**TRANSACTIONS OF SOCIETY OF ACTUARIES
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DIGEST OF DISCUSSION OF SUBJECTS OF SPECIAL INTEREST

INDIVIDUAL LIFE AND HEALTH INSURANCE

New Products and Special Markets

A. Modern computers make it feasible to consider marketing a flexible policy under which the premiums and benefits could be changed to meet the changing needs of the policyholder.
   1. What problems with respect to such a policy are raised by current laws—in the United States and Canada—and how might these problems be solved?
   2. What problems, including those involved in the payment of commissions, does such a policy pose?
   3. What policies of this type are now being marketed and with what success?

B. What have companies devised in the way of products or sales packages to serve special markets, such as teachers and medical students? Have the sales results justified the costs of development?

C. What problems are involved in the design of a participating policy in which the amount of insurance is reduced after a short period of time and which has paid-up additions and one-year term insurance purchased by dividends to maintain the original amount?

Monday Session

MR. ARDIAN C. GILL: Computers may make it *feasible* to produce a highly flexible policy with benefits and premiums that vary with the policyholder's whim. Whether it is *desirable* to do so is another question. The truth probably is that the general public neither needs nor wants a great deal of flexibility. Any attempts on our part to anticipate his changing needs and to build into our policies the necessary flexibility may well be futile for the run-of-the-mill policyholder.

There are, however, special situations where the need to change is predictable and where a company, to serve its own ends, will build in all the flexibility that its talent and programing priorities will permit. I refer to the individual policy tax-sheltered markets in the United States.

In pension trusts, in individual H.R. 10 plans, and in schoolteacher annuities, we need to accommodate small increases in benefits to avoid issuing small policies. We need to accommodate stop-and-go without the payment of back premiums. A schoolteacher back from a salary-less sabbatical is not anxious or able to pay back premiums for which he will

have no tax exemption. It would be ideal to handle these changes within the same contract.

Assuming that you have provided for stop-and-go in a life insurance policy, you still have one problem after an interruption. Your agent will want renewal commissions to be paid on the equivalent of the skipped premiums. However, New York's Section 213 speaks of "premiums for the first *n* years *after the first year of insurance*" in its references to renewal commission schedules, so you may be precluded from paying as much commission as you would otherwise be willing to pay.

We have experimented with a plan that permitted the face amount to be increased. Our agents tell us that the advantage of saving a $10 policy fee or of having everything in one policy is overbalanced by the need to worry about beneficiary and rights clauses, split incontestability and suicide clauses, and the inherent commission confusion which arises. The standard nonforfeiture law did not contemplate contracts of this nature. If both the premium and the face amount increase at some unknown future date, how do you apply the equivalent level amount provision or the requirement that adjusted premiums be a uniform percentage of the gross premiums? About all that you can do under the standard nonforfeiture law and under Section 213 is to assume that the laws apply as they would to two separate policies. You are still left with a problem on extended term. After the face amount is increased, the cash value is increased to a lesser extent. If a lapse occurs, you may double the amount of extended term but drastically reduce the term period. It is impossible to reproduce the effect of separate policies without complications at least as great as if we had issued two separate policies in the first place.

Faced with all this, we have settled on a system for changing policies by rider, giving the rider a semiseparate existence, which avoids some, but by no means all, of these problems.

I offer two methods of approach to flexibility, with the guarantee that they are not problem free:

1. Merely apply a split to the net premium in a manner similar to the method in Question C, under which dividends are split between one-year term and paid-up insurance. You could then vary insurance and premiums with considerable freedom.

2. Merely apply the net premium to the purchase of extended term insurance or to extend the term of insurance already purchased. This permits flexibility in the time of premium payments as well as in their amount. This method is discussed at some length by Maurice LeVita in Volume XV of the Conference of Actuaries in Public Practice, *The Proceedings*.

The advantage offered by these two fundamentally similar methods is that only attained-age functions are required in both the purchase and the valuation and one need not worry about what past changes took place and when.

MR. HAROLD F. PHILBRICK: For many years Massachusetts Mutual has included a flexible feature in its ordinary life contract designed to meet the changing needs of a policyholder. This feature gives the policyholder the right to change to a higher-premium form of insurance with the cost spread over the premium-paying period remaining after the change has been made. After such a change is made, the policy has unique reserves, net premiums, and dividends. Before modern computers were available, we did incur a small additional cost to carry a policy on the unequal-payment plan. This small additional cost was warranted since the added flexibility that this privilege gave was deemed a very desirable sales feature by our agency force.

Over the years we have introduced a variety of riders to permit greater flexibility in choice of coverage for specific needs. These were initially made available only with the issue of new permanent insurance. It soon became evident that total insurance needs often change without a corresponding change in the need for basic permanent coverage. Consequently, we extended our practice to allow riders, such as mortgage protection, family income, level term coverage, insurability protection, and family coverage, to be attached to existing permanent insurance wherever feasible. Since we normally value each rider separately, the only significant additional cost introduced by attaching riders after issue was the expense of reissuing the policy with the attached rider and of obtaining evidence of insurability when required.

We make a small attachment charge to offset part of the expenses incurred in connection with such attachments. The agent completing the attachment receives a commission based on the annual premium for the rider being attached. We have a fairly heavy volume of attachments, which confirms that the availability of this service is appreciated by our policyholders and our agency force.

We use our current rate and valuation bases for all rider attachments. This means that a 1958 CSO reserve basis rider would be attached even if the basic policy had been issued on the 1941 CSO basis. This has introduced some problems with respect to proof of compliance with the standard nonforfeiture laws, but we have been successful in obtaining approval of our attachment riders in all states.

Under a fully flexible policy designed to meet the changing needs of

the policyholder, the insured should in principle have the right to change his coverage whenever his circumstances change. This could be considered an extension of the current guaranteed insurability procedures offered by most companies. In lieu of having fixed amounts available at fixed times and subject to a maximum age limit, the amount would be contingent upon the actual changes in the policyholder's circumstances, such as the purchase of a new home, a salary increase, and so forth. In my opinion, the antiselection plus the difficulty of administration would make such an extension unfeasible. Beyond the limited availability of additional coverage without evidence of insurability offered under the guaranteed insurability provision, additional needs would have to be provided subject to current evidence of insurability. As a result, I believe that any "lifetime" policy would probably involve merely a modification and extension of our present unequal-payment and attachment procedures.

MR. D'ALTON S. RUDD: A small group of us has been looking at the completely flexible policy into which John Q. Policyholder writes to say that he is going to put another $100 a month and would like his insurance increased. A little later he writes that he wants to cut down the amount of his insurance but wants the $100 plus another $40 a month applied toward more savings with the flexible policy. We found in our discussions, however, that we ran into two problems—old-fashioned actuarial shibboleths of antiselection and the sacred right of agents to first-year commissions.

MR. WILFRED A. KRAEGEL: The type of policy that is contemplated here does not lend itself very easily to the structure which the life insurance field has developed over the last couple of decades. The evolutionary approach seems almost inevitably to lead to more obstacles than to benefits to be derived.

I wonder, though, if it might not be better for us to give some thought to the flexible approach viewed in a more revolutionary sense. Would it be possible for us to consider what kind of life insurance contract we might have if we were starting over today instead of one hundred and twenty-five years ago? Under these conditions, having the complexity of the individual's financial circumstances to contend with in today's social and economic life and having the capabilities of our technology and techniques available, what sort of products would we come up with?

Is it possible that we could give some thought to the ideal products to meet today's needs in light of today's capabilities and then worry about

how to get over the obstacles in the regulatory, taxation, and compensation areas?

This is a relatively naïve and oversimplified view, but it seems to me that, if we are going to do anything significant in this area, this is the point of view from which it must be undertaken.

MR. NORMAN F. BUCK: I have been involved lately in many conversations on marketing a flexible policy, and I think that the standard reaction, as mine was at the outset, is to think of all the reasons why it cannot be done. We think in terms of present regulations and problems that we know will face us if we try to make a change as revolutionary as this could be. However, we are faced with a situation in which perhaps the market for ordinary insurance is being taken over in part by other forms of insurance. That does not mean that the market for ordinary will not continue to increase in the absolute, but as a percentage it might diminish in favor of various types of mass-marketed insurance.

One of the important things that individual ordinary insurance has to offer is its very flexibility, the fact that it can be tailored to the needs of the individual. This is one feature that a government-sponsored program does not have. This is one feature that a group insurance program or almost any type of mass-marketing program does not have. Perhaps we need to look at this in the broader context to see how we can achieve a greater flexibility and how we can use the computer on this problem.

MR. GILL: We have had not a special product but a merchandising plan for sales to the medical market.

The insurance is completely bank-financed, with the policy pledged as collateral against the loan. Each year the bank lends an additional premium, with a maximum of three. There is then a year's hiatus until the bank-loan repayment begins. Thus there is a maximum of four years between issue and the time that the doctor can afford to pick up the costs himself, usually a year after entering practice. Sales, therefore, as a practical matter, are limited to interns and residents. Dental students and veterinary medical students are eligible.

We have been operating the plan since 1961 with good results. We now produce a little over $1 million of premiums a year from this source. The banks' default rates have been negligible, on the order of 0.2 per cent per year of the loan portfolio. As the banks acquired experience, they have been willing to lend more premiums with less collateral. They are accustomed to prospective doctors' obtaining credit for practically everything, and insurance financing is taken in stride.

Repeat sales are quite common. In fact, this creates one of the problems of the market, if you can call it a problem. Over a few years an agent can build up quite a large clientele; once the doctors begin practice, the agent tends to sell insurance to them and to their friends and associates. He abandons the penurious for the prosperous and turns up his nose at interns. A company must, therefore, continually place new agents in this market.

Once the banking arrangements are made, the direct cost of maintaining the program is small. Development costs run between 1 and 2 per cent of first-year premiums, depending on the period of amortization. The persistency rate is extremely favorable.

Mortality is a question mark. Physicians certainly know more about their health than the typical applicant, and they may know more than can be learned by obtaining statements from their colleagues, since they often treat themselves. I doubt that this antiselection exists to any extent in the intern and resident market, but it may be a factor in the repeat sales, when the insureds are more apt to be impaired lives and are more insurance-conscious. Unless mortality turns out to be poor, the business appears to be worth the cost of development. It is doubtful that the same sum spent in obtaining business from other markets generally would produce a better result.

MR. JAMES T. HENDRICKSON: We have a sales package involving bank financing of premiums for medical students. We formally entered this field about six years ago—in November, 1961.

Senior medical students in approved schools of medicine, dentistry, veterinary medicine, or osteopathy or graduates of these schools fulfilling internship requirements are eligible to participate in this financing plan. Premiums are financed over a five-year period. (In certain situations a six-year plan is also available.) Doctors in their first or second year of practice are eligible for a three-year financing plan.

The minimum amount of insurance that can be purchased is $15,000, and the maximum is $100,000. Premium waiver is required, and other supplementary benefits may be included. Term policies cannot be used, but a ten-year level term rider may be included for an amount equal to the permanent insurance.

The plan is handled by the execution of a note on each anniversary for the sum of the annual premiums borrowed. The bank bills for interest (at 6 per cent), payable half-yearly in advance.

The notes are endorsed by the agent but not by the agency head. To help protect its loans, the bank requires that an amount equal to 10 per

cent of the premium be withheld from the first-year commission and held in escrow; a separate escrow fund is held for each participating agent.

During the six years that we have been in this field, we have sold over 1,500 cases for about $65,000,000, or an average per case of $42,000. This insurance has been approximately 3½ per cent of our sales during this period. This represents about 17 per cent of our sales at ages 25–29, the ages at which most of the sales under this plan are made. The use of this plan has shown some tendency to decrease since its introduction. In 1962 the sales on this plan were 23 per cent of the total sales at ages 25–29, while in 1966 this percentage had decreased to 13.5 per cent.

At present there are approximately 1,000 accounts in effect, involving loans of almost $2,000,000 on about $40,000,000 of insurance. About $25,000,000 originally issued on this plan is no longer under the plan; most of this insurance is still in force with the premiums being paid by the doctor.

During the period from January 1, 1965, to April 15, 1967, only 43 of our 72 agencies had sales on this plan. The number of agents involved in these sales was 123, of which 53 sold only one case. Thus only 70 agents had sales of two or more policies on this plan. Ten agents produced about 40 per cent of the total during this period.

With regard to the persistency of this business, we have little to report since our experience is rather limited. The persistency is satisfactory to date because the bulk of the business is still in the financing period.

However, some studies that we made earlier in the year indicated that the lapse rates after the end of the financing period has been reached will be somewhat higher than other business at the same durations. Only 80 per cent of the 1961 business which reached the end of the fifth policy year in 1966 was continued in force; the amounts involved were rather small, so this 20 per cent lapse rate may be only a fluctuation.

The costs to develop the plan were not high because we use our regular policy forms and the bank was helpful in working out the details of the plan; but the administration of the plan, which involves correspondence with agents about note renewals and collection of interest, is becoming increasingly difficult.

MR. ROBERT C. TOOKEY: There is a decreasing term to 65 plan for teachers that has sold very well. It is sold on a semigroup basis, a constant amount being deducted each month from the teacher's salary. The amount of term insurance is whatever this flat deduction will buy using one-year term rates at his attained age.

Teachers' mortality is exceptionally good. This can be checked by

looking at some of the mortality studies that have been made by the government. In the case of college professors, mortality is about 65 per cent of the average for the nation.

MR. GILL: Question C refers to problems of the design of plans where the face amount reduces a few years after issue, with the reduction made up by dividends applied to provide a combination of one-year term and paid-up additions. I would point out that this reduction need not occur a few years after issue; there are plans in Canada with the reduction postponed for twenty years or to age 65. (Deferred paid-up additions are purchased.) Also, the face amount need not be reduced at all. In the original plan the insurance is supplemental to a level face amount policy.

In the United States, however, the plans do tend to fall into the pattern of face reduction after one, two, or three years, with about an even division of popularity. A company will find it most convenient to reduce the face and to commence the supplemental insurance at the time that its first dividend is paid.

The most obvious problem is one of safety, or adequacy of margins. The supplemental amount is not guaranteed. Nonetheless, failure of the plan in any but extreme circumstances would call into question the judgment of the designer. The ratio of the supplemental amount to the initial amount is the determining factor here.

