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Graded Premiums

A. What has been the effect of graded premium programs on the volume of life insurance written and the distribution of new business by plan, age and size?
B. Have any serious operating, policyholder, or agency problems developed?
C. Is there any emerging trend as to standardization with respect to policy fee or amount groupings, expense differentials by policy size, treatment of females, etc.?

New York Regional Meeting

MRS. JULIA S. OLDENKAMP stated that the Lincoln National adopted the principle of grading premiums by size of policy in June 1957. Coincident with this change the minimum policy size was increased from $1,000 to $1,500. With respect to section A, she indicated that although the company experienced a marked increase in average policy size during the latter part of 1957, it was believed that this was due more to the increase in the minimum policy than to the adoption of graded premiums. Similarly, there is no indication that the grading of premiums has had a material effect on the distribution of their new business by age and plan.

In discussing section C, Mrs. Oldenkamp introduced the following data as to the graded premium practices of the forty largest United States and Canadian companies in terms of Ordinary business in force.

1. Of the twenty largest companies, 85% grade premiums or dividends; of the next twenty, only 40% grade premiums on all plans.
2. Of those companies which grade premiums, about two-thirds use a band approach and about one-third use a policy fee method.
3. Among the companies which employ the band method of grading, there is considerable variation in the pattern of the bands used and in the maximum difference in the premium per $1,000 for a given plan and age.
4. Policy fees adopted range from $7 to $10. For about one-half of the companies using the policy fee approach, there is some modification of the fee for small policies; for the remaining companies, the minimum policy size is either $1,500 or $2,000.
5. Almost one-half of the companies which grade premiums offer lower premiums (or higher dividends) to women for most plans and in all amount groups. Another one-third offer lower rates only in the higher amount groups or for certain plans.

MR. WILLIAM C. McCARTER stated that at the beginning of 1957 his company, Northwestern Mutual, adopted a graded premium system with three size bands: less than $5,000; $5,000 to $9,999; and $10,000 and over. The grading principle has also been applied to policies issued before 1957 through variations in dividends by size of policy.

With respect to section A, Mr. McCarter indicated that since the introduction of graded premiums the Northwestern Mutual has issued an increased proportion of policies for $10,000 or more and has experienced an increase in average policy size of about $700, or 7%. There has also been a decrease in the average policy size for each of the size bands, indicating an upgrading in amounts in order to take advantage of lower premium per $1,000 in the next band. Like the previous speaker, Mr. McCarter indicated that the introduction of graded premiums does not appear to have brought about any significant change in the distribution by plan and age of the new insurance issued.

Commenting on section B, Mr. McCarter stated that the Northwestern Mutual had experienced no particular difficulty in effecting the change to the graded premium basis. One of the particular practices of his company which he cited was their handling of term conversion applications where the amount of the term insurance policy is $1,000 or $2,000 below the $5,000 or $10,000 minimum. They allow conversion to the minimum amount in the next size band on the basis of appropriate evidence of insurability.

Mr. McCarter also described a simplification of the Retirement Income plan which was brought about indirectly by the graded premium change. Their contract now consists of a basic Retirement Annuity contract supplemented by a decreasing term insurance benefit during the "a" period when the reserve is less than $1,000 per $10 of monthly income. This supplementary life insurance coverage has no cash value and hence the cash values under the combined contract are the regular Retirement Annuity values which are the same per $100 of annual premium regardless of age at issue, sex or age at maturity. For this contract the adjustment for size is made through the dividend and is the same as for policies issued prior to 1957.

MR. FRANK H. DAVID stated that at the beginning of 1959 the Prudential introduced a graded premium scale with the following size bands: $2,000 to $4,999; $5,000 to $9,999; $10,000 to $19,999; and $20,000 and over. Premium differentials between bands vary with the mode of premium payments to recognize that the per policy expense depends on the number of premium collections in a year. At the time of this change, the minimum policy size for regular Ordinary issues was raised from $1,000 to $2,000.

Discussing section A, Mr. David described the results of a comparison of a sample taken from recent regular Ordinary issues and a similar sample of April 1957 issues. Like the other companies, the Prudential experienced an increase in the proportion of policies for $10,000 or more, a decrease in the proportion of policies for less than $10,000, and little change in the age distribution of the business issued.

Discussing section C, MR. JAMES B. COPPLE pointed out four principal ways in which the lower female mortality on life insurance may be reflected by a mutual company. These are:

1. The use of an entirely distinct mortality table for premiums, values and dividends.
2. The use of premiums, values and dividends for a male age x years younger.
3. The use of special premiums but male values and dividends.
4. The use of male premiums and values but special dividends.

Mr. Copple pointed out that although the first method is probably best from a theoretical point of view, it is complicated to handle and substantial equity can be achieved by less expensive means. While the second method gives satisfactory results in most instances, the age adjustment for younger ages and endowment plans should be larger than that for older ages and life plans. Further, there are four or five states which do not permit a rating down in age.

For these reasons Mr. Copple concluded that under current conditions the best practical solution is the use of special premiums or special dividends. The former has the advantage of a lower initial cost but the special dividend approach permits a more accurate reflection of the actual amount of and incidence of the lower female mortality.

Mr. Copple presented a summary of the practices of twenty large companies which grade premiums or dividends. Of the seventeen companies which recognize lower female mortality directly, about two-thirds use special gross premiums for all or part of the business issued on female lives.

MR. ERNEST J. MOORHEAD, in discussing section A, pointed out that when his company, New England Life, introduced the principle of grading by size they also removed a restriction which had previously limited the issue of $1,000 policies to only certain plans. The result has been a disconcerting increase in the number of $1,000 policies.

