

**DIGEST OF INFORMAL DISCUSSION**

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**PRE-AUTHORIZED CHECK PLAN**

- A. What success have companies had with the pre-authorized check plan?
- B. What methods have been most successful in securing bank cooperation?
- C. Have there been any serious problems because of checks returned on account of insufficient funds?
- D. Have the savings in collection costs justified monthly premiums as low as one-twelfth the annual or one-sixth the semiannual rate?
- E. What legal problems are involved in indemnifying banks against loss or amending policies to provide for the plan?
- F. Has it been used for premiums other than monthly or in connection with other collections such as monthly mortgage loan payments?
- G. How does the persistency of this type of business compare with the persistency on policies of the same size paid for by other modes?
- H. Has there been a shift in the distribution of business from semiannual and quarterly mode of premium payments as a result of the introduction of this plan? To what extent have sales increased?

MR. J. F. RYAN described the plan introduced by the New York Life four months ago with the copyrighted name "Check-O-Matic." The plan is available in connection with both new and existing policies, provided that (1) premiums are payable monthly, (2) the monthly premium on each policy is at least \$10, and (3) the premium-payer has a regular checking account (*i.e.*, not a special checking account).

To place a policy under the Check-O-Matic plan, the premium-payer must complete two forms, one authorizing the insurance company to draw a check each month against his checking account for the purpose of paying premiums on his policy, the other authorizing his bank to honor checks drawn on his account by the insurance company to its own order. The first monthly premium must be paid in cash with the application.

When a policy is placed under the plan, the company sends to the bank the insured's authorization to the bank, together with a brief covering letter explaining the plan. The company also sends the premium-payer a checkbook reminder notifying him of the amount of the monthly check and the premium due date.

The company then prepares mechanically each month a separate check for each policy under Check-O-Matic and deposits these checks in a New York bank for clearance through normal banking channels.

The New York Life is currently using the plan in 15 states and expects

to extend the plan to all states by the end of 1956. About 7% of the sales in states in which the plan is offered were placed under the plan. This represents about \$13,000,000 of new business with an average monthly premium per policy of almost \$28 and average face amount of about \$13,500. In addition, about \$33,000,000 of existing life insurance was transferred to the plan.

They have attempted to secure the cooperation of banks by personal visits of their banking officers to a number of leading banks prior to the introduction of the plan and by educational attempts to show how the plan meets the objections recorded by the A.B.A. to earlier draft plans.

They have adopted forms and procedures that enable banks to handle Check-O-Matic checks at no higher costs than those involved in the handling of personally signed checks. They designed the check so that it conforms with accepted banking standards, including the bank transit number. They drafted the authorization to the bank to cover checks drawn by the New York Life to its own order, so that the bank is relieved of responsibility for verifying the policy number, the amount of premiums being paid by check, or the frequency of checks, but not against overdrafts.

On the back of the authorization to the bank is an indemnification agreement under which the New York Life agrees to indemnify the bank against certain losses which could result from the operation of the plan. Thus the bank does not have to refer to individual authorization forms every time a check is presented. Banks can accept the New York Life name on the check as a sufficient guarantee and can process the check in the same manner as a personally signed check. The bank does not even have to verify a signature. However, it has to make sure that there are sufficient funds in the account when it processes the check.

Under the Check-O-Matic plan, no initial contact with the bank is made by the premium-payer, agent, or branch office. The first notice to the bank is made by letter when the home office sends the authorization form to the bank. In the absence of word from the bank that it is not willing to accept the plan, it is assumed that the bank will participate and the Check-O-Matic checks are deposited at the appropriate time. Over 900 banks or almost 95% of the banks approached have accepted the plan.

The New York Life will not agree to pay any special charges for the handling of Check-O-Matic checks, nor will it agree to place deposits in banks as an inducement to have the banks agree to the acceptance of the plan.

Less than 3% of the checks deposited have been returned on account of insufficient funds after the first deposit and about half of these returned checks were cleared after they were redeposited.

Calculations indicate that anticipated savings in collection costs justify the reduced monthly premium rate adopted for Check-O-Matic policies. This reduced rate is one-sixth of the semiannual premium rate for life insurance policies; it is one-third of the quarterly premium rate for A & S policies because of the lower average size premium.

These savings come mainly from a completely mechanized system for preparing checks and from the adoption of negative accounting procedures. The branch office has been completely eliminated from the Check-O-Matic premium collection procedures. The branch office simply assumes that each monthly premium is paid until it is notified to the contrary by the home office.