Clearly, as the supplemental amount increases in relation to the guaranteed amount, there is more insurance to buy and less dividend with which to buy it. The trick is to find a happy mean. This will be easier if a different amount is used for each issue age. This is the majority practice.

There is no general rule in safety margins that would apply to all companies. But there are certain factors to consider:

1. When dividends are high, as they are at the moment, more safety margin is needed than when they are low, since the chance of a dividend cut is greater.

2. It is important to get off to an early start with the additions under this plan. Obviously, as additions build up, the amount of term insurance required is less, there is more dividend to apply to additions, and so forth, with an accelerating effect. This means that a flat-dividend scale tends to work better than a steep one.

3. Oddly enough, a higher valuation rate will generally mean a safer plan, other things being equal. The reason for this is that more paid-up additions are bought with the same dollar amount of dividends, with the accelerating effect that I mentioned earlier.

Once you have the basic policy designed, you will have to cope with such things as the accidental death benefit, which typically does not

apply to dividend additions or one-year term insurance. Similarly, extended term insurance may be for the guaranteed amount or for the total amount including supplemental insurance. We chose to provide the total amount under extended term. The extended term periods shown in the values table must be understated if you choose this route, since only the guaranteed cash value can be assumed to purchase the extended term. Two states required a second table of values showing the longer periods for insurance only of the guaranteed amount.

Then there is the question of substandard extras. On one-year term dividend options the amount of term insurance is reduced. If the same method is applied here, you will charge more for the term insurance. Your additions will build up at a different rate, and you will have different illustrative costs for each substandard class, not to mention what this does to safety margins.

The direct way out is to charge the substandard extra premium for the full initial face amount throughout the life of the policy. You will have to decide what to do after the supplemental insurance is paid up. You will probably reduce the extra when the dividend option is changed, something of a novelty in administrative procedure.

This leads to the problem of the policyholder who wants to change his dividend option. You *have* to let him do it in New York; but, unless you set up procedures that give you an opportunity to talk him out of it; you will have some public relations problems when a lower-than-expected death benefit is provided.

Another obvious but very serious problem is what to do if the dividends fail to provide the full amount of supplemental insurance. Some solutions are (1) to provide for collecting the difference in cash, (2) to allow a change of the guaranteed amount at a higher premium, and (3) to permit conversion of the term insurance. We expect to offer a policy change if such a contingency should occur, either to a fully guaranteed whole life plan or to a plan with a larger guaranteed amount.

MR. RUDD: In November of 1965 our company introduced a dividend option for all permanent plans on standard risks providing additional insurance of a percentage of the face amount, depending on age at issue, made up of term insurance and paid-up additions. At each anniversary the computer is used to solve two equations in two unknowns to determine how much of the then-current dividend is to be applied to purchase paid-up additions and how much is to be applied to purchase one-year term insurance for the next policy year to maintain the scheduled amount of additional insurance.

When you have a new product, you wish to introduce it. The product was designed knowing the power of the computer, but how do you get it into your system? Fortunately, we already had a trailer in our master record for dividend-purchased term insurance because of a block of policies issued in the early thirties. Thus we were able almost immediately to introduce the new option through minor modifications of only our issue programs. However, we forbade backdating or changes to policies issued previous to the date of introduction to give us a year in which to make all modifications necessary to our change-and-file-maintenance runs to handle the complicated anniversary logic. A year later we were finally in a flexible position.

MR. FRASER M. SMITH: Our objective in designing a policy of this type was to have available a policy which would appeal to the large market of young people who need permanent insurance protection but who desire the lowest-level premium outlay possible.

In most types of participating policies the premiums contain a margin which is subsequently returned as dividends. In policies of this type the margin, in a sense, is the possible reduction in insurance coverages. One of the main concerns in the design of our policy was to balance the desire for low initial premium outlay against the need for sufficient margins to maintain the initial protection. In the course of the development of our contract, we ran very extensive tests on varying interest, mortality, and expense assumptions to determine the degree of conservatism present. These tests indicate that we should be able to maintain the full initial protection until death under the most adverse conditions that we feel are likely to occur.

Our policy, which has a minimum initial amount of $10,000, provides a reduced amount of insurance after the second year which varies by age at issue. The purchase of the difference between the initial and basic protection after the second year is controlled by a special dividend option available only in this policy. Since the policy and dividend option are designed to work together to provide level protection and since the policy loses its purpose without the dividend option, we have attempted to assure that the option comes into effect and remains in effect. Thus an application for this policy provides automatic election of the option. The policy provides that the option will remain in effect until terminated by the election of another option, by the surrender of paid-up additions, by written request, or on the expiration of the grace period of any premium. If the option is terminated by request, it may subsequently be reinstated subject to company approval and financial adjustments.

Since we expect most of these policies to continue with the special dividend option in force, we have based much of our administration on the initial amount of insurance. Thus our policies are underwritten on the initial amount of insurance, and any substandard premiums are based on a level amount of insurance equal to the initial amount. If the protection provided by dividends is terminated, the substandard premium is reduced to the corresponding premium for a level amount of insurance equal to the basic reduced protection.

The amounts of any additional benefits attached to this policy—such as accidental death benefits, family income riders, level term riders, or guarantee issue riders—are based on the initial amount of insurance. In the case of nonforfeiture values the extended term benefits follow the guaranteed amount while the reduced paid-up insurance is for a level amount.

The sales of the policy have been satisfactory, totaling roughly 3.8 per cent of our ordinary issue by amount. This amounts to about 17.5 per cent of the ordinary policies issued with a face amount of $10,000 or more.

MR. ROBERT H. JORDAN: In reference to Question C, we encountered some important problems.

1. *Substandard business.*—This plan, with its substantial one-year term insurance benefit, should be made available to the same range of classes to which our general term portfolio is available. The substandard rating cannot very well be reflected in the one-year term insurance and paid-up dividend addition rates, as is done on other plans, because this could lead to an inability to provide the whole of the supplemental benefit at an early date even though there had been no change in dividend scale. Since the special dividend option should apply in practically every case, total death benefits thus being level, we concluded that an equitable substandard charge would be the regular ordinary life substandard premium for the same rating and the same initial face amount. This was borne out by a study of the net amounts at risk for the two plans at several ages.

2. *Maintenance of equity.*—Premiums and cash values for our plan are very close to those for a corresponding life plan for the ultimate face amount. However, our regular dividend formula is geared to initial face amounts. In order to maintain equity, some modification of the dividend formula was necessary.

3. *Determination of a suitable "margin" in the dividends.*—Considerable judgment is involved in deciding the duration at which paid-up additions equal or exceed the difference between the initial and the ultimate face amounts. We approached this problem by testing several "margin"

levels. We calculated the amount of supplemental benefit, using a net single premium equal to a given proportion of the present value of dividends, and proceeded from there. Except for minor adjustments that were made where needed to give smoothness and consistency, we were able to use directly the results of one of these tests.

Tuesday Session

MR. HAROLD G. INGRAHAM, JR.: Using a conventional, fixed-dollar contract, it is possible to augment and shift the blend of coverage systematically from term to permanent to meet changing insurance needs.

A relatively small ordinary life contract purchased by a student still in school can contain a series of guaranteed insurability options to be exercised on marriage, at the birth of the first child, and at triennial ages from 25 to 40. Such a plan provides flexibility and keeps pace with needs and purchasing-power growth.

There is a family of basically fixed-dollar contracts designed to anticipate cost-of-living increases where no life company investment in equities is involved. Accretion rate and proceeds are guaranteed. The increasing or escalator coverage is at the rate of $2\frac{1}{2}$–3 per cent effective per year. Other escalator plans exist for hospitalization on a $7\frac{1}{2}$ per cent escalator basis or for college education on a 10 per cent basis. As this family of contracts always anticipate increases in cost of living but never anticipate decreases, they are comparatively expensive.

In Holland and Great Britain there recently has been limited sales success with equity-based life insurance contracts providing variable benefits. In Holland these contracts use a new money or unit of value—"the fraction"—which represents a part, or fraction, in an investment fund. A summary of this contract can be found in *LIAMA Bulletin No. 324.* Commissions are 7 per cent of each premium. The contract is considered suitable only for those who already have fixed-dollar coverage and incomes that will permit them to meet the requirements of varying (and probably rising) premiums.

In Canada an equity-based policy was introduced in April, 1966, with reported initial sales at a satisfactory level. The principal difficulty in policy design was that of fitting a fluctuating sum insured into the framework of the legislation. A similar problem would exist in the United States.

In order for United States companies to market successfully equity-based life insurance policies, they must be given the power to invest higher proportions of funds in common stocks than they are now permitted to do. Two other deterrents to investment by life companies in

common stocks are (1) the surplus of mutual companies is limited and (2) the NAIC rules require that common stocks be valued at year-end market value.

Many in the industry prefer the approach of directly selling mutual funds in conjunction with the sale of fixed-dollar life insurance to a more complicated and sophisticated equity-based insurance contract providing variable benefits.

MR. JOHN J. STEVENS: We now are marketing policies which allow the addition of permanent or term insurance on either the primary insured or the spouse. Basic policies include virtually all permanent adult plans, par or nonpar. Add-on agreements may be almost any nonpar permanent or term agreement with the benefit period not exceeding that of the basic coverage.

Some problems posed by this type of policy are the following: (*a*) Should policy-fee or band structure be altered to provide for coverage or for life expenses as well as for policy costs? (*b*) Should coverage additions be allowed at any time, since this practice involves off-anniversary premium and commission payments? (*c*) Should settlement options and loan provisions be included as part of the policy guarantees, or should they be separate with each agreement?

MR. WALTER N. MILLER: Most companies today offer a variety of supplementary benefits—level and decreasing term riders, guaranteed insurability riders, family riders, and so on—that are available at issue or as additions to existing policies. I suspect that this sort of structure actually might lend much more flexibility than trying to build it all into one policy.

MR. D. LORNE BLEECKER: With the flexibility of these riders, it seems to me that we should stay with our traditional contracts. Rather than introduce complex and fancy policy forms, it might be better to have more investment in equities so as to improve investment yields, which in turn can be brought into the dividend structure of conventional contracts.

MR. INGRAHAM: Recently some companies have sold policies on a premium-financed basis to selected college Seniors and medical students (physicians, dentists, osteopaths, and veterinarians during internship, residency, or Senior year of medical school). Financing is done through banks with whom advance arrangements have been made by company

field representatives. The financing is evidenced by notes which the field representative endorses as guarantor. Policies are assigned to the banks, which also require the agents to deposit in escrow amounts varying from 10 to 20 per cent of the first-year commissions. In the case of loan default the bank has recourse to the escrow fund, the cash values and dividends, and the guarantor.

Usually only a relatively small number of a company's field force actively concentrates on selling these "financed" policies. When they are properly sold, there is evidence of good persistency both during and after the financing period.

For business with college Seniors a note maturing in eighteen to thirty-six months often is used for the first premium. For medical students the first two years' premiums might be paid by, say, a six-year note, the third- and fourth-year premiums by automatic premium loan, and subsequent premiums in cash. A nominal annual cash payment of 10–20 per cent of premium by the insured during the financing period is highly desirable.

Now available is a special ordinary life policy with a pure endowment designed to cover one or several financed premiums and payable after the policy has been in force on a premium-paying basis for three to five years. Alternatively, such a policy may provide a series of pure endowments. This type of policy provides earmarked funds to repay financing and avoids the problem of a policy encumbered by a maximum loan after note repayment. It can be sold as a policy specifically tailored to the needs of college Seniors and medical students.

Introduction of such a special policy on an unrestricted basis to a company's field force may tempt unqualified agents to solicit this business. It is extremely important that all aspects of any financing arrangement be properly communicated to the students and that proper follow-up activity be maintained to ensure adequate persistency.

Issue of these special policies usually is limited to the ages between 18 and 29 but may range to 45 when marketed to young-married people.

For teachers there is a substantial market for tax-sheltered annuities under Code Section 403 (b). Individual retirement annuities and retirement income policies with flexible deposit features are offered by many companies to the smaller school districts. In the large city school districts, group unit-purchase contracts on a variable-dollar basis are popular. Significant general characteristics are:

1. The average annual contribution for a participant ranges between $800 and $1,200.
2. The average policy issue age ranges between 45 and 50.

3. About 60–65 per cent of the buyers are females.
4. Usually no more than 3–5 per cent participate initially.

Administrative problems in such areas as "gap period" invoice billing may be troublesome and expensive with individual policies. Also agents may squander time on "china egg" cases where they have limited control.

MR. HARRY WALKER: It seems to me that with young medical students we have a market that should be served by three-, four-, or five-year term insurance. The initial premium under a five-year plan would exceed the first-year interest on the finance plan but, after three or four years, the term net cost would be lower than the loan interest.

Suppose that there is a five-year loan program. At the end of five years, one of three things will happen: (1) the loan will be repaid and the policy continued with no loan; (2) the loan will be refinanced through a policy loan or some other loan through the bank; or (3) the policy will lapse.

In the first case, the student is fortunate at the end of five years if he has cash to repay his loan after paying all other costs incidental to his profession. But it would be interesting to compare the financial result of buying a term policy at the outset and then exercising the retroactive right to change to permanent insurance with the financed permanent plan. I think that he would be better off with term insurance. In the second case, suppose that the student at the end of the four- or five-year period is forced to or wants to continue the policy, can pay the premiums, and can refinance the loan. Have calculations been made to see how he fares as opposed to buying term which can be converted to permanent insurance at the attained age without a loan? In the third case, if he drops the policy, how much has this insurance cost him for a five-year period?

What about the company? We have been unhappy with having to lend at 5 per cent. How anxious should we be to promote business which can give rise to 5 per cent policy loans?

CHAIRMAN JOHN A. FIBIGER: We recently made a comparison like this, and it would appear that term insurance would give a better result in the market.

The question of first-year commissions comes up with agents who are active in the market. The plan is a marvelous device for getting a full first-year, permanent-plan commission on a deposit of almost zero by the insured. The enthusiasm of those who do the marketing was minimal for the suggestion of term insurance

MR. FRED G. LETWIN: Our company has studied this type of policy, under which the first premium is paid by a note, and we are not convinced that it is a good way for the insured to start an insurance program. It is comparable to borrowing money to start a savings program, which one would not recommend.

