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Recent Experience

A. What has been the effect of recent economic conditions (recession, higher interest rates, inflation, etc.) on the volume and distribution of new business?
B. What has been the recent trend in lapse rates? How has this situation been affected by recent product changes?
C. What statistical information has been developed to show the trend of expense rates in recent years? What significant steps have been taken which affect such rates?

New York Regional Meeting

MR. DONALD J. VAN KEUREN, in discussing section B, said that from a low point reached in 1945 the lapse rate for Metropolitan's regular Ordinary business had shown a slow but perceptible rise each year until 1957, when the recession caused an abrupt rise which continued into the spring of 1958. Since then the lapse rate has eased off somewhat. For 1958 as a whole, the regular Ordinary aggregate lapse rate was about 6 percent, approximately that of 1935.

He noted that the aggregate lapse rate is strongly affected by the proportion of newer business to total in force. About one fourth of the increase in 1958 over 1957 was accounted for by the increase in the proportion of new issues and about three fifths of the increase resulted from the higher lapse rates customarily associated with the last four years of issue. An analysis by issue year indicated that the lapse rate on older business was not nearly so unfavorable as the aggregate rate would make it appear and that the increase in lapse rate was most pronounced in the issue year.

With the introduction of the family policy there was some lapsation for replacement purposes but the effect on lapse rates was not nearly so great as had been feared; the increase in lapse rate was about 10 percent on Debit business and some 2 to 3 percent on regular Ordinary business.

MR. JOHN F. RYAN observed that the experience of New York Life followed about the same pattern. While their total voluntary terminations have been increasing each year in absolute amount, analysis showed that withdrawals in 1954, 1955, and 1956 were practically 100% of those expected. For 1957 and 1958, however, withdrawals were considerably in excess of the expected volume of withdrawals.

He added that the family policy itself can be expected to result in extra lapses. A considerable portion of their family plan business is written on a monthly premium basis which shows a high lapse rate. Accordingly, a company which writes a good amount of family plan insurance can expect to see its lapse rates go up.

MR. BERT A. WINTER, in his discussion of section C, observed that a Cost Allocation Division organized about twenty years ago by the Prudential to develop more accurate and efficient methods of cost allocation by branch of business had produced an equally important by-product of its studies in the form of staffing guides and other expense standards for use by management. He felt that the accuracy of branch allocation was enhanced by being based on unit costs which are accepted as fair standards by management dealing with a large variety of conditions.

He said that their statistics show the effect of the resumption in the last three years of the general price inflation that had extended from the end of World War II to the end of the Korean War. Steps such as mechanization of routine administrative operations have not yet begun to pay off fully in the savings still expected when they become fully operational.

He pointed out that the practice of allowing for size of policy in premium rates or dividends further complicates the expense picture. While the resulting incentive to increase the average size policy tends to reduce expenses—which are essentially per policy—when expressed as a percentage of premium or amount of insurance, these reductions in cost are accompanied by corresponding reductions in premium or increases in dividend. Accordingly, the practice does nothing to diminish the threat to surplus of continued inflation of per-policy expenses, but rather it enhances the threat since it substantially removes the protection formerly available from successful efforts to increase the average size of policy sold.

He regretted that he had little new to offer in the way of methods of reducing expense without impairing effectiveness—increased effort to make fully operational the new mechanized systems, and rigorous scrutiny of the necessity for increases in staff or other operating expense.

MR. ARTHUR PEDOE observed that Industrial life insurance used some very simple schemes to keep expenses down and he recommended adopting some of these schemes rather than making Industrial life insurance similar to Ordinary life insurance. He noted that in his company in Canada (he is now retired), the Prudential of England, about 85 percent of the business was written on three plans, yet the agent was allowed to write any one of 30 to 40 plans. He quoted Mr. Ryan as saying that a similar situation existed in the New York Life. Mr. Pedoe regarded this sort of situation as wasteful. He declared that the way costs are going we have quite a problem.

He said that the Canadian Association of Actuaries has a committee of one—he is the chairman of that committee—to report on the trend of expenses. From an observation of the figures for the year 1958, he said that the unit expenses were still moving upwards. Further, expenses have been increasing each year for at least the last ten years. He felt that it was very serious to have unit expenses going up in spite of increases in average size of policies.

Mr. Pedoe noted that Mr. Winter had said that the effect of mechanization had not yet been shown in the expense ratio. Mr. Pedoe expressed doubt that it would ever show, although he also felt that it was necessary to adopt these giant brains, considering the way business is done these days.

He made an appeal to the effect that companies should publish figures giving their functional costs. The expense ratios obtained by the Canadian Association of Actuaries, which had been quoted at the Cincinnati meeting, were obtained merely by applying cost figures on an expense financial basis and comparing the total expected with the actual expenses; they were consequently of limited value. He felt that if some company had been analyzing its functional costs to show how they were built up, it would be a surprising disclosure to show how these functional costs had varied over the last 10 or 15 years.

