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GENERAL

A. In the light of current investment conditions is it advisable to increase maximum limits for the acceptance of single premiums and premiums paid in advance? Are investment prospects such that guaranteed interest rates on these funds might be increased?
B. What steps can a smaller company take to meet the current demand for pension plans?
C. To what extent have companies
   1. Transferred to their field or district offices functions which had previously been performed in the home office?
   2. Transferred to the home office or to central collection offices functions which had previously been performed in agency offices?
D. What steps have been taken to revise or supplement company retirement plan benefits to recognize higher salary scales and the possibility of still further inflation? Have satisfactory means been found to base benefits on final salaries?
E. What are the advantages and disadvantages of the "Bank Loan Plan" under which a policyholder purchases a limited payment life policy and borrows part of the premiums at a bank, thus obtaining an interest deduction for Federal Income Tax purposes?
F. What changes have been made in War Exclusion Riders, Disability and Double Indemnity provisions because of the recent court decisions defining "war"?

MR. E. M. McCONNEY stated that, in any problem involving risk, all factors must be considered, such as size and type of company, its surplus, and the liquidity of its portfolio. The current increase in interest rates will enable a company to meet overoptimistic prior commitments and consider increasing limits for new single premiums and advance premiums. It must be kept in mind that changed economic conditions may lead to a demand for the return of such funds.

He referred to Dr. Goldsmith's paper in March which advanced the theory that interest rates run in 15 year cycles and that 1946 marked the upturn which was held down by governmental action. This would leave only a few years of advancing rates. However, he pointed out that many economists hold that the past is no measure for the future because of standby controls together with political and fiscal banking maneuverings.

In a participating company the guaranteed rate means little because the dividend is the controlling factor. Errors in nonparticipating companies fall on the stockholders.

MR. E. G. FASSEL reported that in view of the recent change in the Wisconsin law the Northwestern Mutual has been studying premium discount practices. For theoretical purposes it might be assumed that the discounted premium return on death is a benefit augmenting that of the policy. For an ordinary life policy with regular gross premium of P'_x and with a gross charge of $B'\ddot{a}_{\overline{r}|}$ covering the first r premiums, he developed the present value of the additional death benefit of discounted value of gross premiums paid in advance as $P'_x(\ddot{a}_{\overline{r}|} - \ddot{a}_{x:\overline{r}|})$, making the present value, at issue, of the total benefit, plus the present value of expenses of E' on the augmented policy, $A_x + P'_x(\ddot{a}_{\overline{r}|} - \ddot{a}_{x:\overline{r}|}) + E'$. Equating this with the present value, at issue, of the gross premium payments, $B'\ddot{a}_{\overline{r}|} + P'_x(\ddot{a}_x - \ddot{a}_{x:\overline{r}|})$, and substituting for $P'_x\ddot{a}_x$ its equivalent $A_x + E$, where E is the present value of the expenses on the ordinary life policy, he derived the equation $E' - E = (B' - P'_x)\ddot{a}_{\overline{r}|}$. Hence, if $E' = E$, then $B' = P'_x$, i.e., the regular gross premium discounted is the correct charge provided that the expenses incurred are the same in amount and incidence as if the premiums had not been discounted. This is the rationale of the usual practice of paying regular annual premium commissions on discounted premiums as the premiums fall due. However, such commissions are usually more valuable than on the discounted premiums at the single premium commission rate. To the extent that such funds would otherwise come in as single premiums, the company is justified in paying the higher commissions through the interest margin in relation to new investments at that time. There are evidently policyholders who are interested in anticipating premiums at, in effect, a savings bank rate. The margin in relation to long term investments allows for withdrawal liquidity.

MR. W. W. TERRYBERRY reported that the Connecticut Mutual, in view of the improvement in the interest rate on new investments and the availability of United States Government bonds at a more attractive yield, has increased the discount rate from 2% to 2½%. The maximum number of premiums that may be discounted remains at 20 but the restriction on policies of shorter durations has been removed so all remaining premiums may be discounted.

The discount agreement provides for revocation, so the fund may be withdrawn without surrender of the policy by excluding interest for the first two years with a six-month deferment clause.

MR. L. F. SLEZAK in discussing section C said the Occidental of California has not made any recent changes in its methods of operation but is possibly the largest life company using exclusively a home office billing and collection system. The field offices consist of both general agencies and branch offices. In neither case are such offices required to perform any of

the functions of premium billing or collection, nor commission accounting or payment. The field offices will accept premium payments and issue a temporary receipt and, under certain conditions, may also issue sight drafts in payment of commissions.