In our study we found that it was cheaper for the insured to buy term insurance and then convert it to permanent insurance at the end of one year when the money was available to pay the higher premium. If the insured keeps the loan about five years before repaying it, the additional cost to him is equivalent to about 40 per cent of one annual premium. However, we also found that the term route cost the company more money, since we paid two first-year commissions when term was purchased first.

Another problem with this policy is that new agents cannot sell it if they are under the company's financing plan. Out of the agent's first-year commission we hold back 20 per cent of the first annual premium to be used to guarantee payment of the premium notes. This reduction in first-year earnings makes it practically impossible for a new man, selling this policy only, to validate under our company's financing plan.

Our agency department has convinced us that we need to stay active in the college market and that this is the type of policy that we need to meet competition; therefore, we have introduced it even though there are some drawbacks to it.

MR. PATRICK L. HUMPHREY: We found that we could not write enough to pay policy printing costs unless we made a deposit in the financing bank or guaranteed the loan, and we were unwilling to do both.

MR. INGRAHAM: Commission problems with respect to flexible deposit features contained in certain retirement income or retirement annuity policies offered in "money purchase" situations (e.g., H.R. 10, tax-sheltered annuity, or profit-sharing plans) can be controlled by treating such flexible deposits as essentially a consecutive series of single-premium retirement annuities for the purpose of determining cash values, dividends, and commissions.

Under this approach, each year's total deposit would consist of the premium for the basic retirement income or retirement annuity policy plus an additional flexible deposit premium of an amount which might vary within certain prescribed limits. The commission on the basic policy portion of the premium would be based on the appropriate scale applicable to retirement incomes or retirement annuities and subject to the com-

pany's usual vesting rules. However, the commission on the flexible deposit portion of the premium would be based on the scale applicable to single-premium retirement annuities (say, $2\frac{1}{2}$ or 3 per cent) and would be payable to the agent of record when the deposit was made—who would not necessarily be the original writing agent for the policy.

The relative proportions of premiums applied to the basic policy and flexible deposit feature should not confront the original writing agent with any "conflict of conscience." Instead, the proper mix of premiums should be structured by the marketing circumstances of the case, as indicated in the following examples:

1. *H.R. 10 plans and money-purchase pension trust or profit-sharing plans.*—In these situations the participant (in H.R. 10 plans) or the employer (in money purchase plans) typically pays x per cent of salary as the premium each year for the policy. Subsequent salary increases are accommodated by increases in flexible deposits. For these cases, the best approach would be to apply virtually the entire first year's premium under the basic policy.

2. *Tax-sheltered annuity plans.*—(*a*) If the participant anticipates increasing but not decreasing future years' premiums, apply the entire first-year premium into the basic policy. This approach permits the largest possible increase in future years' premiums under the same policy. (*b*) If the participant wishes maximum flexibility to either increase or decrease future premiums, split the first-year premium 50-50 between the basic policy and the flexible deposit feature. (*c*) In a highly competitive case where the agent wishes to illustrate the maximum possible monthly retirement income per dollar of premium outlay, apply the maximum proportion of premiums permitted by the company each year under the flexible deposit feature. This approach should only be used where it is clearly understood by the participant that no further increases in the level of premium outlay under the contract can be accommodated under the flexible deposit feature.

MR. MILLER: Very good results can be achieved in the tax-sheltered market if a company is willing to develop policies tailored specifically to meet the needs of this market.

New York Life has developed a policy with flexibility features such as those outlined by Harold Ingraham. In addition to developing the proper product, two things are necessary in order to be able to succeed in getting good results: (1) A company must have a sophisticated field force—or at least a large enough segment of it—with the knowledge to operate in this complex market. (2) The second necessity concerns administrative pro-

cedures and requires the company to be prepared, either in the home office or in the field, to render a considerable degree of service of the type not generally required in other aspects of the ordinary market. In addition, there is the increased complexity of administrative procedures arising from having to administer a flexible policy, account for changes in level of premium payment, stop-and-go, and so forth. Service includes such things as helping teachers and school administrators to calculate exclusion allowances (which can get quite complex under current statutes), furnishing annual notices of policy status, and preparation of the type of specification forms which many school districts require before allowing companies to solicit the business.

MR. INGRAHAM: Starting with a plan introduced by a Canadian company in 1962, a number of United States and Canadian companies have policies that use dividends to provide some form of level additional coverage in order to meet price competition with nonpar policies.

The United States and Canadian approaches are different. For most United States companies, the face value of the special ordinary life policy is reduced after one, two, or three years, and dividends are used to buy paid-up additions and one-year term sufficient to replace the reduction. A variation uses a three-year modified life policy with a three-year-term rider. The amount of reduction usually decreases with advancing issue age. Canadian companies keep the initial amount constant and add the term and paid-up additions to it. This avoids the idea of reducing basic amount and emphasizes the enhancement concept. Other variations in the Canadian approach are summarized in *LIAMA Bulletin No. 62* of July 10, 1967.

Answers to the question of what happens when the dividend scale changes are (1) if dividends increase, purchase additional paid-up insurance; (2) if dividends decrease, buy as much one-year term as possible and, if this is insufficient, let the total death benefit for the year decline. (A few companies permit the payment of an extra premium to maintain the level amount.)

There are several problems in designing and marketing this product:

1. The plan may be difficult to explain to the field force, who, in turn, may have difficulty explaining it to the public.
2. The field force may regard it as another way of getting more volume for less premium at the agent's expense.
3. Preparation of rate manual dividend and nonforfeiture value information involves a degree of actuarial complexity which might preclude smaller companies from offering it.

4. Difficulties have been encountered with a few insurance departments—particularly Illinois and New York.
5. For a company whose ordinary life policy is priced on a low-premium-low-dividend basis, it probably is unnecessary.

From a marketing standpoint, the combination of a term rider and a modified life policy using the special dividend option may avoid field objections. The modified life policy could be presented to a prospect. If price competition emerges, the term rider then could be superimposed to illustrate the low "going-in" cost and low ledger cost per $1,000 necessary to achieve the sale. This approach also avoids the introduction of yet another policy to clutter a company's portfolio.

MR. EDWARD T. HILL: Since the type of policy under discussion belongs to the family founded by North American Life's enhanced protection plan, it seems worthwhile to make some detailed comments about this plan. In particular, I would like to mention how and why its method of dividend application differs from what seems to have become the generally accepted method.

In 1961, when this company was getting ready to introduce a new ratebook based on the 1958 CSO Table, we decided that one aim would be to discontinue the use of nonparticipating permanent plans. We are a mutual company and had previously offered a full line of both participating and nonparticipating policies. We were not greatly concerned about the prospect of being without the more expensive nonpar policies but believed that we would be at a serious competitive disadvantage without a nonpar whole life policy. However, we agreed that, even if we were willing to continue with a nonpar whole life policy, we would have been unwilling to adopt the rates which our competitive position appeared to require. In addition we felt that the absence of a low-rate whole life policy would make the sale of permanent rather than term more difficult, and at that time we were faced with an abnormally high ratio of term sales.

Casting about for an alternative—and I might say that credit for the original idea belongs to Bill Anderson—we came up with the scheme of using annual dividends, not to produce the traditional, increasing series of paid-up additions to the face amount of the policy but to purchase an addition which would be more or less level from issue. By July, 1962, this had resulted in the introduction of the enhanced protection policy.

At the outset we thought that a desirable attribute of such a plan might be that the level of additional insurance should be related *directly* to the dividend scale and that *some such relationship should continue through the lifetime of the policy*. Thus, when dividend scales change,

there should be recognition of this in the level of the "enhancement" (our name for the additional coverage) at an early date.

It is easily seen that such a requirement militates against the use of the one-year term plus paid-up addition approach, at least as I have seen it used. Under such a method the effect of an increase in scale is merely to advance the date when the portion of the dividend applied to purchase one-year term protection vanishes and there remains only a normal paid-up addition option. The effect of a decrease in scale results in the occurrence of a date when there is insufficient dividend to provide the original amount of insurance, and decreasing coverage ensues. This deferred reduction in coverage may occur a lengthy period after the reduction in scale and may result in policyholder dissatisfaction, or, for those companies that allow it, significant one-year term costs in connection with maintenance of the coverage at the original level. While it is not impossible to modify such a scheme to serve our purposes, we concluded that they would be better served by the adoption of a different basic process.

Accordingly, we decided to discard what has since become the very popular method in favor of one which amounts to a retrospective net-reserve accumulation. Here the dividends play the role of net premiums and, when added to an existing enhancement reserve fund, are accumulated with interest and survivorship, cost of insurance being deducted in arrears.

At issue the enhancement is calculated by finding the present value of future dividends and dividing it by a whole life single premium. For the purposes of this calculation, the interest rate and a modification of the mortality basis used in the current regular dividend scale are used. A safety factor, graded by age, to take into account the varying likelihood and effect of a scale change, is applied to this and the initial enhancement results. At the point of a scale change, a new set of enhancements for new policies is calculated in like manner.

For policies in force an increase in scale results in a comparable calculation at attained age, taking into account the existing enhancement reserve fund. This results in an increase in protection, which is immediately granted.

Where scales decrease, additional privileges are accorded the policyholder. He is given the right to begin to make payments to maintain coverage at an early date, and an attempt is made to reduce the frequency of making such decisions. Accordingly, at the end of the quinquennium following the scale reduction, a calculation is made as in the case of an increase, and, if a decrease results, an extra premium to maintain the coverage is calculated on a basis not more expensive than a basis guaran-

teed in the contract. The policyholder is given the option of paying this amount or accepting the decrease.

It will be noted that, except in the interval between a scale decrease and a deferred reduction, we are always able to state that, if the current dividend-scale factors are maintained, the current enhancement will continue throughout life. It may also be noted that the enhancement formula and the enhancement reserve fund technique are independent ingredients which work particularly well together.

I might say that we have had more than five years' experience with the plan, including several scale increases and one decrease in a relatively minor area of operation, and have found the administration quite satisfactory. Possibly because it provides level premium, level amount, permanent life insurance at a rate generally less than whole life nonpar, the plan has contributed to the maintenance of a satisfactory permanent-to-term ratio, a high and growing size of sale, and a continuing high level of persistency. We have achieved considerable success in the market place and have had the gratification of seeing companies representing an important segment of the industry place their stamp of approval on the concept by adding similar policies to their own portfolios.

MR. L. JEFFERSON STULCE: The new policies seem to raise some important philosophical questions. When we undertake to predict experience thirty or forty years into the future and show under our *conventional* par policies the thirtieth-year or fortieth-year dividend, who takes the risk that our projection is slanted too optimistically? It is the premium-payer, who may in some future year find his net cost somewhat higher than was illustrated at the time of sale. But, under these new policies, who is injured if the long-range estimates of the future are made too optimistically? Here we ask the *beneficiary* to take the risk.

What would be thought about a large insurance company which reveals to a widow at the time of her bereavement that the insurance proceeds "illustrated" at the time of sale will not be paid in full, notwithstanding the fact that the company is financially sound and strong and that all premiums have been punctually paid over a period of many years? Would a financially strong insurer *really* cut back on the proceeds payable in later years, considering the public relations aspects? If not, what implications are there for the mutual company which would permit this group of policyholders to be subsidized by policyholders purchasing the more conventional type of participating contract? Do not the sales illustrations of a number of companies reveal this new policy as a better

"bargain" than the conventional par policies being offered, and how are such inequities between policyholders justified?

We hear about policies being sold on the representation that they are $50,000 of permanent insurance, when the guaranteed amount of insurance after the first three years or so is less than $35,000. Since adjustments for emerging experience are deferred into the future, there is a kind of reverse tontine result. If the experience emerging is not so rosy as anticipated, the policyholders who live (and pay premiums) the longest are more likely to receive lower death benefits than those whose deaths contributed to the bad experience earlier. While I understand that these policies are so far being offered only by fine companies with unquestioned integrity, who can say who will be utilizing these policies in the future and how optimistic these "illustrations" will become—particularly in new companies desperate for business and a "competitive" contract to attract agents? This new idea seems well fitted for the company with unconscionable management, willing now to overstate future expectations without much concern about being personally accountable when the time of accounting does ultimately arrive.

I am pleased that a few insurance departments are questioning these policies and whether they are indeed operating in the best interests of both the public and the insurance industry.

We have seen new evidence that some of our companies will strain rather far to outdo other companies in competition. Some of us need to put into better perspective the questions of beating competition on the one hand and matters of conscience and longer-range public relations aspects on the other.

There may be an element of truth in the facetious comment that some of our participating dividend scales look a little as though we are indulging in a liar's contest. If such a contest is under way, it is certainly escalated and intensified with the development of these new policies, which offer the surest evidence yet that some of our companies need to inject into their optimistic dividend illustrations for future years more restraint, realism, and moderation.

Term Insurance

A. Is the proportion of term insurance being sold continuing to rise? If so, what implications does this have for the insurance industry?

B. What has been the trend in the conversion of term insurance to permanent plans? What programs have been adopted to encourage the conversion of term insurance? What types of credits or special allowances other than the reserve or a proportion of the reserve are being granted upon conversion of term insurance to permanent plans? What is the rationale for these credits or special allowances?

Monday Session

MR. JACK V. MASTERMAN: To obtain some information for Question A, I examined the reports of the Superintendent of Insurance for Canada over the past eight years. On the basis of the total new issues for Canadian companies and the Canadian issues only of other companies, the sale of term insurance is continuing to rise. There has been a rise in the ratio of term to total insurance sold, from 37 per cent in 1958 to 43 per cent in 1966. This ratio was greater than the immediately preceding year's ratio in every year except 1962. Sharp increases were noted in 1959, 1960, 1961, and 1964. In the remaining years the ratio changed only slightly from that of the immediately preceding year. The last two years, 1965 and 1966, have shown only very modest increases. It is possible that this is indicative of a leveling-off or a slowing-down in the rate of increase of term. However, it is too early to draw such an optimistic conclusion.

The sample surveys taken by the Life Insurance Agency Management Association and published in the *Buyer Guide* also indicate that the percentage of term sales is still rising.

The ratio of term sold to total new business reflects a particular company's attitude toward the sale of term insurance. Our company has witnessed a decrease in this ratio from a peak of over 45 per cent in 1960 to 43 per cent in 1966. We believe that this has resulted from a combination of factors, not the least of which is our program for the training and financing of new agents.