Omaha Regional Meeting

MR. ALTON O. GROTH opened the discussion by stating that in the Equitable of Iowa there was no appreciable change in the proportion of term written during the last two years, but that ordinary life had increased substantially at the expense of endowment and limited premium life.

Lapse rates at the Equitable increased somewhat in 1958; in fact, the first year lapse rate which has been very low over the years reached a 10-year peak. This experience is attributed to general economic conditions. Replacements of existing insurance by recently developed products, such as family plan coverage, minimum deposit plans and policies with lowered premiums due to size grading, have been relatively insignificant.

With regard to section C, Mr. Groth stated that his company determines each year, from the annual statement, first year and renewal expenses per policy. These have increased steadily, although a substantial yearly increase in the average size has slowed the increase in overhead per $1,000 of face amount. Premium grading by size, by encouraging larger sales, should slow the increase in expense per $1,000. Other statistics developed annually, such as average annual salary per employee, assets per employee, payroll cost per $1,000 of insurance, per policy and per

$1,000 of premium, combined payroll and machine costs per unit, etc., indicate that expenses continue to rise and are difficult to control.

His company has taken many steps to try to reduce expenses. The use of handwritten interoffice memorandums and letters has been introduced. Interoffice letter style has also been streamlined for both typed and handwritten letters. A provision introduced in policies seven years ago, namely not requiring the policy for endorsement of beneficiary changes, is beginning to show savings in clerical expenses and postage. This provision is also available to old policies through amendment. Two years ago revised rules gave the beneficiary the same rights of election of settlement options after the insured's death as he could have directed for her while alive. Requests for directions from insureds have thus been reduced substantially. The latest series of policies provides for a minimum of $2,000 proceeds to be left with the company, the minimum installment being $20. Also new is a revised automatic premium loan clause providing that, after one premium has been paid automatically by loan, the clause is inoperative on the next due date. The clause will still protect against inadvertent lapse and will bring economies in years to come as compared to the previous clause. Other changes have been the elimination of signed loan agreements for cash loans, with the endorsed check constituting the agreement, and the adoption of block style for the policy face for ease in reading and filling in significant information. All checks are now on punch cards to facilitate reconciliation with bank statements. Spelling out the amount of the check has been discontinued. A further substantial time and expense saver adopted by Equitable of Iowa and many other companies has been the preparation of copy for rate books from punch cards, with the copy being reproduced in finished form by photo-offset methods. In certain areas expenses are increasing temporarily because of dual maintenance while highly mechanized procedures are being installed. After the transition has been completed, significant savings are anticipated.

MR. RALPH H. GOEBEL asked Mr. Groth how the elimination of the former automatic premium loan provision saved expenses. Mr. Groth replied that a high proportion of total loan transactions were represented by APL's. If they could be cut down, much time and expense would be saved.

MR. RICHARD H. TALLMAN stated that new business written by Northwestern National increased 99% over a 5-year period, the average size policy rising from $5,100 to $7,400. Inflation and the favorable climate for life insurance contributed to the increase, but the company's agency expansion program and development of policies suited to the agents' markets were most significant. In the same 5-year period the proportion of whole life and term has increased from 68% to 85% of total sales at the expense of limited premium life and endowments. The increase in decreasing term sales was very great. The relative increase in whole life sales was due to a ready market being capitalized on by bringing out competitive high minimum specials. Decreasing term contracts were introduced to fill a compelling need of his company's field force. He also stated that a composite of 16 other companies, some large and some small, showed a similar but less marked trend to term.

Lapse rates on the LIAMA basis have risen steadily since 1952 for his company. The rise is attributed mainly to an agency expansion program and product changes and to a slight extent to economic conditions. Some of the recent sales growth has not been healthy, and persistency is now being emphasized. Sale of more term, especially decreasing term, has increased over-all lapse rates, since these plans are inherently less persistent. He also stated that a composite set of Best's Lapse Ratios for the 16 companies showed a rising trend similar to that for his company.

Turning to section C, Mr. Tallman stated that his company studies its expenses annually for ratemaking purposes, bringing out expenses per policy, per $1,000 and as a percentage of premium. Federal income taxes are taken as a charge against the interest rate and have been rising. On a per unit basis the expenses have remained quite stable, except for first year per policy expenses which have risen substantially. Increased costs and an increase in average size, with total numbers issued each year not increasing too much, have caused the rise. Renewal per policy expenses have remained about the same, increased costs being offset by increased efficiency and volume. Main causes of increasing expenses are agency expansion, increased salary costs and development expenses connected with data processing investigations. Steps taken to slow down the increase are the institution of salary, agency and equipment budgets on a yearly basis, preparation for a consolidated function data processing system, and exploration of possible clerical savings by engaging management consultants.

MR. DALE R. GUSTAFSON stated that total home office expenses of the United Benefit, a company with over 600 employees, have increased by only about $30,000 in 1958 and probably will increase little in 1959 despite growth in business. He attributed this to the fact that their president sits right on top of cost control. A cost committee operates for the purpose of informing him on what can be and is being done. Every employee knows that everyone from the top down is interested in doing a more efficient job.