An additional factor in reducing costs was the adoption of a special commission arrangement for Check-O-Matic policies. Under this arrangement, commissions are paid only once a year, instead of 12 times a year. The commission for any policy year is paid after the company has deposited the first check for a Check-O-Matic premium falling due in that policy year and the check has been cleared.

An important problem involved in the indemnification agreement is that, in general, the banks will not accept the plan without a fairly broad indemnification agreement. This agreement is such that in some circumstances the company could be liable for damages in an amount entirely unrelated to the premiums. This would be possible if some other business transaction of a bank depositor were adversely affected because there were insufficient funds in his account as a result of New York Life having erroneously drawn a check on his account. This is a business risk which generally has to be assumed on bank check business and he did not know of any serious problem arising under this type of agreement in companies which have been using it for a number of years.

The only other legal problem encountered in the bank check plan is the matter of getting state approval. Two states have refused to approve the bank check plan but the Company expects to resolve these difficulties within the next month.

MR. W. E. LEWIS remarked that he had found by communicating with a number of companies that all limited their pre-authorized checks to monthly intervals only. Since any longer interval violates the budget concept of these plans and yields relatively smaller cost savings, he thought it likely these plans will for the most part be confined to the monthly basis.

As recently as April 1956, the Bank Management Commission sent a letter to member banks of the American Bankers Association on what it called the "Draft Plan for Paying of Insurance Premiums and Other Instalment Payments." The letter reflected continuing strong opposition by

banks to pre-authorized checks. One of the chief fears expressed was that these "draft" plans will spread to savings and loan associations, mortgage companies, public utilities and other organizations.

This letter also reported the results of a recent questionnaire to member banks. Of 7,227 banks answering the question "Are you in favor of these plans generally?" 90% were opposed. Even among the 2,945 banks presently participating in these plans who answered this question, 73% reported themselves as not in favor.

Obviously the life insurance companies have quite a selling job on their hands. It therefore behooves the life insurance companies to demonstrate to the banks that the system works well for life insurance premiums before attempting to use it for such other collections as mortgage loan payments.

He felt it encouraging, however, to note the following statement in the letter: "This overwhelming adverse reaction should perhaps be discounted to some extent in that some banks not now participating in such a plan may have been considerably influenced by the Bank Management Commission's letter of September, 1954. They also might not have been aware at the time they answered the questionnaire of the latest plans put forward by the life insurance associations which solved some of the operating problems present in most of the original plans." It is also encouraging to note that all clearing house banks in at least two large cities have for many years paid utility bills for their checking account customers.

One of the reasons given by banks for objecting to these plans is that their checking account customers will not know what their balances are. To minimize this objection, the Lincoln National has taken pains to keep its pre-authorized checks at the same level amount each month. To do so they exclude from the plan any interest on or repayment of policy loans, and dividends will not be applied in reduction of premiums.

MR. J. J. MARCUS discussed the Pru-Matic plan which the Prudential introduced in April 1956. The local Prudential office draws checks monthly against the policyholder's account. The bank's handling of the check is little different from one drawn by the policyholder himself.

Although the plan has not been in operation long enough to gauge its success, there are indications that the plan has been something less than successful so far as the number of policies placed under it is concerned. However, it does appear that the average monthly premium of such policies is greater than for policies paid in the conventional manner.

As to methods used to secure bank cooperation, they followed a similar procedure to that which Mr. Ryan outlined. In addition, when they announced the plan, they sent letters to all banks in which they had deposits, explaining the operation of the plan and asking for an indication as

to whether they were willing to render this service to their depositors. About 40 percent of the banks replied in the affirmative.

The local offices are authorized, contrary to the practice of the New York Life, to provide banks, in which policyholders have deposits, attractive booklets describing the plan. The first approach of a local office is usually when a specific premium-payer expresses his desire to pay premiums in this manner. A significant number of the banks approached on this basis declined the use of the plan.

Their \$10 minimum monthly premium for policies on the plan appears to screen out marginal business. Although there have been a handful of checks returned, they have not caused any serious problem.

MR. R. M. SELLERS asserted that since July 1952 slightly more than half of all Ordinary sales, by volume, in the Commonwealth Life Insurance Company have been made on the pre-authorized check plan. The plan has been successful with the field force, the home office, and the public alike.