Omaha Regional Meeting

MR. VICTOR E. HENNINGSEN said that Northwestern Mutual adopted a graded premium system on January 1, 1957, using three amount groupings—under $5,000, $5,000 up to $10,000, and $10,000 and over. Premiums are reduced $1.00 per $1,000 and $1.25 per $1,000 for the second and third groups respectively. To check the effect of graded premiums on the volume and distribution of new business, the two years' experience with graded premiums for 1957 and 1958 was compared with the two preceding years 1955 and 1956, excluding pension trust new business. He said the effect of graded premiums on size of policy has been to increase it. In

1955 and 1956, 30% of new policies were issued in the under $5,000 group, 31% in the $5,000 to $10,000 group, and 39% in the $10,000 and over group. With graded premiums in 1957 and 1958, the proportion of policies issued for $10,000 and over has increased to 47%, with corresponding decrease in the two lower amount groups. Apparently almost entirely as a result of upgrading many of the policies to the $5,000 and $10,000 minimums, so as to get the graded premium savings, the average amounts per policy decreased in each of the three groups, but the average amount per policy for all groups combined increased $700 or 7%, now amounting to $10,703.

Mr. Henningsen was of the opinion that graded premiums have undoubtedly increased the volume of new business to some extent, but no attempt has been made to measure the increase.

He saw no indication that graded premiums have had any effect on the distribution of new business by plan and age. There has been a gradual, but definite, shift away from low premium term plans and high premium endowments and limited premium life plans to the middle range of ordinary life and life paid-up at 65 plans, but this shift does not appear to have been influenced one way or the other by graded premiums. Neither does some change in distribution of new business by age appear to be related to the introduction of graded premiums.

Concerning section B, he stated that no particular difficulty has been experienced with graded premiums. To avoid errors in the field, gross premium rates should be furnished for all frequencies for each of the amount groups. Where the amount of insurance applied for is slightly less than the $5,000 or $10,000 minimum of each group, the gross premium can exceed the gross premium for exactly $5,000 or $10,000. In these cases, the amount of the policy is automatically increased to $5,000 or $10,000, as the case may be, except in pension trust cases where a specific amount of insurance and income are required under the trust indenture. Where the situation occurs on term conversions, conversion is allowed to the minimum amount on a personal health certificate or an abbreviated examination, according to the circumstances.

On policies outstanding prior to January 1, 1957, current dividend scales recognize the size group by an increased dividend. Initially, a flurry of requests arose to combine outstanding policies so as to get the larger dividend credit. This is permitted if the policy date and plan of the policies to be combined are identical. No difficulty materialized in refusing to combine policies of unlike date or plan.

The graded premium system resulted in the introduction of a step rate plan to replace the former 1 to 5 Year Initial Term plans used in series.

The purchaser is thus enabled to realize the saving in premium through issuing the entire amount under one policy.

MR. DALE R. GUSTAFSON, speaking on section A, said that United Benefit's new products with graded premiums by size have been in use only a few weeks. They have not had enough time to see the effect of graded premiums on their average size policies sold or distribution by plan or age. No significant effect on volume of life insurance could be discerned by looking at industry total figures.

Speaking on section B, he said the concept of grading premiums by size has been very enthusiastically received by their field force. In spite of the complexity and negative aspects of some of the changes in their new rate book, they have experienced a substantial increase in new business with the new rate book, believed to be largely because of the salability of the discount idea. While some problems and a few complaints arose because of a higher premium charge for most small policies and because of the increase of their minimum size policy issued from $1,000 to $2,000, except at juvenile ages, his company has as yet been confronted with no serious problems because of grading premiums by size.

Speaking on section C, Mr. Gustafson said that a great many companies have assumed that the total annual amount of expense that does not vary per policy is between $8 and $12, while a few companies have used figures smaller than that. United Benefit concluded that the total amount of their expenses that could properly be assumed to be constant per policy was approximately $10.70 per year. On this basis, they adopted the following amount groupings and discounts:

Face Amount of Policy	Discount per $1,000
$ 2,000 to $ 2,999	No discount from rate printed in Rate Book
$ 3,000 to $ 5,999	$2.00
$ 6,000 to $11,999	$3.50
$12,000 to $24,999	$4.25
$25,000 and over	$5.00

A method of grading premiums developed by several companies applies a given rate printed in their rate manual to the first $3,000 or $4,000 of insurance, and a lower rate per $1,000 to the amount purchased in excess of the first basic amount.

MRS. JULIA S. OLDENKAMP repeated the information she had given at the New York regional meeting, and pointed out that there is no clear pattern of standardization with respect to method of grading premiums. Mr. Gustafson had reported that a survey showed substantially more mutual companies using the amount grouping basis than the policy fee basis, but many, including very substantial ones, are using the direct policy fee approach. The stock companies seem to be almost equally split between the amount group and policy fee approach. Mrs. Oldenkamp reported that of the 40 largest companies, 68% of those which are grading use a band method and 32% a fee method; of the companies after the first 40 who grade premiums, some 80% use the band approach and 20% the fee approach.

Based on the 16 largest "band" companies, the number of bands used varies from three to five, with the majority using four bands. The most common dividing points are at $5,000 and $10,000. All but one company varies premiums, with the one varying dividends. Among the 8 "policy fee" companies studied by Mrs. Oldenkamp, the fees range from $7.00 to $10.00, with either some modification for small amounts or a minimum policy of either $1,500 or $2,000. The maximum difference in premium per $1,000 for the smallest and largest amounts of insurance offered by a given company, whether band or policy fee, ranges from $1.25 per $1,000 to $5.00 per $1,000, the median difference being $2.50 per $1,000.