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INVESTMENTS

A. To what extent have companies' net earned interest rates risen above their low points several years ago? What is the outlook for the future course of the interest rate over: (1) the next few years? (2) the longer terms through which policies presently being issued will extend?

B. Is the National Association of Insurance Commissioners' method of dividing amortizable bonds into two classes in the valuation of securities an improvement over methods used heretofore? What has been the effect of using two standards in determining whether or not a bond is amortizable? Is there a need for a method of valuing stocks by which the problem of market fluctuations is minimized?

MR. W. H. HUEHL stated that the two main reasons for the steady rise in interest rates which most life companies have experienced during the past six years have been the shift from Government securities to higher yielding mortgages and other securities and the rise in the level of interest rates on new investments. He emphasized the importance of Federal Government policies which can either increase or decrease interest rates as much as $\frac{1}{2}$ of 1%. He predicted that for the next few years there will be little change in interest rates on new investments.

MR. D. N. WARTERS mentioned the strong effects of Government actions on interest rates and indicated that political pressure in the near future will operate in favor of low interest rates and consequent gradual inflation. He believed that most companies were nearing the end of increases in interest earnings because of switches from one type of investment to another. He felt very strongly that, even though insurance companies are able to invest at a favorable rate, it is hard to maintain that rate because of the call provisions under which securities can be refunded as soon as the interest rate decreases. The S.E.C. and many state utility commissions are very insistent that such call provisions be included in new utility bond issues. He warned against being misled by the increases in interest earnings which are appearing in current annual statements.

MR. A. N. GUERTIN mentioned the differences between the proposed industry suggestions on valuation of securities in 1951 and the recommendations which were finally adopted by the N.A.I.C. The industry had suggested that all bonds not in default be amortized and that a security valuation reserve be set up to absorb all losses arising on disposal of securities and to absorb the loss occurring on transfer of a bond to default status. One class of bonds would accumulate a 1% reserve, the other a 20% reserve, out of equal annual accretions over 20 years. In addition net

realized capital gains would be added to the reserve and net realized capital losses deducted, but until a maximum reserve was accumulated only 50% of capital losses would be so charged. Preferred stocks would have a similar 20% loss reserve.

The regulations put out by the N.A.I.C. in 1951 provided for a security reserve as suggested but made the regulations apply to common stocks as well as bonds and preferred stocks and the recommended loss reserve was converted into a fluctuation reserve. This was done by requiring unrealized as well as realized losses to be taken into account in accumulating the reserve.

In spite of some differences between the industry suggestions and the N.A.I.C. regulations, he believed that this method of valuing securities is an improvement and offers a road toward a satisfactory solution of the problem.

He stated that there is definitely a need for a method of valuing preferred stocks which will minimize the problem of market fluctuations, but more study is needed before a similar plan can be applied to common stocks. He also pointed out that actuaries had suggested the need for more flexibility, particularly in view of other possible sources of loss and possible other uses for special reserve funds. He urged all actuaries to study the entire problem of valuation of securities and submit their suggestions to the Joint Committee of the A.L.C. and L.I.A.A.

MR. R. M. SELLERS stated that the new method of determining the eligibility of bonds to be carried at an amortized cost basis, although not as desirable as the recommendations contained in the Hubbell Report, is a substantial improvement over the former methods and studies indicate that it will reduce the percentage of corporate bond portfolios not amortizable from 2.1% to $\frac{8}{10}$ of 1%. The most important effects of these changes have been: to establish known and published minimum standards which bonds must meet if they are to be carried at amortized values; to remove substantially all of the dangers inherent in the former system under which the N.A.I.C. staff was empowered to assign arbitrary values to securities which were not eligible to be carried at amortized values; to reduce the wide swings in surplus, or threat of such swings, caused by the former method which required many more bonds to be carried at market or arbitrary values; to widen the investment field by reducing the number of bonds which are to be carried at other than amortized values; to provide easier and more economical administration by supervisory authorities.

He believed that a better method is needed for valuing preferred and common stocks and nonamortizable bonds. He recommended that all actuaries carefully study the recommendations of the Joint A.L.C.-L.I.A.A. Committee on valuation of assets, released May 25, 1954.