



SOCIETY OF ACTUARIES

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Business Life Insurance Proposal

(Continued from page 1)

of life insurance range from modest supplemental benefits to substantial sums designed to create estates for the executives.

Tests That A Sound And Adequate Proposal Should Meet

There are sound reasons for a company to purchase ordinary life insurance on its executives, but the proposals used for sales purposes frequently do a poor job of illustrating how these plans work and the real cost of the program. Illustrations often try to portray the plan as a no-cost item. To be sure that business insurance proposals give a true picture of their cost and enable the buyer to reach an intelligent decision, the following tests should be made.

(1) The time value of money must be recognized. And, because the purchase contemplates transferring large sums from the firm to a life insurance company, the firm has a right to know what rate of return is involved in this transfer. I believe that for business insurance proposals rate-of-return information is essential.

(2) Mortality assumptions should be appropriate and consistent with those used in determining the life insurance premiums and dividends. Fallacious calculations, such as those using the life expectancy concept, census data, and the 1958 CSO table, must be avoided.

(3) The likelihood that some lives will prove to be substandard should be taken into account, specially when comparing an individual policy arrangement with a group insurance plan.

(4) All tax aspects, not just the favorable ones, should be fully explained. It is common for agents to stress favorable Section 79 status or estate tax results, but to down-play the widow's ordinary income tax liability.

(5) Cost illustrations should recognize that not all covered executives will stay in the plan until death or retirement.

(6) Comparisons between costs of different funding methods should employ actuarial procedures that properly reflect the yearly benefits.

(7) Deferred compensation benefits should be measured in terms of their after-tax values.

(8) When benefits are related to salary, the proposal should explain how increased benefits will be provided and, if a different premium band or policy form is to be used, the cost of the new plan compared to the original.

(9) Proposals should provide appropriate funding for all benefits offered. For example, plans designed to provide retirement benefits should not use a minimum deposit arrangement.

(10) Disclosure information is useless once the program is approved by management, hence it should be presented as part of the original proposal.

Responsibility of Actuaries

The only people who have sufficient background to appraise these proposals are actuaries. So it is up to us to instruct agents and those who train them and design sales material for them. Statements in proposals that can be made only after actuarial analysis should be certified by qualified actuaries.

Before corrective steps have to be demanded by others, insurance company actuaries had better find out what their agents are doing in presenting business insurance proposals, and get rid of inappropriate procedures whenever these are found. □

Steering Clear of Antitrust Violations

You can reduce the chance of inadvertently getting yourself and the Society into legal difficulties stemming from your Society activities if you will read the Academy's ANTITRUST GUIDE, a 23-page pamphlet written by the Academy's General Counsel, William D. Hager. Our President, Julius Vogel, has sent a copy to each Board member and each committee chairman, and commends it to every active Society member. See the Academy Newsletter, May 1980, for a description of its contents.

You can obtain one free copy (additional copies 50¢ each, prepaid) by writing to Cheryl Long, American Academy of Actuaries, 1835 K Street, N.W., Ste. 515, Washington, DC 20006.

ACCEPTABILITY OF PAPERS FOR THE TRANSACTIONS

by Edward J. Porto, Chmn.,
Committee on Papers

Potential authors of papers for publication in the *Transactions* should take note of the following changes that were made several years ago in the general considerations for acceptable papers:

- (i) The requirement that the subject be "of interest to a substantial proportion of Society members" has been replaced by the less stringent requirement that it be "of professional interest."
- (ii) The requirement that the paper be more suitable for publication in the *Transactions* than in some other publication has been deleted.

These liberalizations first appeared in the 1978 Year Book, but may have escaped many members' notice.

In regard to (i), the Committee on Papers obviously will continue to include interest to members among the factors that determine whether a paper is acceptable; but this factor has been down-graded considerably in importance.

On another matter: Ever since ARCH came into being in 1973 there has been one exception to the long-standing rule that a paper published or widely distributed elsewhere will generally not be accepted for the *Transactions*. Please be assured that a paper built on a previous contribution to ARCH will not be barred from the *Transactions* if otherwise acceptable. □

NEWS FROM LONDON

After 3½ years of work, a Committee to Review the Functioning of Financial Institutions, chaired by former Prime Minister Sir Harold Wilson, published its Report in June. Two F.I.A.'s were prominent in its work: Mr. Gordon V. Bayley, a past president of the Institute, was one of the 18-member committee; Mr. Peter G. Moore, a past Institute vice-president, was a committee consultant, specially for its study of pension funds. An article on the Report is planned for our next issue.

Another Institute past president known to many here, Mr. Ronald S. Skerman, has been awarded the Institute's Gold

(Continued on page 7)

News From London

(Continued from page 6)

Medal "in honour of actuarial work of pre-eminent importance."