The system of home office billing and collection has been quite satisfactory and he feels that it gives proper service to policyholders. It is advantageous under the following situations:

1. It makes a program of agency expansion easier since it is relatively simpler to train new agencies and branches in procedures.
2. It provides a centrally controlled continuity of service to policyholders. This is particularly important when there are large volumes of brokerage and orphaned business.
3. It makes the training of field clerical staff easier. This is valuable during periods of high clerical turnover, as at present.

MR. M. R. CUETO mentioned that New York Life during the past few years has transferred to the field offices certain functions as follows:

1. In 1949, in the interest of making funds more quickly available to policyholders, branch offices were authorized to grant policy loans up to $500 net cash per policy on not more than three policies on one life. After review, the program was liberalized from $500 to $1,000. Under this program the branch offices were completing about 81% of loans of all types. In 1952, branch offices were authorized to grant loans, within certain limits, up to $3,000 net cash on one life. The verification of loan transactions by the home office was eliminated although provision was made for spot checking. The program was extended to cover earlier policy editions and loans to minors and collateral assignees. The loans completed by the branch offices now represent about 95% of the total loans.
2. In 1948, to speed payment of death benefits, the company permitted a majority of its cash settlements to be handled by the branch offices, where most claims amounting to $5,000 or less representing about two-thirds of all cash settlement cases are paid promptly after receipt of proofs. Major procedural changes were required to adopt this program. The branch offices now telegraph reports of deaths to the home office giving the date and other essential information. Where the commuted value of all insurance policies does not exceed $5,000 and where no restriction applies, the home office wires authorization to pay the death benefit to specified payees upon receipt of satisfactory proofs. The branch offices can't make payment if any one of these conditions exists: (*a*) death is due to an accident and any policy contains the accidental death provision, (*b*) death in any way relates to aviation, (*c*) death occurs within two years (one year under certain policy forms) following written application for reinstatement, (*d*) death is due to homicide or suicide, (*e*) the policy is assigned or the beneficiary is the "estate," (*f*) the policy contains a

common disaster clause, (*g*) the policy is payable under an optional settlement.

3. In 1945, branch offices were authorized to pay dividend deposits and cash value of paid-up additions. The limits have been increased since that time until today they aggregate $1,000 on each life.

From the viewpoint of public relations it is believed that considerable good-will has been engendered by the above programs which have proved of material assistance to the field force. With respect to the second part of this topic his company during the past few years has transferred the renewal premium collections from the home office and in the case of some of the other large cities from a central collection office to branch offices, thereby making the above programs with their advantages to policyholders and field men available to all such offices.

MR. W. J. NOVEMBER reported that the Equitable of New York has transferred to local cashiers' offices a variety of functions from the home office, subject to prescribed conditions such as a maximum amount limit, resulting in a sharing of these functions by the home office and field offices.

He emphasized the dampening effect Section 213 first year expense limits have on a trend of this sort, even though the trend is to the best interest of policyholders. Under paragraph (e)(1) of subsection 2 of Section 213, all expenses of local offices must be charged against the allowances for such expenses and for renewal compensation provided in paragraph (e)(2). It is unfortunate that control of acquisition costs should operate so that management must consider the effect that a move to improve administrative procedures will have on margins for acquiring new business. One of the reasons margins have become narrower is that there has been a tendency for local offices to assume greater responsibility for administrative functions. In revising Section 213, this should be taken into account. It would be well if the expenses in local offices associated with functions of this type could be removed from the first year expense limit test, but he appreciated the practical difficulties involved.

Within prescribed limits, cashiers' offices now complete policy loans, pay surrender values of dividend additions and deposits, approve death claim payments when special service is desired and settle some group casualty claims. They now endorse beneficiary changes on policies when single sum settlements are involved, issue change of name riders after marriage, approve requests for change in mode of premium payment and issue the official receipts acknowledging such changes, and handle the calculation and prepayment of premiums within a specified limit.

