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Dividends

A. Are the traditional three-factor and experience-premium methods of distributing surplus adequate for the achievement of equitable results under present conditions? What other methods are being used or considered?

B. What administrative problems have been encountered as a result of the extension of the one year term dividend option (both the premium reduction and balance on deposit versions) to all plans of insurance where this is required by state regulation?

MR. JOHN M. BOERMEESTER opened his discussion of section A by enumerating some of the recent developments in the industry that have tended to create new dividend classes. Some of these developments are:

1. Guaranteed issue, where several cost patterns may emerge as a result of varying underwriting conditions.
2. Variation of premium by size of policy and by sex and variation of cash value by size. With the passage of time, equity may demand debits or credits in the dividend formula.
3. Guarantee of purchase price for life income benefits, which will undoubtedly produce dividend problems if the assumed annuitant mortality rates do not hold.
4. Credits granted under the new federal income tax for qualified pension trust business.
5. Family plans where mortality costs will be a blend of those of adult males and adult females and children.
6. Automatic inclusion of disability or accidental death benefits, which results in different patterns of expense.
7. The 1958 CSO Table with new cash value levels, which will change the incidence of the emergence of surplus.
8. Expansion of both substandard insurance classes and preferred risk classes.

Mr. Boermeester felt that, in light of these new dividend problems, we might inquire how the mechanics of determining dividend scales could be simplified. The defects of the three-factor contribution method have been widely discussed, and he wondered if actuaries have not clung to the method too tenaciously in view of the modern equipment and techniques which account for the various costs and expenses of insurance. The procedure followed by companies using the contribution method is to develop thousands of asset shares to indicate where dividend margins are available. A tentative dividend scale is developed and is tested by new asset share calculations. If it is satisfactory, it is adopted; if not, a new cycle of operations is performed.

He suggested that, if the dividend scale is controlled by the relationship which exists between asset shares, cash values and the incidence of contributions to surplus, the dividend formula could be considered in the nature of an interpolation device. We might start with asset share assumptions, obtain reasonable guide values at pivotal ages and durations, and operate upon these amounts as pure numbers, imposing certain conditions which relate to initial values, the slope of values and contributions to general surplus. Such a system might provide more equity and with a well-designed computer program be less expensive than our current procedures.

MR. NEIL W. MACINTYRE, speaking on section B, said that Mutual Of New York had anticipated two types of administrative problems.

1. The possible preparation of the voluminous illustrations of the bank loan type. Their solution was to prepare and distribute a set of minimum deposit illustrations for their one high early cash value plan only.
2. Election on a large scale of the one year term dividend option (in particular before conversion to magnetic tape is completed). The agents were asked to restrict the use of this option to those cases where there was a demonstrable need. An analysis of issues of the second quarter of 1960 showed that 52% of the applicants for the high early cash value plan elected the one year term option. The corresponding figure for all other eligible plans was $\frac{2}{3}$ of 1%, a very gratifying result.

MR. JAMES J. CONNORS said the principal problem involved with the extension of the one year term dividend option to all plans of insurance was connected with determining the underwriting rules. The New York Life will not offer the one year term option on certain plans (term policies, permanent policies with supplemental term coverage, joint life policies, single premium policies and educational endowment policies), at ages under 15, or on policies in certain substandard categories. They prepare one year term illustrations only for the four minimum amount plans on which the option was originally offered, instead of for all plans on which the option is currently available.

He said that more administrative problems arise from the option itself than from its extension to all plans. Some of these are:

1. Modification of existing dividend procedures to provide for calculation of one year term amounts and preparation of special dividend notices.
2. Establishment of valuation, Policy Exhibit and other accounting procedures.

3. Termination of the option. The New York Life provides for return of a pro-rata portion of the one year term premium where the option is terminated off the anniversary. It also provides for termination of the option on the anniversary if the policy's indebtedness then is secured by outstanding dividend deposits.

He said that the problems would have been much greater if they had not had the use of electronic data processing equipment.