Our industry seems to have become more strongly identified by the public as a provider of insurance protection and less recognized as offering a sound means of long-term savings. More emphasis on savings seems to be required in our presentations to the public. Insurers may have to reduce their costs by some means or change various features of their plans in order to provide better financial returns; they may also have to move more to equity-based policies and riders in order to recapture their share of the saving dollar.

The current generation of young adults seems less inclined to sacrifice for the future, than former generations; they purchase luxuries which are now within their reach. The need for saving still exists, however, and new approaches and new products must be developed which will be attractive to this group.

There is no way to measure the effect on our business of the various government schemes that have been introduced in past years. It has been argued that these have caused the public to buy additional pensions from insurers to augment the retirement incomes from the government plans. It seems doubtful that any extensions of these plans will have the same effect in the future. Our industry must recognize the needs of the public and provide satisfactory products to meet them; otherwise we invite further government intervention, with the consequent continuation of the rise in the sale of term insurance.

With respect to Question B, our company has experienced a good increase in the conversion of term plans to permanent. If our rate of conversions made so far this year continues to the end of the year, the amount converted will be over 2½ times the annual amount converted just five years ago. We expect our conversions for 1967 to be about $23 million, which will represent 2.2 per cent of all term insurance in force at the end of 1966 regardless of whether the conversion option has expired or not. In 1962, our conversions were slightly under $9 million, or 1.3 per cent of the term in force at the end of 1961.

We attempt to keep our field force thinking at all times of conversions. At the time of making the initial term sale, we try to have our agents point out to the policyholders the existence of the conversion option and to suggest that consideration be given later to exercising it. A few weeks prior to every policyholder's change of age, a card is sent to the agent. If the policy is a term plan or contains a term rider, the convertible amount and expiry date of the clause are noted. The agent is expected to make a service call upon the policyholder to discuss the policy in relation to the individual's current circumstances. At that time, conversion would again be discussed. Just prior to the expiry date of the conversion clause, a notice is sent to the branch office informing them of the convertible amount and the expiry date. The information is passed to the agent, who will then call on the policyholder to let him know that the clause is about to expire and to discuss the advantages of exercising the conversion option.

In addition, some recognition is given to the agent by publishing in our agent's bulletin a list of agents who have converted $25,000 or more of term insurance in the preceding month. We also run a service campaign

annually in the fall. When a service call is made upon an individual who has some form of term coverage, conversion is discussed.

Our company grants a reserve credit and unearned premium refund from the date of conversion to the next premium due date as a conversion credit on all nonpar level term business.

Some companies are now allowing a conversion credit, a portion of which is unrelated to the reserve or cash value of the policy. One form that this credit takes is a flat-dollar amount per thousand of term insurance converted. The traditional thought on the saving in underwriting expenses on conversions is that it offsets to some extent the extra mortality cost anticipated in converted policies. If, however, it is found that the savings in expenses exceed the extra mortality costs, then the difference can be allowed as part of the conversion credit to the policyholder. A flat amount per thousand is allowed by some insurers on this basis.

An additional element is included in the conversion credit on renewable term plans by some companies. A portion or all of the charge contained in the premium for the renewable feature is allowed on conversions between renewable dates. Whether this practice has some theoretical justification or has been adopted primarily to stimulate conversions is an open question.

MR. FREDERICK S. TOWNSEND: Out of curiosity, I examined Conning and Company's printed studies on twenty-two large stock life insurance companies which are predominantly ordinary life insurers (excluding companies engaged in industrial life and accident and health insurance). These studies include the annual compound growth rate in insurance written for the whole life and endowment account and the term account from 1961 to 1966. Of the twenty-two companies, eleven showed a higher growth rate in the whole life and endowment account, and eleven showed a higher growth rate in the term account.

Among those companies showing a more rapid growth in the whole life and endowment account, I found the following changes had transpired between 1961 and 1966: (1) reinsurance assumed had experienced a sharp decline in the term account in 1966; (2) modified premium whole life policy had been classified as term insurance in 1961 and as whole life insurance in 1966; (3) a special reinsurance transaction had been experienced in the whole life account in 1966; (4) a substantial amount of quasi-group insurance written as term insurance in 1961 had been lost; (5) writing permanent insurance through associations had been begun successfully; (6) a pension department had been established with a strong increase in sales registered; (7) a competitive whole life policy for the busi-

ness insurance market had been introduced; (8) sharp gains with a direct-mail program for whole life insurance had been experienced; (9) writing whole life insurance on a franchise basis had been begun; and (10) term conversions had increased.

Unfortunately, I reached no conclusions from these data other than a growing suspicion that a company can increase either its permanent sales or its term sales by developing the right product and selling it at the right price. The trend toward either permanent insurance or term insurance will depend as much upon the actions of company management as upon the buying habits of the general public.

With regard to Question B, available information on the conversion of term insurance to permanent plans of insurance is very skimpy. Five companies reporting their experiences with term conversions from 1961 to 1966 show five-year gains in the volume of term insurance converted (dividing 1966 term insurance converted by 1961 term insurance converted) of 277, 200, 164, 151, and 50 per cent. Although the volume of term conversions is small, it appears that the trend may be classified as sharply upward.

The element of leverage makes it quite attractive for companies to solicit term conversions; for instance, if the term insurance in force is approximately 10 times the amount of whole life and endowment insurance written, a 1 per cent conversion rate in the term insurance in force results in a 10 per cent increase in whole life and endowment insurance written.

A group of eight stock life insurance companies reported the following term conversion results for 1966:

As a Percentage of Term Insurance in Force	As a Percentage of Whole Life and Endowment Insurance Written
4.8%	22.7%
4.3	38.4
3.9	6.1
2.6	7.9
2.3	8.3
2.1	9.6
2.0	29.7
0.6	4.9

MR. CHRISTOPHER H. WAIN: Conversion of term insurance to permanent plans has been increasing substantially in the Prudential. From a volume of about $75,000,000 in 1964, we have climbed to $255,070,000 in 1965; $591,242,000 in 1966; and an indicated total in 1967 of approximately $700,000,000. Actually, these numbers are better

described as term conversions and new business arising from such conversions that are included in the same policy. Our systems permit additional insurance to be included in the policy as long as evidence of insurability appropriate to this additional risk is obtained.

The primary incentive for term conversion for the agent is the allowance of both full commissions and full glory (production credits, convention qualification, and the like) for any conversion made after term insurance has been in force for a year and as long as the converted policy is not backdated more than six months or into the first policy year. No credits or allowances other than the return of unearned premiums are allowed to the policyholder on attained-age conversions.

MR. ARDIAN C. GILL: Our conversion credit for term insurance is somewhat different. We give a conversion credit of approximately 10 per cent of the term premium for each year of duration at the time of conversion. Obviously, this may be more or less than the reserve.

As far as the rationalization is concerned, I think that it is the same as the reserve credit. As I understand it, you are willing to give back part or all of the accumulated profit or asset share because the man stays with you, and you are willing to put him in a zero fund position like any new policyholder. While this is an empirical formula, it fits the profit curve a lot better than the reserve does.

We have had this practice for only three years. I do not know whether it will stimulate our conversions or not; it is a bit early to tell. I suspect, however, that the way to get conversions is simply to have a term-conversion drive. We are just winding up one now with a monthly conversion rate of about double the average rate.

MR. ROBERT W. WALKER: We have always thought of and encouraged the sale of term insurance as anticipating conversion. We expect that at some future date conversion will follow. Our five-year term policies are written in such a manner that they automatically convert to permanent insurance at the end of a five-year period. They are routinely billed for the premium on the permanent plan, and the results have been particularly good.

In a five-year term policy there are two conversion periods. The policy may be converted as of the original date at any time prior to the end of three years. We provide a routine reminder to the insured that this portion of the term-conversion privilege is terminating. At one time this reminder was routed through the agent's office, but we found this quite unsatisfactory. The agent simply does not follow it up.

Ten or fifteen years ago we instituted a program whereby we write the insured directly. We provide the agent with a copy of the form letter ten days in advance of mailing it to the insured. Attained-age conversion may be effected at any time during the five-year period. Between 50 and 60 per cent of the term policies eligible for conversion are converted.

We have had no significant increase in the proportion of term insurance. We have provided more term insurance riders, but this has not changed the relationship of term-type benefits to our total sales.

Tuesday Session

MR. WALTER N. MILLER: While the proportion of term sales has shown a considerable increase over the last fifteen years, it appears now to have leveled off.

Industry figures taken from LIAMA buyer studies, counting decreasing term for the initial amount, show the proportion of term to total sales as 32–33 per cent during the early 1950's. There was an increase to about 40 per cent in 1959, with little variation since. In the last three years it was 40.2 per cent in 1964, 40.8 per cent in 1965, and 40.2 per cent in 1966.

LIAMA provides some breakdowns by type of term coverage. For term coverages on dependents under family plans, the figure was zero prior to their introduction in 1957 but peaked in 1959 at 6 per cent. Since that time it has drifted downward to 4.5 per cent in 1964 and 1965 and 4.0 per cent in 1966. What this means is that about half of the over-all increase from 32 to 40 per cent is due to the advent of family plans.

The proportion of total sales accounted for by level or decreasing coverages issued as riders or as elements of combination policies ran at about 19 per cent from 1949 through 1959, drifted down to about 16 per cent in 1962, and in 1964 through 1966 was 16.0, 17.4, and 17.0 per cent.

The proportion of total sales represented by level and decreasing term policies, including term riders thereon, was 13 or 14 per cent from 1949 through 1959, increasing to 17 per cent in 1960 and to a peak of 19.7 per cent in 1964, then decreasing to 18.9 per cent in 1965 and 19.2 per cent in 1966.

Individual company figures and trends can vary widely from those of industry. Comparable figures for New York Life show a general picture quite similar to the industry's in that they indicate quite an increase in the proportion of term to total sales over the last fifteen years, with a small decline in recent years: 20 per cent in the early 1950's, increasing to 28 per cent in 1960 and 31.4 per cent in 1965, and decreasing to 29.9 per cent in 1966. Sales of term coverages on dependents under family plans peaked at around 5 per cent of total sales in the late 1950's and were

down to 2.8 per cent by 1966; term coverages as riders or elements ran at 12–14 per cent in the early 1950's, then came down to 10 per cent in 1965 and 9 per cent in 1966. Term policies were 10 per cent of total in 1949, 6 per cent in 1955, 11 per cent in 1960, and about 18 per cent in 1965 and 1966.

While our over-all trends have been in line with those of the industry, our general level of term sales has been quite different. There are some particular factors that have influenced our results.

Our "Nylic" compensation system for agents is the primary reason why our general level of term sales has been below that of the industry. Our lower proportion of family-plan sales probably reflects the fact that our company's primary markets are not in the blue-collar area, which is the main market for family plans. The increase in our proportion of sales of term policies reflects the fact that, since introduction of our 1958 CSO policy edition in 1963 and a further revision of our term rates in 1965, our term product is more competitive than it had been.

As to the implications of these trends, I believe that the fact that term sales have stabilized recently shows that there is no significant factor affecting the current situation which was not present a few years ago.

It is encouraging that, on an industry basis, family policies seem to have achieved a stable and fairly significant level of popularity. Because of the coverage of children who would not be covered otherwise and the conversion privilege for multiples of the term amount, there is a built-in pool of potential future individual policy sales which may be achieved more easily than if there had been no family coverage and agents had to prospect from scratch.

The increase in sales of term policies bears watching. Even though the sale of such policies has been stable in recent years, the increase over the last fifteen years has been relatively larger than the increase in total term sales. Some of it is due to increasing sales of decreasing term to cover balances on home mortgages, but it probably also reflected an increasing utilization of the "buy term and invest the difference" concept, which ties in with our decreasing share of the public's savings dollar.

The main implication of these trends is, I feel, that the industry must continue to intensify its efforts to make permanent life insurance more attractive and to explain why it is attractive.

MR. JAMES H. HUNT: Recently I had to give a speech to a group of agents. I have thought for a long time that the term insurance commissions under New York Section 213 are not what they would be if we had pure competition in that area. These agents were mainly from the tradi-

tional providers of life insurance as opposed to the growing concept of the mutual fund providing term insurance packaged with its principal product.

I suggested that, if the traditional providers were to continue to get their share of the market, something would have to be done about agents' compensation. I discussed commission "disincentive" to sell term, pointing out that straight life commissions typically are six times those for term. I sought to raise two questions: (1) Is the 35 per cent commission which results from Section 213 logical? I concluded that it really is not. (2) Is this result of Section 213 in the public interest? I think that is a debatable question.

This talk of mine was reported in the *Wall Street Journal* with a headline to the effect that agents are keeping their term policies under wraps. What I said was that the agent has every incentive to keep his term policy under wraps, which is not the same thing.

I sent Superintendent Stewart of New York a copy of the speech; we actually had discussed the point earlier. I gathered that the trade associations never have really raised this point with the New York authorities.

Section 213 came from the Armstrong investigation of 1906, and many things have changed since. I did not do much research, but I did learn that Section 213 was changed in 1929—nearly forty years ago—with the one result being a reduction in the allowance for term insurance.

MR. ROBERT B. GOODE: The phrase "keep term insurance under wraps" came out of the *Consumer Reports* articles of the January, February, and March issues and subsequent letters to the editor. I think actuaries would do well to read these articles and prepare rebuttals.

MR. MILLER: We promptly prepared a rebuttal to the *Consumer Reports* articles, but, to my knowledge, we have not had one case in which we have had to use it so far.

Regarding Question B, while the trend in term-conversion rates has been slightly up in recent years, in my company these rates have not been changing too much. This same pattern obtains with our over-all rates of renewal on renewable term policies.

One of our most effective programs to encourage term conversions is a matter of product design. Our five- and ten-year level, nonrenewable policies are convertible automatically to whole life at the end of the term period, using one unified policy form covering both the term and whole life elements. Currently, the rate of automatic conversion at the end of the term period is about 80 per cent. In some other areas we have a pro-

gram for reminding the agent that the conversion privilege will expire shortly.

With the aid of our marketing department we have developed a wide variety of material concerning the advantages of conversion, especially that of converting relatively sooner than later.

Another major factor is that our "Nylic" compensation system for agents provides incentive for conversions. The idea of originally selling term coverages with the thought of conversion and then following up by "prospecting" for conversions is ingrained in a substantial portion of our field force.

