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DIGEST OF SMALLER COMPANY FORUM

PREMIUMS AND DIVIDENDS

A. What considerations govern the mortality bases used by smaller companies in determining for ordinary insurance (1) nonparticipating premium rates and (2) dividends? What mortality studies can readily be made to assess the suitability of available mortality tables or modifications of them?
B. What are the advantages and disadvantages to the smaller company of special termination dividends or special quinquennial dividends?
C. Is it desirable and feasible to have separate dividend scales for policies which include disability benefits, double indemnity benefits or both?
D. What are relative advantages to the smaller company of (1) three-factor dividend system and (2) experience premium system? How is the latter applied?

MR. T. P. BOWLES stated that a small company does not have a sufficient volume of mortality experience to justify a scientific mortality investigation. Consequently, some of the smaller companies rely heavily upon the published tables of mortality put forth by reinsurance companies.

Regardless of the method used to obtain rates of mortality, it is important that there be a reasonable relationship between the rates assumed and the pattern of mortality experienced by the company. Mr. Bowles suggested that mortality ranges be established for the company by means of a mortality investigation using valuation records; a pattern established from these ranges will provide a mortality basis of some reliability.

MR. G. D. McKINNEY, speaking on section B, expressed the opinion that the advantages of special quinquennial or terminal dividends were purely competitive. By withholding a portion of annual earnings, larger dividends can be paid to persisting policyholders at the end of each five-year period, thereby reducing the average yearly cost as shown in net cost illustrations. Mr. McKinney expressed the opinion that such special dividends add to overhead, distort rates without promoting equity among the policyholders, and are unfair to policyholders who do not receive them. Companies not using these special dividends face severe net cost competition from companies which do.

MR. F. E. HUSTON pointed out that surrender dividends were favorably discussed in the Guertin Committee report on Nonforfeiture Benefits and Related Matters. Such dividend represents a special distribution of funds to the withdrawing policyholder—funds presumably earned under his policy in excess of the nonforfeiture value, but which have not been previously distributed as annual dividends.

MR. A. L. MAYERSON stated that quinquennial and terminal dividends provide a good way of distributing unforeseen surplus. In addition, if reserves on a group of policies have been strengthened by withholding surplus on that group, surrender dividends which return the surplus withheld are essential. Where used only for competitive reasons, such dividends appear to Mr. Mayerson as a subterfuge to avoid annual distribution.

MR. J. F. MACLEAN was of the opinion that smaller companies should maintain proportionately more surplus over guaranteed values than larger companies. The termination dividend provides an additional margin, while enabling smaller companies to be competitive in net cost. At the Bankers Life of Nebraska, termination dividends are considered a release of the policyholder's share of committed contingency funds, including the reserve for potential settlement option losses, and are paid only on surrender for cash.

MR. E. F. ESTES, discussing section C, reported that for the Bankers Life of Nebraska, gains from disability and double indemnity combined are rarely as much as 5% of total gains before dividends. As a practical matter, these supplementary benefits have been disregarded in the dividend scale. In a small company, the circumstances would have to be quite extreme to justify the labor of setting up and administering special dividend scales for these benefits.

MR. R. G. RINK, on section D, listed the advantages of the three-factor dividend system and the advantages of the two-factor dividend system. For the three-factor system: (1) It takes into account separately each of the three main sources of surplus, and, except for the amortization of early expenses, it pays out the gains as earned. (2) It is more flexible than the two-factor system in reflecting changes in mortality, especially where such changes predominantly affect one section of the mortality curve. (3) As it avoids long equations involving commutation columns, it is possible for personnel with little technical training to prepare the dividend schedule. (4) It is readily adapted to punch card procedures. An article entitled "Calculation of Life Insurance Dividend Tables," by H. Elizabeth Metcalf in the August 1953 issue of the I.A.S.A. *Interpreter* gives a detailed account of one such procedure. (5) As it is the traditional method of distributing dividends in the United States, it is more likely to be understood by nonactuarial people than the two-factor system.

For the two-factor system: (1) It can be used to avoid the unpopular decreasing dividend schedule. (2) It yields a smooth schedule. (3) It gives a series of realistic dividends by a calculation based on experience factors. Withdrawal rates do not usually enter this calculation; the effect of withdrawals may be minimized if the slope of the dividend schedule is devised with care.

The two-factor method has been used for Midland Mutual policies issued since January 1, 1948. Using a slightly loaded select experience mortality table and the valuation rate of interest, a level basic dividend was calculated. This dividend was modified in the second through the fifth policy years to 80%, 85%, 90%, and 95% of the level dividend, thereby producing more satisfactory asset shares. Where the premium paying period exceeded 20 years, a basic dividend was computed for the first 20 years and another for the remaining period; this improved the asset shares, although it also caused an undesirable break in the continuity of dividends. Basic dividends were computed at quinquennial ages and interpolated for all other ages; final dividends consisted of the basic dividends plus an excess interest factor.

MR. MAYERSON pointed out that the two systems are based on different philosophies and give different results. The three-factor formula is an attempt to distribute surplus as it arises. The experience premium method essentially consists of refunding any premium charged in excess of that which would have been charged at issue if dividends were not contemplated and if the future could have been foretold.

Under the two-factor system, adjustments are complicated, especially if a necessary change in scale is not made promptly.

Mr. Mayerson also referred to the desirability of a separate dividend for double indemnity. The New York Department has found that profits on disability waiver and double indemnity have been quite large; in one company a surplus of approximately fifteen dollars a thousand has been accumulated. With profits of that order, Mr. Mayerson felt companies were obligated to pay an extra dividend.