of funds to new industries at a formative stage of their development, and (3) the industry channeled capital to developing regions of the country roughly in proportion to regional premium volume."

The first hypotheses is shown to be valid, while the last two are not. It is hardly surprising that life insurance companies were not a source of venture capital, either then or now. The primary concern of life insurance investment departments has always been preservation of capital, with high rates of return (until recently at least) a secondary concern. (However, as the author notes, this did not stop some companies from trying to earn yields higher than those on investments permissible under law. Even in those days, companies used subsidiaries, which for this purpose invested in higher-risk, higher-yield securities.) Further, state regulation often had the effect of requiring most investments to be made "close to home", with the effect that very little life insurance funds found their way into the less developed areas of the country, namely the South and the West.

Mr. Pritchett has produced an interesting and readable book on the early days of the business, and a worthwhile addition to the archives of insurance industry history. □

MATH ODDITIES

Readers who enjoy number puzzles may like these. Both were submitted by Howard Young, 16269 South Hampton Court, Livonia, MI 48154.

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  MIAMI        CANADA
+ TAMPA     + NIGERIA
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 BOSTON       FINLAND
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Within each of the indicated additions, each letter has an unique correspondence with a digit. There are definitely determinable answers. Geographical overtones may be immaterial.

Howard will correspond with interested readers as to his technique for solving these and similar puzzles. He uses a combination of deduction and trial/error, and is looking for some more efficient technique.

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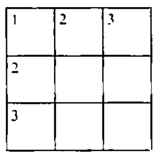
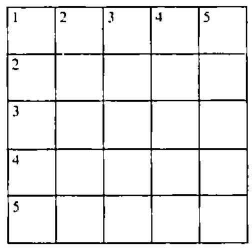
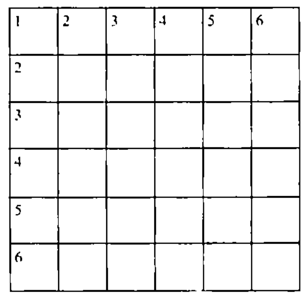
Or readers may prefer the square form of the cross-number puzzle, similar to a crossword except that numbers and digits replace words and letters.







Across or Down

1. 19x	1. 16y	1. 6z
2. 5x	2. 37y	2. 8z
3. 13x	3. y	3. 2z
	4. 10y	4. 7z
	5. 18y	5. 5z
		6. 11z

Here trial and error will seldom prevail, but there is a principle involved. Clues can be found in this same issue (see "Circular Numbers", page 4.)