As to the rationale of special term-conversion allowances, the expense saving because of no underwriting is the obvious item. An associated saving occurs with respect to issue expense under automatically convertible policies. There also are other factors.

We specifically recognize underwriting and issue-expense savings. We reflect the underwriting saving not in any special conversion allowance but in the premium and dividend structure of the term coverage. The issue-expense saving is reflected primarily in payment of a first-year dividend on permanent plans issued as a result of automatic conversions (generally, our dividends commence at the end of the second year).

The anticipated extra mortality costs on term conversions used in our premium and asset-share calculations are reduced by underwriting-expense savings. This means that such expense savings are credited among all term policyowners, just as the anticipated extra mortality costs are shared by all of them. With our results on achieving term conversions, we think that it is better to produce a more favorable over-all cost picture for term coverages than to hold expense savings out as a specific item to be credited only to those who convert. In this connection we obviously wish to cut down, insofar as possible, the spread between our par term premium rates and nonpar rates. Also, before the end of the term period the existence of a reserve allowance provides incentive to convert even though no special allowance is available.

We have taken a different approach in our version of the guaranteed insurability option. As with term conversions, the anticipated extra mortality cost is shared by all who purchase this option through the premiums paid. However, we reflect the underwriting-expense savings on the new policies issued by giving a specific credit against premiums for such new policies. This underwriting savings allowance, which is based on a rationale similar to that underlying special term-conversion allowances, reflects that our major objective in this area is to encourage the exercise of purchase options by "good" risks as well as "bad."

This point illustrates that there are a number of areas in which policies are issued without evidence of insurability that give rise to extra mortality and also to expense savings. There seems to be no definitive answer to the question of whether these savings should be credited (*a*) to the entire group having the purchase (or conversion) right or (*b*) specifically to those who exercise such right. The answer depends on the company's experience in the area in question and on its over-all objectives.

I recently conducted a survey of sixty companies regarding their current practices. Of the sixty, thirteen said that they had a special term-conversion allowance of the type covered by this topic—ten of the twenty-five stock companies in the survey and three among the thirty-five mutuals. I believe that the larger proportion of stock companies reflects the fact that most mutuals feel, as we do, that items such as underwriting-expense savings on conversions are best recognized in the cost structure for their term coverages.

Seven of the thirteen companies with special allowances made them available across the board. The other six limit their availability—three generally to all or most level term coverages, two generally to all or most decreasing term coverages, and one to a special term plan only.

Twelve of the thirteen companies indicated that they apply the allowance on a one-shot basis against the first premium for the new policy, although I suspect there may be some special rules if premiums for the new policy are payable monthly and the allowance exceeds a monthly premium.

Six of the thirteen companies with special allowances stated that they do not reflect any factors other than underwriting savings. The other companies, collectively, mentioned a number of other factors.

Every one of the sixty companies surveyed has a guaranteed insurability option. Of the thirteen with special term-conversion allowances, six also have special allowances under the terms of their guaranteed insurability option riders. Of these six, four said that their allowances were essentially the same in both areas; the other two companies have different bases.

Of the forty-seven companies which do not have special term-conversion allowances, thirteen have special guaranteed insurability option allowances. Looking at the comparison from the other side, we find that nineteen companies have special guaranteed insurability option allowances, three are stock companies, and sixteen are mutuals. This pattern is the opposite of that for conversion allowances. Of these nineteen, six also have special conversion allowances. Of the forty-one companies with-

out special guaranteed insurability option allowances, seven have special term-conversion allowances; six of these are stock companies.

We get better mortality results on policies that are converted automatically at the end of the term period than on other term conversions. On the automatic conversions, we have practically no evidence of anti-selection. This is only to be expected with such a high conversion rate, and, therefore, all that we are talking about here is the difference between mortality measured select from the original issue age and that measured select from the issue age of the permanent policy. Our premium and dividend structure for the term portion of our term whole life policies reflects anticipated extra mortality on both automatic conversions at the end of the term period and conversions prior to that point, reduced by estimated underwriting-expense savings.

According to our latest studies, our election rates on the guaranteed insurability option are about 15 per cent over all on regular option dates plus an additional $1\frac{1}{2}$–2 per cent for policies purchased off regular option dates under our marriage and stork options. These rates have been increasing, seemingly steadily, over the past four or five years.

We have no special term-conversion allowances, and what we do on the guaranteed insurability option is to pass on the underwriting savings as a specific credit.

MR. BURTON D. JAY: Normally, when there is a conversion allowance on a guaranteed insurability option or a term conversion, do you grant a full first-year commission on the new policy—on the full premium or the net amount actually received? If you grant it only on the net amount, you seem to have a further commission reduction which should permit you to increase the allowance further. This may hint at shades of rebating.

MR. MILLER: On our guaranteed insurability option rider, where we have a special allowance, we pay a full commission based on the entire premium for the policy purchased.

MR. JOHN K. ROBERTS, JR.: Has New York Life's persistency on these automatically converted policies been good? I would think that it might be worse than normal.

MR. MILLER: It is somewhat worse, but the key point is that it is much closer to what you might call "regular" persistency than to persistency on a new issue. For example, on a five-year term policy converted automatically at the end of five years, our lapse experience in the first year of

the permanent plan is much closer to a sixth-year lapse rate than to a first-year rate.

MR. GOODE: One of the characteristics of the rate of exercising guaranteed insurability options, as long as we have been studying it, is the sharp increase with increasing age. We had a disappointing rate of term conversions for years. After working on the problem with our marketing people, we thought that we had found the answer to stimulating conversions. We decided to give a discount to the person who converts term insurance. The discount is a flat 10 per cent of the first premium on the new policy regardless of age or plan.

Our discount is unique in two ways. First, it applies to all insurance in force regardless of when it was sold, including those older policies that already provided for reserve credits. Second, the commission on the new policy is based on the net cash received.

We introduced the discount about twenty months ago, and term-conversion activity has not changed much; volume remains consistent and quite good.

Field reactions to the discount have run the range from praise for a wonderful innovation to comments about cutting commissions. We plan to continue the approach and to promote term conversions in this and other ways.

Underwriting

A. What has been the recent mortality and lapse experience on military risks? What underwriting precautions may be indicated by this experience?

B. What have been the mortality and persistency on policies issued with expected mortality of more than 500 per cent? What proportion of such policies is paid for? Can the issue of such policies be justified on the grounds of profitability alone?

Monday Session

MR. NORMAN F. BUCK: In *The Actuary* of June, 1967, Mr. Poissant, chief actuary of the Veterans Administration, gave figures on Vietnam combat death rates per thousand for 1966. Over all, for all branches, the figure was 16.1 per thousand per year, with the following breakdown:

	Per Thousand
Army	17.7
Navy	2.6
Air Force	3.6
Marines	31.5

Vietnam combat death rates per thousand per year were:

	Per Thousand
1965:	
Statistical Abstract	13.2
1966:	
Statistical Abstract	17.6
SEGLI-Poissant	16.1
K. Masai	18.2
1967:	
Various	21.0
K. Masai	21.8

In World War II, the overseas Army's per thousand per year death rate for the period 1942–45 was 22.5—about the same as the current rate in Vietnam.

We have some history presented by Ed Lew in Volume XLVII of the *Transactions of the Actuarial Society of America* and in Volume V of the *Transactions of the Society of Actuaries*. Battle deaths per thousand per year, based on total strength per year, for United States land forces were:

	Per Thousand
Mexican War	14.7
Civil War—North	34.9
Civil War—South	Not available
Spanish War	2.7
Philippine Insurrection	2.8
World War I	16.4
World War II	10.0
Korean War	6.3

In 1948 we made a study of the first-year lapse-rate experience on government-allotment military business. There was a very high lapse rate on the lowest pay grades. We repeated the study on 1955 business and found: total company, first-year lapse rate, 16 per cent; government-allotment military business, 15 per cent; lowest four pay grades, 31 per cent; issue ages 18–34, 35 per cent—more than double the total figures.

On the basis of these figures, not because of mortality so much as the very poor persistency, we established the following practices: ordinarily no business from the lowest four pay grades, no military specialist agents, no brokerage business, and none "if alerted for service abroad in hazardous areas."

As a result, our military business has not gone up during the Vietnam conflict. It has been running on the order of 2 per cent or less of our sales. We have had a long history of not being eager for this business, primarily because of the very high lapse rates; we have not, therefore, had a problem.

MR. HARRY A. WOODMAN, JR.: Last fall Ed Sweetser reported on the experience of New York Life standard military issues of 1964–65 exposed to June 30, 1966, or to 1966 anniversaries, if earlier. In that period 27 Vietnam war deaths had been experienced.

We have now added another year to that exposure and have a total of 63 war deaths on 1964 and 1965 issues. The experience is slightly higher than it was before. For standard issues the total experience is up from $1\frac{1}{2}$ war deaths per thousand to $1\frac{3}{4}$ deaths per thousand. This experience terminated as of June 30, 1967, or 1967 anniversaries, if earlier. It therefore includes only a small part of the 1967 experience, and it does not include any 1966 issues. So we really do not have a good idea what the effect of the 1967 stepup in Vietnam activities has had.

The adverse experience is on Army and Marine personnel. The war death rate for Army personnel is up from $3\frac{1}{2}$ to 4 deaths per thousand; this includes 42 of the 63 deaths in the experience. The war death rates for officers and enlisted men are about the same.

For Marines we had 13 deaths. Twelve were enlisted personnel, and the war death rate is almost 6 per thousand. The war death rate on Air Force and Navy personnel, excluding pilots, is not bad at all, as you would expect.

The mortality by policy year, with a total of three policy years' experience now, is quite level for officers, but it decreases significantly for enlisted personnel—very high the first policy year, very low the third policy year.

This experience was underwritten under a program in which we were

still issuing $10,000 of insurance ($25,000 for pay grades 0–4 and higher) to personnel who had received orders to Vietnam. Because of the continuing high mortality experience on Army and Marine personnel, we introduced in June a new program in which we discontinued this former practice. We now will not issue to risks alerted to Vietnam duty who are in a major combat status, such as infantry, Marines, and special forces. We will issue $10,000 ($25,000 for pay grades 0–4 and higher) to those alerted for Vietnam duty who are not in a major combat status or to those in a major combat status who have not as yet been alerted for Vietnam duty. We have no special limits for the nonalerted, noncombat category.

MR. NEIL W. MACINTYRE: This report summarizes the recent mortality and lapse experience on military business of the Mutual Life of New York. The study includes the standard issues of October, 1962, to December, 1965, exposed from issue to the 1966 policy anniversaries. The 1955–60 Basic Table was used to calculate the expected deaths for the mortality experience.

Mortality Experience: Ratio of Actual to Expected Deaths—Face Amount of Insurance

Policy Year	Experience Including War Deaths	Experience Excluding War Deaths
1	349.6% (41)*	191.2% (23)
2	265.6 (21)	104.8 (10)
3	457.0 (18)	121.1 (5)
4	.... (4)	.... (1)
Total	340.2% (84)	146.5% (39)

* Number of policies in deaths in parentheses.

The bulk of our exposures was at the younger ages, and, to obtain a better feel of the financial impact of the experience, the mortality ratios were translated into deaths per 1,000 of exposure in military issues. The annual claim rate was 2.75 per 1,000 for all deaths; 1.56 per 1,000 for war deaths; and 1.18 per 1,000 for nonwar deaths. War deaths were determined on a status basis.

1. *Experience excluding war deaths.*—Excluding war deaths, the overall mortality ratio of 146.5 per cent is clearly on the high side. The experience, however, is fragmentary (39 policies terminated by death), and, once past the first policy year, it is in the anticipated range, the ratio of actual to expected deaths for the second to the fourth years combined

being 108 per cent. If the actual deaths from accidents in the first policy year were at the expected rate, the ratio of actual to expected deaths here would be reduced from 191 to 132 per cent. In analyzing the experience in more detail, we found that the experience is particularly adverse for men in the first three pay grades, the ratio of actual to expected deaths being 182 per cent.

2. *War-death experience.*—Considering only war deaths, the ratio of the actual Vietnam deaths to the total expected deaths is 194 per cent. In analyzing this experience in more detail, we found that the ratio of actual to expected deaths is very high for commissioned officers—318 per cent. There were, however, only thirteen policies terminated by death in this cell.

3. *Projection of experience for the 1966–67 policy year.*—We also projected our experience forward for the 1966–67 policy year. At the time of our study about 75 per cent of this policy year had elapsed. The war deaths showed a sharp increase, the ratio of war deaths to expected deaths being 231 per cent for the period in comparison to a ratio of 194 per cent for the period from the 1962 policy anniversary to the 1966 policy anniversary. The ratio of actual to expected deaths for the nonwar deaths, however, was relatively favorable, being projected as 109 per cent.

Lapse Rate

The lapse rate by policy duration for our military business is shown in the accompanying tabulation.

ANNUAL LAPSE RATE OF MILITARY BUSINESS

(Issues of October, 1962, to December, 1965, Exposed from Issue to the 1966 Policy Anniversary)

Year	No. Policies	Face Amount of Insurance
1	15.0%	13.9%
2	11.2	10.4
3	8.2	7.7
4	6.1	5.8

Compared to the over-all lapse experience of our entire portfolio, the lapse rate is about the same in the first policy year, substantially in excess for both the second and third policy years, and somewhat in excess for the fourth policy year.

We also analyzed the experience for various subdivisions, including pay grade, branch of service, policy size, and marital status.

1. *By pay grade.*—The experience of men in the first three pay grades was particularly adverse. In the first policy year the lapse rate was about 50 per cent in excess of that of the over-all military experience, and in each of the second to fourth policy years 100 per cent in excess of the over-all experience. The experience on commissioned officers was very favorable—roughly about one-third of the over-all rate for military business at each duration.

2. *By branch of service.*—By branch of service, the lapse experience of Army policyholders is the least favorable and that of Air Force policyholders the most favorable.

3. *By policy size.*—The lapse rate in each of the first four policy years is lowest for the $2,000–$5,000 policy size and the $25,000-and-up policy size; it is highest for the two intermediate policy sizes.

4. *By marital status.*—The lapse rates at all durations were higher for single than for married personnel. The lapse rates in the various cells for single personnel (payroll classification and policy duration) range from 20 to 100 per cent higher than those for married personnel.