The July issue of FIASCO contains a letter from an Australian actuary, Mr. John T. Corbett, describing his company's option, included in all policies accepted standard, that permits an annual increase in face amount proportionate to the rise in the consumer price index.

In its annual policy cost comparison article, *The Economist* says this about

non-par whole life policies:

The amount finally paid out . . . is arrived at by the life office's in-house mathematician who peers into the future—the actuary. . . . If his assumptions are cautious or even pessimistic (as they usually are) then at the end of the day, there will be a surplus over the guaranteed sum (as there usually is) that goes into the company's reserves. The policyholders' returns on non-profit policies are puny. . . . As a method of investment with-profit policies are plainly preferable to

non-profit ones.

The Institute's President for the next two years is Mr. Anthony R. N. Ratcliff, F.I.A. 1953. Mr. Ratcliff's interest in North American matters is evidenced by his having been an Associate of the Society since 1965. An American actuary who chatted with him just before he took office readily confirmed FIASCO's appraisal that he has a friendly personality and enjoyable sense of humor. To the extent that a company Chief General Manager may be said to have specialized, his major field has been Pensions. We look forward to a visit from him. □

FINANCIAL CONDITION OF OASDI SYSTEM

by E. J. Moorhead

The 1980 Trustees Report

Readers determined to keep abreast of the condition of, and outlook for, the OASDI system — we hope there are many — can do so by requesting a copy of each of two clearly written and fairly brief documents, viz.,

(1) *Summary of The 1980 Reports On The Social Security Trust Funds*, June 19, 1980, prepared by the Social Security Administration and Health Care Financing Administration. Consisting of only 23 pages—two of which are highlights of highlights, and five others are charts—this gives the major findings and forecasts extracted from the customary three Trustees Reports.

(2) Francisco R. Bayo and Joseph F. Faber, *United States Population Projections for OASDI Cost Estimates*, 1980, Actuarial Study No. 82, Social Security Administration, June 1980. In its 54 pages this presents the population projections used in the 1980 Reports. Separate sections describe assumptions, methods and results; life expectancies and fertility rates are charted.

Copies of these can be had free from Office of the Actuary, Social Security Administration, Baltimore, MD 21235.

The existence of Item 1 above makes it redundant for this newsletter to continue our customary series of annual articles summarizing the Trustees Reports. Instead we shall comment in this space on a few features revealed by the Reports. Only OASDI will be discussed here; Medicare will be saved for later.

How Have Short-Range Estimates Worked Out?

Table 1 herewith undertakes to display how the official estimates of income, disbursements, and changes in fund balances for the years 1980, 1981 and 1982, have been modified through three successive Trustees Reports. Actual results for 1978 and 1979, and 1980 estimates for 1983 and 1984 are shown for comparison.

It can be seen that the annual estimates for 1980 made ever since the 1977 amendments were adopted, have been within a reasonably compact range, but the original estimates for 1981 and 1982 have had to be changed materially in the unfavorable direction. For 1984, the 1980 range of estimates extends all the way from plus \$25 billion to minus \$43 billion, a spread of \$68 billion which seems certain to raise some eyebrows.

OASDI, TABLE 1

Estimates of Financial Condition of Combined Trust Funds
Given In 1978, 1979 and 1980 Trustees Reports
(Figures in billions of dollars)

| Calendar Year | Report Year | Income | Disbursements | Net Increase in Funds | Funds Dec. 31 |
|---------------|----------------|------------|---------------|-----------------------|---------------|
| 1978 | 1979, Actual | 91.9 | 96.0 | -4.1 | 31.7 |
| 1979 | 1980, Actual | 105.9 | 107.3 | -1.5 | 30.3 |
| 1980 | 1978, Estimate | 119 to 116 | 119 to 121 | 0 to -5 | 29 to 24 |
| | 1979, " | 121 to 119 | 121 to 123 | 0 to -4 | 31 to 27 |
| | 1980, " | 121 | 124 | -3 | 27 |
| 1981 | 1978, Estimate | 140 to 134 | 131 to 134 | 9 to 0 | 38 to 24 |
| | 1979, " | 141 to 139 | 134 to 139 | 7 to 0 | 37 to 26 |
| | 1980, " | 142 to 138 | 145 to 149 | -3 to -11 | 24 to 16 |
| 1982 | 1978, Estimate | 157 to 150 | 143 to 149 | 14 to 1 | 52 to 25 |
| | 1979, " | 159 to 155 | 148 to 154 | 11 to 1 | 48 to 27 |
| | 1980, " | 163 to 158 | 165 to 174 | -2 to -16 | 22 to 0 |
| 1983 | 1980, Estimate | 182 to 179 | 183 to 198 | -1 to -19 | 21 to -18 |
| 1984 | 1980, Estimate | 204 to 200 | 200 to 224 | 4 to -24 | 25 to -43 |

(Continued on page 8)