At the present time, more than 1,200 banks are cooperating, despite the fact that there are important areas in which they have been unable to secure cooperation or in which cooperation has been discontinued. Deposits are maintained in only 222 banks. In 29 states in which they are not licensed to do business and hence have no prestige or legal status whatsoever, the cooperation of 166 banks, or 81% of those asked to participate, has been secured. The ratios are naturally much higher in areas where his company is well and favorably known. In general, no trouble has been experienced in the metropolitan areas. In no case have bank balances been maintained that would not have been maintained otherwise; nor has any payment been made to the banks. The entire approach has been that the service is rendered for the bank's client, not for the insurance company. Their system does not require any special services of the bank.

Serious problems have been avoided with checks returned on account of insufficient funds by a vigorous program of upgrading the quality of the business sold on this basis. Further, a change to a conventional mode of premium payment is required in any case where a second check is returned on account of insufficient funds within a twelve months period.

Prior to initiating this mode of premium payment, a detailed study of costs for this method of premium payment was made and established the propriety of using one-twelfth of the annual premium. The use of a minimum monthly premium of \$10 was involved in establishing the propriety of using one-twelfth of the annual premium.

The same bank indemnification agreement has been used since July

1952, without legal complications. More than \$5,000,000 of premiums have been collected to date. One bank which was sued by the beneficiary of a policyholder was defended and the suit was dismissed.

The first year lapse rate by volume for business sold by agents who write Ordinary insurance only has been as follows for each mode of premium payment: annual 4.4%, semiannual 9.8%, quarterly 32.9%, salary savings 5.9%, pre-authorized checks 6.4%.

There has been a decided shift in the distribution of business from annual, semiannual, and quarterly modes of premium payment since the introduction of this plan. Each mode has been decreased by approximately 50%.

He feels that the pre-authorized check plan has been particularly effective in their new agent training program.

MR. J. A. LIVINGSTON related that the Chairman of the American Bankers Association wrote a letter in September 1954 to all members of that Association regarding the "draft plan for paying insurance premiums." In that letter, eight reasons were set forth as to why the Bank Management Commission was not in favor of such a plan. Reason No. 8 was as follows: "Finally and probably the most important reason from the bank operations point of view, is the fact that if banks accept this draft plan for payment of insurance premiums, other companies such as finance, mortgage, utility, and department stores might similarly attempt to utilize this service. If this were to happen, there would be a staggering increase to banks in the cost of handling accounts."

Through the cooperation of the insurance companies working through various associations, agreement has been reached on the style of check to be used, the size and style of the authorization form, and the size and style and wording of indemnity agreements. These forms are acceptable to most banks. Thus the first seven objections of the American Bankers Association have been answered in large measure. However, there is no answer to objection No. 8, though in his opinion this objection has been used as an excuse rather than as a reason for not handling the plan.

In approaching bankers, his company, Liberty National, states that the bank draft plan of premium payment will not spread, and they emphasize that they think it is only usable where the amount of monthly payment is *constant*. He pointed out that most mortgage loan payments are subject to frequent change because of a change in the tax and insurance rates.

In the past two years, the number of checks drawn per month by the Liberty National has increased from 578 to 8,021. All but five of the nearly 250 banks in their home state are handling these checks for them. Ap-

proximately 90% of the banks contacted in the remainder of their sales area have agreed to handle such checks. Any attempt to extend the bank draft plan to mortgage payments at this time would make it exceedingly difficult to enlist additional banks in the bank draft premium collection plan and might well upset existing relations.

MR. H. G. EIMERS stated that the Washington National has been using the pre-authorized check plan since August 1955. They currently have only 1,600 such policies in force, but the volume is growing rapidly. They supplement their plan with a postdated check plan wherever the banks refuse to cooperate.

In their first year, they had about five percent of the checks returned. One percent was due to such difficulties as special checking accounts, etc. Of the four percent returned for insufficient funds, one-half were honored upon being redeposited.

Checks are presently being typed each month, but he expects the volume to justify the use of IBM equipment very shortly. At that time, it is expected that the savings in collection costs and the increased persistency will justify the low monthly premium, which is one-twelfth of the annual plus ten cents per policy.

Although they have not been using the pre-authorized check plan long enough to compile accurate lapse rates for comparison, they are experiencing a considerable reduction in first year lapses.

He is firmly convinced that the cost savings, the increased persistency, and the sales appeal of the pre-authorized check plan will justify its use.