5. *Lapse rate at time of termination of government allotment.*—The lapse rate at the time the policy leaves the government-allotment method of premium payment is particularly adverse. Our studies here may be summarized as follows:

Length of Time Policy in Force	Per Cent Lapsing within 16 Months from Termination of Government Allotment
Up to 1 year	77%
2–4 years	58

As would be expected, the longer the policy is in force, the greater is the probability that at termination of allotment the policyholder will transfer his policy to one of the other modes of premium payment.

6. *Revisions in company procedures to improve persistency.*—Revisions in our procedures to improve the lapse rate include the use of a persistency-rater by new agents, a revised application that includes the home address of the policyholder, and, finally, the restriction of issuance in the lower pay grades if the persistency of an individual field underwriter is adverse and the anticipated lapse rate of a block of business is high. These changes are all relatively recent, and it is still too early to determine their effectiveness.

7. *Distribution of business by pay grade.*—The distribution of the 1966 military business by pay grade and rank was as follows:

Pay Grade and Military Rank	Percentages by No. of Applications
Pay grades 1–3, enlisted men	18%
Pay grade 4, enlisted men	18
Higher pay grades, enlisted men	43
Commissioned officers	18
Not specified	3
Total	100%

We no longer issue policies on people alerted for Vietnam, and we have also tightened up our underwriting in general. We classify all military risks in two types—the restricted-issue type and the nonrestricted. For the restricted-issue type (someone in the special forces or the Marines), the amount of insurance varies from $5,000 to $10,000, depending on the pay rate and marital status. For the other category we also vary our amounts, but here the range is from $5,000 to $40,000, varying by marital status and pay rate.

MR. FREDERICK S. TOWNSEND: United Services Life Insurance Company issues insurance only to regular, reserve, retired, or former commissioned or warrant officers of the uniformed services of the United States; to officers and former officers of the National Guard; to members of the families of the above; and to cadets and midshipmen of any of the United States Service academies, senior ROTC students, officer candidates, and trainees.

The following information is quoted from the company's annual and interim reports.

1964 Annual Report.—Our mortality experience on other than aviation business was a very satisfactory 30 per cent of expected against 31 per cent in 1963. However, as a result of heavy aviation claims during the final quarter of the year, our over-all mortality was up to 42 per cent of expected compared with 38 per cent in 1963.

June, 1965, Interim Report.—This year heavier than usual aviation claims and Vietnam losses have increased the mortality ratio to 59 per cent of expected. Through June we have had one hundred and four claims for $1,340,906, of which twenty-six claims for $530,068 resulted from aviation. Nineteen claims for $445,238—of which six for $123,143 were aviation—were from the Vietnam area and are included in the above figures. We have found it advisable to limit to $20,000 of permanent in-

surance the coverage available to applicants scheduled for duty in southeast Asia.

September, 1965, Interim Report.—Additional death claims incurred in Vietnam during the third quarter amounted to $315,777—considerably less than the $418,638 for the second quarter. Both figures include the full liability for policyowners reported as "missing." Our total claims were down to 55.73 per cent of the expected—a marked improvement over the 59.31 per cent on June 30. If actual claims were equivalent to the assumptions used in the calculation of our premium rates, the ratio would be 100 per cent.

1966 Annual Report.—The following table vividly reflects the impact on earnings of the war in Vietnam:

Year	Mortality Ratio	Pretax Profit from Mortality	Vietnam Losses
1964.......	41.8%	$2,232,248	$ 244,415
1965.......	67.8	1,411,386	1,135,717
1966.......	81.5	884,586	2,053,703

June, 1967, Interim Report.—Vietnam losses for the first six months of this year were less than those for the last six months of 1966; for the second quarter of 1967 they were less than those for the first quarter. Claim experience other than Vietnam has been favorable.

VIETNAM CLAIMS

Last six months of 1966	$1,584,435
First six months of 1967	1,312,196
First three months of 1967...........	723,918
Second three months of 1967	588,278

MR. BUCK: We began issuing policies with expected mortality of more than 500 per cent in the middle of 1963 and established three superhigh tables of mortality—21, 28, and 36, where each digit means another 25 per cent of expected mortality, in other words, 625, 800, and 1,000 per cent. We made 218 offers and had 18 acceptances. We figured on a high nontaken rate, so we did not issue policies until we had an expression from the applicant that he wanted the insurance at that price. The number of offers has diminished each year. The underwriter gets discouraged with the low acceptance rate, and the program has virtually died.

As to the question of whether this can be justified on the basis of profitability alone, I think that the answer to that is "no," with some expletives. Our chief underwriter feels that it is very good for public relations with the agents. What the public relations value is with the applicant

when he is offered the insurance at 1,000 per cent mortality, I do not know.

MR. GEORGE L. HILL: Because of limited experience on policies with expected mortality of more than 500 per cent, our small experience may be of interest.

The New England Life has been experimenting in this area since November, 1964. Data on policies issued in the last twelve months are not yet available, but in the first two years approximately fifty-eight individuals were offered insurance at various ratings from 600 to 1,000 per cent or at ratings of 200 per cent plus flat extras of $10–$30 for periods of two to nine years.

Of the fifty-eight cases on which offers were made, thirty were paid for, involving issue of $960,000 of insurance, or an average of $32,000. Of the thirty policies placed in a two-year period, seven have lapsed or been surrendered, there have been three deaths, and the remaining twenty are still in force. By policies the mortality has been over 1,200 per cent of standard, but fortunately the deaths were on smaller policies and totaled only $35,000. The experience is inconclusive but suggests that it may not be profitable.

In addition to this experimental underwriting on individual applications where a definite rating is assigned, we have much more extensive experience on lives that would normally be declined or rated above 500 per cent. This experience arises from our large volume of individual policy pension trust business. These lives are usually examined, but the special underwriting classification is also used for those who refused to be examined. To be issued insurance, an employee does not have to be at work, but he is required to be employed. The amount of such insurance is determined by amount of salary and the pension formula.

Mr. John Stearns reported on the mortality of this business in a paper in the *1956 Transactions* of the Society. Our latest data cover the period from 1961 to 1966 policy anniversaries. Mortality ratios are generally very high in the early policy years compared to standard select mortality, where the standard mortality rates are relatively low. The ratios drop sharply by duration, especially at the higher issue ages.

For all issue ages combined the mortality of male lives in this 1961–66 period, compared to the 1955–60 Intercompany Select Table, was as follows:

Policy Years	Ratio
1– 2	574%
3– 5	349
6–10	227
11–15	147

These figures are based on 219 policy deaths.

The decreasing percentages by duration may, of course, be influenced by any requirements imposed by the employer for continued employment.

CHAIRMAN E. SYDNEY JACKSON: We have been underwriting risks over 500 per cent for some time. We have figures for the five-year period 1961–65. During this period we placed about five hundred policies —almost one hundred a year. The lapse rate on these policies followed very close to Linton B rates. Our mortality experience has been light; we have had eight deaths. I cannot quote a ratio on that, but the extra premiums received on the business substantially exceed the total amount of claims. Admittedly, one large claim could make this experience look sick.

So far as the placement rate is concerned, we took a small sample for this year and found that we placed about one policy for every six issued.

A British reinsurance company that I asked indicated that they felt that there was considerable antiselection, and they gave a couple of indications of it. On coronary risks they found that the mortality rate depended on the date of issue rather than, as one would expect, on the date of the coronary attack. In the United Kingdom they offer policies with extra premiums or policies with liens, and the mortality experienced indicated that better lives took the lien. Mortality for those who took extra premiums was substantially higher. Almost all the deaths showed a poor family history.

Tuesday Session

MR. WALTER N. MILLER: From a level of about 400,000 in January, 1967, the number of servicemen in Vietnam increased to about 468,000 by September. The reported number of men killed in action has averaged about 780 per month during this period, compared with 420 during 1966.

The following excerpt is from the V.A.'s official report on the SEGLI program during the fiscal year ended June 30, 1967:

> The intensity of Viet Nam combat activity resulted in a substantial increase in claim payments in this second fiscal year of operations. In the closing months of the year, claims were slightly in excess of 1,600 per month, more than double the average monthly claims of the preceding fiscal year. Since normal peacetime claims, based on the current size of our armed strength, would not exceed 500 per month, the difference is ascribable to increased combat and training activity.

Comparison of reported Vietnam casualties during April through June (which averaged 1,000 a month in this period) with the 1,600 average

monthly total claims SEGLI had in this period indicates that noncombat deaths are also an important factor currently.

Under SEGLI, the covered services contribute for extra hazard costs by paying for all death claims in excess of the amount total claims would be if service mortality were the same as that for the entire United States male population at the same average age. The contributions are percentages of SEGLI premiums. In the first four months of SEGLI's latest fiscal year, this percentage was 60 per cent; it was increased to 100 per cent for the last eight months. The SEGLI report states that "indications are that the percentage will have to be increased to 175% if current claim experience continues."

These developing trends and their effect on military experience caused us to tighten our military underwriting program earlier this year. Presently, our military business constitutes about 3.4 per cent of total sales. As far as the distribution of our military business is concerned, sales during July through September of this year broke down as follows by number of policies: about 5 per cent in the "alerted" nonhazardous area, about 20 per cent in the "nonalerted" hazardous area (these are the two areas in which we have special maximum amount limits), and the remaining 75 per cent in the "nonalerted" nonhazardous area in which we presently have no special limits.

MR. ALTON P. MORTON: Prudential claims for 1966 due to war ran just under 1.3 per cent of total ordinary claims. For the first eight months of 1967 they ran about 2.1 per cent, in part reflecting the increased intensity of combat activity.

The incidence of these claims by duration is interesting. For duration 1, war deaths were about 15 per cent of total war deaths at all durations in 1966. So far, in 1967, such duration 1 claims have been only 11 per cent of the total. This is suggestive, but not proof, of a lessened antiselection by new applicants for insurance. We may have gotten our war-risk underwriting rules into a form that will enable us to control antiselection better.

In general, our rules are like those of New York Life. The amount granted is somewhat of an inverse function of the likelihood that the applicant may experience combat hazards at some indefinite future date. We close the door tightly only on the applicant already "alerted" for combat service.

MR. HAROLD G. INGRAHAM, JR.: In the case of business for college Seniors, a number of companies are restricting students in the Air ROTC to $10,000 or $15,000 of permanent insurance with no guaranteed insurability rider. Other college Seniors, not in ROTC but with a definite mili-

tary commitment, are being restricted to similar amounts with a modest limit, of, say, $5,000 per opted policy.

MR. MILLER: New York Life has issued policies rated more than 500 per cent since January, 1963, when we introduced Special Class G covering ratings above 500 per cent and up to 1,000 per cent. Our general actuarial approach is to charge extras based on a multiple-table approach, also reflecting anticipated higher underwriting expenses and not-taken rates. Our cash values and dividends on all special class policies are the same as those for standard risks. From 1963 through 1966, we issued and paid for about five hundred Class G policies for just under $3½ million. Thus, average size is around $6,900. They amounted to about 60 per cent by number and 45 per cent by amount of paid issues in our 400–500 per cent class.

About 35 per cent by number and 25 per cent by amount were on females, which is higher than our over-all proportion. The primary factor here is that in high substandard classes there are relatively few large-amount policies, which are sold primarily to men. About one-third were at ages 25–39 and about half were at ages 40–54, showing more concentration at the higher ages than is the case for our rated issues generally. Seventy-five per cent are on life plans—primarily whole life—with the remainder about equally distributed among endowments, family plans, and term plans. Our Class G proportion on term plans is less than that for rated business generally.

About 20 per cent were rated for elevated blood pressure alone; 45 per cent because of build and blood pressure; 25 per cent for various medical impairments, single or multiple but mostly multiple; and 10 per cent were in a number of miscellaneous categories.

Not-taken rates have been around 70 per cent by number and 75–80 per cent by amount. These rates were pretty much in line with our expectations and actually are just about 5 points higher than those in our 400–500 per cent class. A lapse study tracing issues of 1963 through 1965 to 1966 anniversaries showed first-year lapse rates of about 45 per cent by number and amount; second-year rates of about 18 per cent by number and 13 per cent by amount; and third-year rates of about 20 per cent by number and 22 per cent by amount. These lapse rates are considerably higher than our over-all level for rated policies, although we expected such a situation because our lapse rates have showed a steady increase when moving from one special class to the next higher class.

With regard to mortality, our experience so far has been favorable but statistically insignificant.

In view of our limited experience, there is no readily available theoretical or statistical measure to evaluate the question of the justification for issuing such policies on the grounds of profitability alone. On the basis of what we know, however, we are satisfied that we have been able to issue in Class G on an equitable basis—not only to Class G policyowners but also to our policyowners generally.

MR. HARRY WALKER: You said that you issue convertible term insurance in the G class, with lapse rates of 45 per cent the first year, 18 per cent the second year, and 20 per cent the third year? It must indicate considerable antiselection on continuation during the term period. What do you think the prospect is for your mortality after converting?

MR. MILLER: Our Class G constitutes a very small proportion of what is a very small group to begin with. We simply do not have enough experience yet to break the thing down finely, and I would not like to hazard a guess.

MR. ARCHIBALD H. McAULAY: I think that it might be said that in the old days the home-office underwriter considered his job as basically a negative one. The home-office underwriter was the doughty warrior guarding the portals of his company and preventing the entrance of those whom he considered bad risks. In retrospect it seems to have taken us a long time to realize that we had much more to do than merely to exclude some risks. We now feel, I believe, that we have the positive job of helping to build our companies. We have to be able to rate practically every type of applicant and, at the same time, to do it in such a way as to detract as little as possible from the sales effort of our companies and yet make a profit.

For highly impaired risks the underwriter of an earlier vintage would consider the word "profit" as being determined by the premium received, the mortality and lapse experienced, and the cost of underwriting. On this basis the profit might be negligible or even negative. However, the underwriter of today, particularly in a stock company, is inclined to reject this rather narrow definition of profit. Instead, he is inclined to broaden the definition and consider the effect of his actions on the other objectives of the company, particularly agency objectives. For example, an underwriter in a stock company may feel that he is making a profit if by a small and deliberate increase in his mortality he can help correct a serious expense problem in the agency department of his company. If we accept the broader concept of profit, consideration might be directed to

the implications of accepting high substandard business from full-time agents.

