**TRANSACTIONS OF SOCIETY OF ACTUARIES
1960 VOL. 12 NO. 32**

POLICY LOANS AND SURRENDERS

A. To what extent has there been an increase in policy surrenders or an increase in demand for policy loans in the last year—in the last six months? What are the prospects?
B. Are companies now charging policy loan interest rates lower than permitted by contract? What are the advantages and disadvantages?
C. What are appropriate policy loan interest provisions?

MR. DANIEL BARRY reported that the ordinary cash surrender values paid by the New York Life have been increasing each year since the first base year considered in their analysis, rising from $41.7 million in 1954 to $77.5 million in 1958. In 1959, there was a further increase of $5 million over 1958. Surrender values paid during the first six months of 1959 exceeded payments for the comparable period of 1958 by 5%, but for the entire year they were up 6.5%.

Since part of the rise in amount reflects the greater exposure to surrender because of growth of assets, rates of surrender were developed by relating surrender values paid during a year to aggregate cash values exposed at the beginning of the year. The rates of surrender are shown in the accompanying table, along with first differences. The table shows that a

Calendar Year	Rate of Surrender	First Differences
1954	1.48%	
1955	1.64	.16%
1956	1.81	.17
1957	2.12	.31
1958	2.40	.28
1959	2.48	.08

slow-down in the rate of increase in the surrender value rate began in 1958.

The increases in policy loans each year since 1954 exhibited an irregular pattern with 1959 being the largest. An analysis by months revealed a significant increase in policy loans during the last six months of 1959. Rates of election and rates of cancellation of policy loans were developed by relating new net policy loans to cash values less loans outstanding for the former and loan cancellations to policy loans outstanding for the latter. The table on page 90 shows these rates by calendar year.

Mr. Barry stated that the contracts of his company are subject to three guaranteed loan interest rates, namely 6%, 5% in advance and 5%

accrued. The figures in parentheses in the table represent the 5% accrued rate, which is the contractual rate of the more recent policy issues. Automatic premium loans have been included.

A projection of the rates of surrender and rates of policy loan election and cancellation assuming a continuation of the "tight money" situation produced evidence of further financial selection by insurance policyholders.

Calendar Year	Rate of Policy Loan	
	Election	Cancellation
1954......	2.14% (3.69%)	17.3% (21.4%)
1955......	2.13 (3.67)	17.4 (20.8)
1956......	2.42 (4.01)	17.3 (20.1)
1957......	2.98 (4.98)	17.6 (20.4)
1958......	2.94 (4.95)	19.2 (22.3)
1959......	3.23 (5.37)	17.0 (19.6)

MR. FRANK H. RICE stated that the upward trend in interest rates has had a very noticeable effect on the policy loan account at Northwestern Mutual, especially when the prime rate of commercial banks on loans where insurance policies are used as collateral approached and rose above the 5% interest rate quoted in those policies. New and increased loans closed in 1959 were up 5% by number and 14% by amount over 1958. A breakdown by month, however, revealed that while new loans made during the early months of 1959 were lower by both number and amount than those made during the corresponding months one year earlier, the trend changed around September so that during the latter months of 1959 new loans were up one-fifth to one-third by number and 85% by amount over the same months of 1958. The increase in amount of policy loans in force each month has been two or three times the increase in number in force. The net cash (new and increased loans less repayments in cash) paid out on policy loans in 1959 was half again as much as during 1958. The number of policies surrendered during 1959 actually decreased from 1958, while the number of dividend additions surrendered was up slightly.

In regard to section B, Mr. Rice stated that his company charges the rate given in the policy provision. He felt that a set interest rate has many advantages. Repayment calculations are simplified, while a variable rate would encourage confusion, complexity, and argument. A rate two or three percent above the guaranteed cash value interest rate is generally accepted. He reported that an examination of the loan provisions of fifteen large companies revealed that the only significant differences seemed to be (1) when interest becomes due and payable and (2) the definition of loan value, *i.e.*, whether the cash value on the next policy anniversary, or the cash value on the date to which premiums are paid, or the cash value one year from the date of the loan would be discounted at 5%.

MR. SAMUEL P. ADAMS said that for Lincoln National's direct business the ratio of paid surrender values to reserves, month by month over the last twelve months, shows a somewhat erratic but apparently downward trend, especially in the last three months. The ratio of the policy loan account to reserves exhibits a steady but slightly increasing trend over the same period, with most of the increase occurring in the last few months. He was of the opinion that there is nothing in the immediate future that might cause a sharp change in the amounts needed to take care of surrenders and policy loans.

In discussing section B, Mr. Adams stated that his company has always charged the full contractual interest rate for policy loans. He felt that charging less than the contractual rate could only encourage the making of policy loans, adversely affect persistency, and impair the policy's ability to do the job for which it was purchased. From the current investment standpoint, the net rate of return on a 5% policy loan after expenses and taxes is not attractive.

MR. WILLIAM J. NOVEMBER stated that although policy loans made during 1959 by the Equitable Society were up only 13% over the previous year, the last six months of 1959 showed an increase of 25% over the comparable periods of 1957 and 1958. The early months of 1960 showed an even greater increase, evidencing a demand for money that is adverse to the company.

In discussing section B, Mr. November said that in 1944 his company reduced the policy loan interest charge on pre-1939 issues from 6% to 5%, thereby using one rate for all policies. The desire to avoid adverse public relations resulting whenever a policyholder with different contracts was charged different interest rates was a consideration. The investment situation prevailing at the time may have been a contributing factor. Although they have considered returning to the 6% rate, they have not felt it advisable to increase the interest charges to policyholders who have been borrowers from the company.

Mr. November pointed out that the use of a variable interest rate would present difficulties under the automatic premium loan clause, considering the way in which the clause is now used in lieu of extended term insurance.

MR. J. ROSS GRAY reported that for some years the Canada Life charged in Canada a policy loan interest rate lower than guaranteed by contract. The policyholder, when he made the loan, was told that the guaranteed rate was 6% but for the following year the charge would be some lower rate. In view of current investment opportunities, they have returned to the guaranteed 6% interest rate and have experienced no particular unfavorable policyholder reaction. The use of different interest rates under the automatic premium loan provision apparently caused no problems.