It has long been recognized that a full-time agent providing a good volume of good business was contributing very substantially to the profit of his company. Perhaps it is only within recent years that we have begun to accept as a corollary the fact that a full-time agent is entitled to demand full-time service from his company. From an underwriting angle, full-time service means, I believe, that the company must try to find a method of insuring practically every risk that a full-time agent comes across in the normal course of his work.

The fact that so many companies are now offering high substandard might suggest that the broader definition of profitability of the business has been accepted and that high substandard is now just part of the full-time service provided for a full-time agent.

MR. MORTON: Just how we keep books on the additional cost of highly substandard business is somewhat a matter of choice. The underwriting costs have already been incurred in deciding that a risk is not acceptable within the conventional range of substandard, so that we can treat any added costs in making highly substandard offers as marginal.

MR. WILLIAM F. DICE: Since October 1, 1962, two of Metropolitan's current classifications include risks over 500 per cent of standard—Rating

RATIOS OF A/E AND AMOUNT OF CLAIMS ($1,000 UNITS)
(Policy Years 1–5)

Plans Excluding Term*	Amount Exposed ($1,000 Units)	Age	A/E	Amount of Claims ($1,000 Units)
Rating 3...	$14,823	10–29	†	$ 25
	15,605	30–39	†	40
	22,829	40–49	257%‡	165
	15,122	50 and over	401	426
	$68,379	10 and over	327%	$656
Rating 4...	$ 6,370	10–29	....	....
	10,746	30–39	†	$ 63
	18,189	40–49	358%	195
	10,128	50 and over	283‡	195
	$45,433	10 and over	321%	$453

* Renewable term, term to 65 and reducing term, and level term riders.
† Based on fewer than ten deaths.
‡ Based on fewer than twenty-five but not less than ten deaths.

3 has a range of about 435–660 per cent and Rating 4 of about 660–1,000 per cent of standard. (Mr. E. A. Lew commented on this on pp. D11–D12 of *TSA*, Vol. XVI.)

The accompanying tabulation shows our mortality experience on these classes of business during the first five policy years, from policy anniversaries in 1962 to anniversaries in 1965, based on the amount of insurance The expected deaths are based on the corresponding experience for standard policies excluding term insurance.

These favorable ratios reflect that excess mortality on these risks is largely of a deferred nature A recent sample showed that a high percentage of these ratings is due to blood pressure and/or overweight, congenital heart disease or heart murmurs, and diabetes.

Our 1966 lapse experience by duration on these policies as compared with standard issues shows little difference This study did not take into account a number of variables affecting lapse experience For example, the substandard classifications are heavily weighted toward the higher ages which, in general, would be expected to have more favorable persistency.

Agents' Compensation

A. What changes have been made in (1) agents' commission scales, (2) financing practices, and (3) the form of pension plans and the scope of insurance benefits?

B. What success have companies had with salaried contracts for agents? Is there another type or form of compensation that would enable the industry to be more successful in attracting and retaining young agents?

Monday Session

MR. RICHARD H. TALLMAN: Five areas of change are noted in agents' commission scales:

1. *Lower commissions on smaller policies.*—A few companies are reducing the first-year commission by 5 or 10 per cent of the premium if the policy is under $5,000.

2. *Some heaping of renewal commissions.*—Second-year commissions have been increased to 10 or 15 per cent of premium in comparison with the traditional 5 per cent. Third-year commissions have been raised to 10 per cent of the premium, compared with the old 5 per cent.

3. *Deferred-compensation plans.*—Half a dozen companies have them, possibly more. Two companies have mandatory plans. Agents with perhaps three or five years of service are required to put 6–9 per cent of their first-year commissions into the deferred-compensation fund. Another two or three companies have voluntary deferred-compensation plans. Under one of these plans, an agent can put 50 per cent of his first-year commissions into the deferred-compensation fund if his income exceeds a stated minimum.

4. *Persistency rewards.*—If anything, a reverse trend may be occurring here. Quite a few companies see no improvement in persistency which can be attributed to their persistency incentives. A minority feel that their plans have improved persistency. Our company adopted a renewal compensation plan heavily oriented toward good persistency about thirty years ago. The plan was changed seven years ago but continues to pay some bonus on persistency business. At the outset the plan unmistakably improved our persistency, which had been bad. We cannot tell today whether the present plan brings out better persistency than we would get without it. One thing that we have noted is that the major portion of the bonus payments is going to agents who stabilized their production at the $300,000–$400,000 level. While this incentive could be encouraging good persistency, it does not appear to be promoting productivity.

5. *Productivity bonuses.*—A number of non–New York companies have introduced or shortly will introduce a productivity bonus into their agents' compensation plans. The tendency is to lower the standard first-year commission rate and then to add a first-year bonus if certain productivity requirements are met.

Other trends in agents' compensation are longer-service requirements for vesting and insurance-in-force requirements for service fees.

We have been studying our own agents' compensation plan, and, among other things, we are considering the possibility of a production bonus, a shift of some renewal commission into the early years, and perhaps dropping the persistency factor.

In general the New York companies are moving toward a slightly higher financing schedule. Most of them use validation schedules based on cash commissions; a few use annualized commissions. The non–New York companies generally use annualized commissions for validations. Smaller companies keep looking for some financing arrangements that will cost little or nothing. The very few companies who are successful in getting back their financing costs are those with highly effective training programs.

A study is now being made by the Life Insurance Agency Management Association that is looking into the relationship between the financing plan and the degree of success by the agent. There is some indication that the degree of success of the agent is greater under the higher-financing plans. If the study confirms this conclusion, the interpretation should be made rather carefully. Higher financing of itself may not cause the agent to be successful. The company or agency manager is no doubt going to be considerably more careful in the selection of the new agent in the first place because of the higher stake that the company will have in him.

We adopted a new financing plan for new agents at the beginning of this year. The new agent is paid a salary for a period of four years under an employment agreement. At the end of four years the employment agreement terminates and the agent goes on the regular commission contract. He must validate his salary during the four years, and he can earn a bonus. No debt is incurred under the plan. The agent is considered to be an employee, subject to social security taxes, federal income, state, and local taxes, and unemployment compensation.

Mr. Lincoln, of the Home Life, described for me the changes that he has observed in one year, between mid-1966 and mid-1967, from a survey that he made of agent benefits in the two years. More than three-fourths of the companies in the survey have made changes, with the majority occurring in their pension plans. Not many have changed their major medical insurance. A fair number have changed their group life insurance, all upward, either in the maximum amount of insurance or in the times earnings factor. Not too much change has occurred in disability income. Most of the benefit-plan changes were in pensions. Some companies have lowered the contributions required from the agent, some have increased benefits, some have improved the vesting provision, and a couple have added widow benefits.

Salaried contracts for agents have been in existence for many years on a very limited basis. Interest in such plans has always been present but appears to have increased. Half a dozen companies now have salaried plans.

We opened a new office in St. Louis a little over three years ago with the intention of using it as an experimental model for several ideas, with the salary concept the basic one. A similar office was opened about a year later in Phoenix. Both were started with a salaried branch manager and one salaried unit manager. Sales representatives were then recruited on a permanent salary basis, with opportunity for salary increases and bonus earnings. In most important respects, this salaried plan is like the new salaried plan for agents that I described a little earlier.

The St. Louis plan is serving its purpose well, both as a model office and as a productive operation. In less than three years a $6,000,000 agency has been built from scratch. Survivorship rates appear to be better than average, although not greatly so. Productivity per man is significantly higher than the company average. Persistency is about the same, although it appears that persistency has to be watched quite closely. We have not yet made a full study of the cost of building an agency in this way. It perhaps would be higher initially than building from scratch by conventional methods, but a profitable production level should be reached earlier.

It would not be fair to say that all the results in this agency are due to the salaried plan. Other factors are the use of certain prospecting aids, the use of full-time submanagement, the manager himself. Except for the manager, these factors have been part of the experiment. Some of the ideas have been applied company-wide, such as the salary plan for new agents adopted this year.

By way of contrast, one company about ten years ago dropped a salaried plan that it had developed during the 1930's. As the country returned to better times, the form of the plan, which was designed for depression conditions, was no longer suited to the later conditions which brought about more competition for manpower and the needs for greater and more immediate income to the new agent. The company therefore moved over into more conventional financing plans.

Agents' compensation has always been changing and is continuing to change in all areas—commission scales, financing, and benefit plans—and the change is steadily upward. The one fact evident more than any other is that the pressures brought about by the competition for manpower, and by the need to get maximum results from money spent for acquiring new business, continue more than ever to force companies to

search for more effective methods of attracting and keeping agents and rewarding the good ones.

MRS. ANNA M. RAPPAPORT and MR. IRWIN T. VANDERHOOF: In 1966, Standard Security Life of New York introduced a new type of agents' retirement plan. The Producers Retirement Plan is a nonqualified, noncontributory deferred-compensation plan covering part-time agents and brokers as well as full-time agents. Most of the company's business is written by part-time agents, brokers, and surplus writers.

This plan is provided in addition to the company's completely vested regular commission contract. The company promises no set retirement benefit but states that retirement income will depend on actual investment results, actual agent turnover, and actual life and health persistency.

The company has made estimates of plan performance for its own use. These estimates were based on (1) tables of agent turnover by P. M. Tompa (MCG[+5])[1] (this seems appropriate since, in the case of this plan, termination is failure in meeting the stringent requirement of $3,000 annual commission for two consecutive years); (2) a reasonable return on equity investments based on studies[2] by Lawrence Fisher of investments in common stocks listed on the New York Stock Exchange each month during the thirty-four-year period from 1926 to 1960.

The only qualification for participation is $3,000 of first-year individual life and health commissions earned. Each year is treated separately. The plan vests after ten years of qualification. These ten years may be alternating or consecutive. An agent loses all prior credits after two consecutive years of nonqualification. There is partial earlier vesting for disability.

The company contributes to its agents' retirement plan two-thirds of 1 per cent of all second through ninth renewal individual life and health premiums. This includes business written in all years, both by qualifiers and nonqualifiers. Three-fourths of this contribution goes into the producer's plan, and one-fourth goes into a similar plan for general agents. No other fringe benefits are provided to agents and general agents.

The contribution for the producers is credited to the individual participants in proportion to their commissions earned. Each year's fund is handled separately. Investment earnings and fund amounts previously allocated to participants who fail to qualify in two consecutive years are

[1] *TSA*, VIII (1956), 35.

[2] Lawrence Fisher, "Outcomes for 'Random' Investments in Common Stocks Listed on the New York Stock Exchange," *Journal of Business*, XXXVIII, No. 2 (April, 1965).

allocated to the remaining participants in the year's fund in proportion to their commission earnings in the original qualification year.

The trustee is a bank. The plan requires that 50 per cent of the assets be invested in Standard Security stock. The older 50 per cent of the amount will be invested in equities chosen by the trustee. The company has stressed to its producers that all investments are in equities and that consequently there are both risks and growth possibilities. The plan has been approved by the New York Insurance Department.

This plan has been very well received by the field. It provides an unusual opportunity for the part-time agent and broker, since it allows him to participate in a deferred-compensation plan without forfeiting any of his regular commissions.

The company believes that this is a valuable tool in recruiting and holding successful part-time agents, brokers, and surplus writers. We also believe that it is desirable that our producers have an interest in working for the long-term profitable operation of the company. The plan has been in operation for only one year, and, although it is too early to determine how successful it will be, preliminary studies indicate favorable results.

MR. ROBERT H. JORDAN: We adopted a new financing plan for new, full-time career agents at the beginning of 1967.

The previous plan had an annualized commission-validation schedule which was applied quarterly (as a general rule), with bonuses for production over validation determined quarterly upon request. Salary changes were frequent.

The new plan has an earned commission–validation schedule which is applied on a monthly basis (as a general rule), with compensation changed monthly, automatically, based on earned commissions. Salary changes will be infrequent.

The features of the plan that are of particular significance are (1) the use of a compensation schedule which grades the agent automatically, quarter by quarter, over three years from the initial salary to earned commissions; and (2) very low incentive and limited opportunity to make changes in basic salary level (except where the agent's performance is truly exceptional).

An innovation in the administration of the plan is the production monthly of a report of each agent's status by data-processing equipment, permitting monthly consideration of his continuance. This is possible because the validation schedule is on an earned-commission basis and the agent's compensation is redetermined monthly, based in part on the previous month's earned commissions.

MR. MAURICE V. DONOVAN: Metropolitan introduced a three-year financing plan for new ordinary agents in 1963. Under this plan, the ordinary agent was guaranteed a fixed weekly income throughout the three-year period, provided that he met specified net-production requirements, and his income could exceed the guaranteed level if his cumulative net-commission credits exceeded the cumulative requirements.

Earlier this year we adopted a financing plan for our combination agents that we believe may be an innovation for the insurance industry, in that it provides for periodic increases in the agent's guaranteed income during the financing period provided that he meets specified net-production requirements. The initial weekly-income level is established on the basis of the applicant's qualifications, and the monthly equivalent is increased by $50 at six-month intervals until a specified maximum is reached. The agent's compensation is also calculated on the basis of the basic-compensation arrangements, and records of cumulative net credits or debits are maintained. Any excess cumulative credits are payable in a lump sum at annual intervals. The more successful producer may elect to transfer from the financing plan to the basic-compensation plan and then be paid the accumulated net-commission credits, but he cannot later transfer back to the financing plan.

Our open-position situation has improved significantly since our introduction of this financing plan for combination agents. While this is encouraging, it does not assure the success of the plan. Validation requirements for the first year under the plan have been deliberately set at low levels, because we want our management personnel to be free of concern about meeting relatively high production requirements during a period when well-planned and thorough training is most essential. Only time will tell whether, as the validation requirements become more stringent, we will experience a substantial increase in the number of terminations because of failure to validate. However, we do hope that the quality of the salesmen that we recruit and retain will improve as a result of the introduction of this financing plan.

On the basis of the favorable initial experience under this financing plan for new combination agents, we have just recently modified our financing plan for ordinary agents along the same lines.

Tuesday Session

MR. DWIGHT K. BARTLETT III: The staff of LIAMA furnished me with the following figures. They reviewed forty-three ordinary companies, of which twenty-two operate in New York and twenty-one do not. One trend noted was a change toward stricter vesting requirements, mostly in

terms of service; fifteen companies have made such a change recently, ten of them New York companies.

Eight New York companies had moved toward heaping of renewals, seven of these being among those having made stricter vesting requirements. In four of these, the second-year commission was increased. Five companies had reduced first-year commissions by 5–10 per cent, increasing them in the second or later years by the same amount. One New York and five non–New York companies had added bonuses recently.

Among combination companies there has been a trend toward annualizing first-year commissions and putting them into a payment pool which is paid out at some rate like 6 per cent weekly, in the hope that this will stabilize earnings. A substantial part of combination agents' compensation is based on premium growth. Several combination companies have moved to financing arrangements for new agents similar to those used by ordinary companies.

A study of agent survival revealed a very strong correlation between the size of debit to which a combination agent is assigned in terms of service commission, content, and rate of survival. Consequently, some companies pay commission subsidies on smaller debits, so that the agent would have at least a minimum guaranteed income on the debits through his regular service or collection commission plus the subsidy.

My company adopted a program this year of guaranteeing the agent who meets certain performance requirements that his service commission would be at least $65 a week, hoping to solve our open-debit problem. It has to some extent. Last year a study showed that debits paying $50 or less in service commissions were open about 20 per cent of the time, whereas those paying $100 were open only 3 or 4 per cent a year. There was also a reasonably strong correlation between the size of debit and sales performance.

In the security benefit area, five New York and three non–New York companies recently have added disability income benefits. Disability programs have been in effect for some time for combination-company agents.

Deferred compensation for agents has been discussed by the Society (as reported in *TSA*, XVIII, p. D245). According to LIAMA, six of the forty-three companies studied have deferred compensation plans—three are mandatory and three are optional. The legal aspects are discussed by Malcolm Osborne in the recent *NALU Gold Book.*

The president of Northwestern National wrote an article for the *NALU Gold Book* in which he explained some of the rationale for the adoption of his company's experimental salary plan for agents. In speak-

ing of the studies that LIAMA made, he said that persistency really is determined by the quality of the issue, with the agent having very little effect on it after the sale. So the industry's pattern of deferring a substantial part of commissions to renewal years makes little sense. Northwestern National would rather pay the money or compensate the agent from the money in the hope that this is where the real need is.

In summary, it seems to me that there is a great deal of experimentation being done on each side of the combination company–ordinary company fence. One side of the fence is trying concepts which are old, familiar ones on the other side, and vice versa. Perhaps there is a substantial drawing-together in terms of agency-compensation patterns and methods of marketing.

MR. JACK V. MASTERMAN: A situation has been developing in Canada related to some aspects of this question. Since contributions to the Canada Pension Plan are different for employees and self-employed, the status of agents has to be determined. Following a test case, a statement was made to the effect that insurers would decide and be prepared to prove into which category their agents fell. Agents had the right to appeal. Whatever the companies decided, however, that status applied for all purposes, including income tax, minimum wages, and vacation-with-pay legislation. No longer would companies be permitted to accept agents' contributions to a registered group pension plan if the agents were considered self-employed.

The Canada Pension Plan covers nine of the provinces, with the Quebec Pension Plan applying in Quebec. A test case here produced the decision that the agents of the insurer involved were employees. Those companies who believe strongly that their agents are self-employed were most concerned, and a further test case is being presented.

Thus the question of whether a salaried financing plan implies employee status and the question of how to provide pension benefits for self-employed agents are of immediate concern.

Health Insurance

A. What has been the impact of Medicare or Medicaid on the market for individual health insurance policies? Have companies made policies with "Medicare benefits" available under age 65?
B. What other factors are affecting the markets for individual health insurance policies? What steps are companies taking to adjust their health insurance policies, both old and new, for the continuing steep rise in health insurance costs?
C. How much integration of life and health insurance has there been in areas of marketing, policy administration, and billing? Have modern computers changed the approach of companies to any combination of these two lines?

Monday Session

MR. EDWIN B. LANCASTER: We offer a hospital indemnity policy providing $20 a day for the first seven days of hospital confinement and $10 a day thereafter (up to 120 days) to individual policyholders (as well as to certificate holders under small groups—less than twenty-five-life cases) whose coverage is reduced or terminated upon reaching Medicare eligibility. About 50 per cent of the Medicare-eligible policyholders' contracts are reduced, and the other 50 per cent are terminated. Our experience to date is that about 22 per cent of the Medicare-eligible policyholders apply for the hospital indemnity policy as a supplement to Medicare.

We have no way of knowing the effect of Medicaid on our market. We suspect that the impact is very small in those states where the Medicaid eligibility is a relatively low figure. In New York, where the eligibility level is relatively high ($6,000 annual income, after taxes and health insurance premiums, for a family of four and increasing by $850 for each additional family member to a maximum of $10,520), there must be some effect, but we simply do not know how to measure it accurately.

We have not introduced a "Medicare benefits" policy under age 65. Since 1958 we have issued an individual comprehensive policy which provides both in-hospital and out-of-hospital benefits with coinsurance and deductibles as a part of the benefit design. The 1965 edition of that policy provides for nursing-home coverage following a period of hospital confinement. One of our basic hospital and surgical policies that has been issued since 1962 provides similar nursing-home coverage. Under all our basic hospital and surgical policies, we administratively cover hospital diagnostic services rendered on an outpatient basis two weeks before and two weeks subsequent to a period of hospital confinement. This Medicare-type benefit has been provided since our entry into the individual medical care field. Thus, we feel that we have a fairly wide range of coverages

available and that there is included in our portfolio one policy that approaches the Medicare benefit design.

Earlier this year we extended the daily hospital room and board benefit available under all individual policy forms to $50 a day. We attempt to maintain up-to-date information regarding prevailing semiprivate daily room and board rates in all parts of the United States and will issue an individual policy with a daily room and board rate up to $10 in excess of the prevailing semiprivate rate in the applicant's area. As to outstanding policies, they can be upgraded either by changing to a new policy form or by adding a supplementary hospital indemnity benefit. The supplementary hospital indemnity benefit is available for $10, $15, $20, or $25 per day. At the present time this benefit is provided through a separate policy. We expect shortly to provide it in the form of a rider to the existing contracts, thus simplifying future administration and claim handling.

The most difficult matter for individual medical care business is the underwriting problem. All who are in this business know that the antiselection is substantial. The public seems to wait until a symptom appears before going to the agent to buy coverage. As a result, we have to include in our contracts exclusions for pre-existing conditions and certain surgical operations for the first six months. It seems to me that this is the Achilles' heel, the difficult part of the individual medical care business.

By contrast, for our very small group business—three- and four-life cases—we do not have this kind of antiselection and underwriting problem associated with it. My view is that if we are to proceed to try to maintain the medical care coverage for the individual in the private sector in the United States, the best way to do so is to move in the direction of the small-group-type approach. This may involve some changes, some things that we have not done up to this time, but I think that it is one of the things we ought to consider very seriously.

Tuesday Session

MR. ROBERT B. GOODE: We should consider here separate components of the market.

First, Medicare and Medicaid have no particular impact on disability income plans, with the possible exception of plans requiring hospitalization or providing blanket accident medical expense benefits for persons over 65.

Second, there is the medical care insurance for persons over age 65. Obviously, Medicare had a severe impact on the over-65 market. Some companies have withdrawn completely, and others have adopted new programs with Medicare in mind. Benefits for new sales to persons over

age 65 include weekly or monthly indemnities while hospitalized, those that fill gaps in Medicare, and basic hospital and surgical coverage or even major medical, excluding or co-ordinated with Medicare. Further details may be found in the Health Insurance Institute booklet *Report on New Health Insurance Policies of Insurance Companies Available to Those 65 and Over as of July 1, 1966.*

The under-age-65 market was perhaps the more important segment to be affected by Medicare, especially for hospitalization and surgical benefits and major medical plans. Companies with guaranteed renewable policies in force had to face up to duplication of benefits; companies with commercial contracts could modify them to eliminate or modify benefits for those over 65.

As to new policies for persons under 65, most companies have made provision for Medicare benefits. All our offerings are on the term-to-65 basis; others have provided for automatic modifications at 65. In our new guaranteed renewable major medical plans we provide for automatic increase of the deductible to reflect any other medical care insurance, including any Medicare- or Medicaid-style benefits if these programs are expanded in the future.

The Connecticut Insurance Department, concerned with duplication of benefits, has required that medical care plans sold to those under 65 either terminate on eligibility for Medicare or give proper recognition to its existence if coverage extends beyond 65.

For Question B, I again separate the business into the medical care and disability income markets.

In the last decade the cost of medical care has been the most rapidly increasing component of the Consumer Price Index, roughly double the increase in the total index. The American Hospital Association projected an 18.6 per cent increase in hospital expenses per patient day for the year ending September 30, 1966, and 30.2 per cent over the two-year period ending then. The head of AMA recently stated that the per capita expenditure on health care jumped from $76 in 1950 to $200 in 1965; he forecast $400 by 1970.

As a result of the serious problems stemming from this dramatic increase, more of us are using internal limits on room and board, surgical, and perhaps other medical care charges. They are proving fairly effective controls.

Many have had to increase rates on in-force major medical policies. On one block of such policies without internal limits, we have increased rates twice in the last four years. Our first increase in 1963 and 1964 gave rise to about 20 per cent extra lapses above normal. In the 1966–67 increase to

survivors there were only about 5 per cent extra lapses. So far I have seen no policies with automatic premium adjustments to reflect the change in some index of the cost of medical care.

With respect to disability income insurance there are several important factors. In the first place, there was a round of changes in limits because of the 1966 social security amendment. Most companies reduced limits for longer indemnity periods, and many introduced riders or policies giving income benefits for short periods, such as six to twelve months, to fill the gap before social security benefits were payable. In the second place, recently there have been reductions in rates for noncancelable disability income plans. In theory, these reflected anticipated favorable experience, but, in practice, competition was the most important factor. Finally, many companies seem to be switching emphasis from medical care to disability income insurance. This is due to the rapid increases in medical care costs and the advent of Medicare. The relative profitability of the two lines of business is also an important factor.

Turning to Question C, I believe that marketing is the starting point for the integration of health and life insurance operations. If both lines are sold by the same agency force and concurrent applications are common, then integration should be considered. Many companies now have joint health and life applications. Disability income probably is more compatible with life insurance.

The ultimate would be achieved when a joint application is used; the same underwriters handle both; policies are issued concurrently; and the basic records for billing, valuation, and statistical analysis are scattered on the same EDP files. Our underwriting and policy-issue functions are combined successfully, as are our administrative functions, but not to the point where the same clerical personnel are working on both lines. Basic EDP files are separate. There are real advantages to having the same people working on product development of both lines.

MR. KARL M. DAVIES: Neither those of us in the Equitable underwriting department nor our agents are anxious for co-ordinated or combined underwriting, because there are more requirements with health. We believe that it is slower, and the agents do not want us to hold up issue of a life policy while we think through the health underwriting. How does Connecticut General handle this?

MR. GOODE: We were concerned about this when we integrated life and health underwriting operations. I think that we are inclined to give a little on the health requirements if we have concurrent applications. We also

issue the life policy and hold up the health policy, if necessary, but this is very rare. We have not had anywhere near the trouble on this that we expected from the agency force.

MR. HAROLD G. INGRAHAM, JR.: We sell a guaranteed renewable income protection policy only in combination with a life policy bearing the same issue date and policy number. The two coverages are issued in separate policies, but premium billing is by one notice or by using one bank authorization. The economy of combining these functions affords a lower price for the health coverage. First-year lapse rates are significantly lower than comparable rates for other health policies.

MR. CHARLES W. KRAUSHAAR, JR.: New York Life has adopted a rider-addition program to enable existing policyowners to update without the expense of a replacement or the purchase of an additional policy. In our hospital portfolio a rider provides coverage for doctors' visits; laboratory service; X-ray; private-duty nursing service; and room, board, and nursing care in a convalescent home. Last June, when we increased our maximum on daily hospital from $30 to $50, we introduced a rider providing for this under an existing policy.

We have a similar rider-addition program for loss-of-time policies. A monthly income benefit can be increased or accidental death and dismemberment added by rider.

We adopted a combined application in 1963 which can be used for a life policy, a health policy, or both. Our experience with it has been good, and apparently it has been well received by the field. In 1963, combined life and health applications were 15 per cent of health applications, and this has increased to the current 20 per cent. Not-taken rates, however, are higher than normal.

Only preauthorized check and salary-deduction arrangements are integrated in our premium billing. One preauthorized check or a single, itemized, monthly billing notice covers all policies, both life and health.

MR. RICHARD H. TALLMAN: We had a rate increase a year or so ago and found that our extra lapse rate was between 15 and 20 per cent. We have not made a second rate increase.

MR. CLAYTON L. JACKSON: We have sold noncancelable income replacement in combination with life insurance for many years. These agency and underwriting problems have not existed with us, because they have been taken as a way of life.

We use a single application. Life and health underwriting is done at the same time, and the records and billing are together. The computer has introduced extra problems, because we are on CFO, which was not set up for this type of operation. Also, the master-record length is not large enough to hold the information in some cases when health insurance is treated as a rider in the CFO operation.

MR. STUART M. SHOTWELL: Mr. Goode spoke of excess lapse rates of 20 per cent on the first rate increase and 5 per cent on the second. Was there any difference in the amount of the increases—was the first substantially larger than the second?

MR. GOODE: No. Actually, we would prefer to avoid these large rate increases. Our plan for the future is more frequent but smaller rate increases for all our major medical business.

DR. LOUIS GARFIN: With regard to updating existing hospital and medical expense contracts, Pacific Mutual has introduced a hospital indemnity policy which may be issued either separately or as a supplement to the existing coverages but not as a rider.

Our experience with premium increases is somewhat the same as that reported by others. The additional lapses were significant but not excessive.

We have integrated life and health insurance for years. Income protection and life insurance policies have been sold in a combination sale for new agents. Our sales track combines these benefits, but we do not have a combined application. We feel that the disadvantages outweigh the advantages. We developed our computer system before CFO was available and provided for both life and health on the same set of file records for the computer. They are administered in the same daily system, but now we are coming to the next generation and find that ALIS does not provide for health insurance benefits.

We have different underwriters for life and health but have no big problem in terms of delay. The billing is combined with one notice that includes both life and health. Administration and sales are combined.