In underwriting and policy issue, cashiers approve inspection reports

when policies have been sent to the local office for delivery subject to such approval. They initiate special examination procedures in new business cases for large amounts and approve reinstatement up to 30 days following the end of the grace period on the basis of a satisfactory health statement. In investment matters they maintain fire insurance records for mortgage loans and advance fire insurance premiums when necessary to protect the Equitable's interests. They initiate and supervise annual tax searches, and advance funds for delinquent taxes while arranging for reimbursement by the borrower. When a mortgage loan is approved, the cashier pays out the funds on most loans and follows up on the loan closing details.

MR. D. N. WARTERS, in discussing section D, pointed out that many of the pension plans adopted in the late 1930's and early 1940's were based on average salary during service. Little thought was given to increasing price levels, probably because during the two preceding decades price levels had been stable or declining. The Bankers of Iowa installed this type of plan in 1940. With the subsequent inflation, the pensions failed to provide the intended living standards. In 1950 they arbitrarily increased prior pension credits. History indicates a strong probability that rising price levels will persist over the years. In the past 100 years, while there have been periods of stable prices and declining price levels, the trend has been one of price increases averaging about 1.1% per year for the period 1850 to 1946 and over 1.5% per year during the last 50 years. To better meet this probability they are now changing the formula so pensions will be a percentage of the average salary of the final 10 years. The percentage will be the sum of percentage credits earned for each year of service, with the percentage credit given for service before age 35 limited to half that given for service after age 35.

Some may fear that a pension based on final salaries may place an uncontrollable liability on the company. This is not so, as the company sets salaries and can balance increases in final years with the amount of pension credit involved.

To make the pension more adequate for the pensioner with dependents, their plan provides that in the calculation of the actuarially equivalent survivorship annuity the age of the retiring employee shall be rated down five years and the dependent rated up five years.

While relating pensions to the average of the final 10 years' salary does much to make the pension adequate at the time of retirement, continuing inflation after retirement creates problems for those who live to a ripe old age. Employees may demand some solution before freely accepting compulsory retirement. It may be wise to build up a fund during the working

life of each employee to be held and used to increase his pension if price levels rise.

MR. D. M. ELLIS recalled that at the Society meeting a year ago, Mr. B. R. Power outlined changes which had been made in pension plans by Canadian companies. Few if any further changes have been made since that date.

The Canada Life had a money purchase plan for many years under which employees had the option of contributing from 5% to 10% of income, with the company matching. About two years ago the company's contribution was changed to a uniform 13% and the conversion factors were modernized.

At that time study was given to adopting a final salary base. Any other type of plan might fail to produce adequate pensions. However, they were not convinced that it was proper to accept a pension liability that had no limit. Their solution was to make the company's contributions greater than would be required with a static salary scale. Annual contributions of 18%, 13% by company and 5% by employee, with a generous accumulation rate provide pensions in some cases greater than final salary. This allows for considerable future inflation. Adjustments may be required but can be made without any commitment that might be embarrassing.

MR. LOUIS LEVINSON believed that company retirement plans based on final salary (or average of the last few years of service) have the virtue of being adjusted naturally to inflationary changes before retirement and require less modification to meet reduction in the purchasing power of the dollar than either the money purchase, or the unit purchase, type of plan. Also they are especially suitable for employees of the supervisory and executive classes where significant advances in rank tend to come later in life than in many other lines of business. A year by year credit may result in a retirement benefit unduly reflecting a rather long period of relatively low salary income, and may not be fairly related to the senior employees' standards of living before retirement.

The Massachusetts Mutual Employee Contributory Pension Plan adopted in 1948 is a final salary plan with retirement benefits based on graded percentages times years of service and each year a paid-up deferred annuity reserve is set up based on current salary. An increase in salary in any year, therefore, entails an immediate liability for pension credits over the full period of past service. When increases in salary levels are experienced, current pension costs may be quite large. This plan provides for an increasing vested interest in the company's contribution after 15 years of service, with full vesting after 25 years.

MR. H. S. GARDNER described the New England Mutual's procedure prior to 1945 under which employees were retired at the pleasure of the company or need of the employee at about 50% of final salary. This plan met conditions existing at retirement but it had a number of serious faults. The cost was very high although most of this was hidden as home office salaries. Also the effect on the efficiency of the company was unfavorable and opportunities for advancement open to younger men were severely limited.

In 1945 they adopted a contributory home office retirement plan with normal retirement at 65 on the unit purchase type with benefits of $1\frac{1}{4}$% of the first $3,000 of salary, 2% of the next $22,000 and 1% over $25,000. The corresponding contributions were 2%, 4%, and 2% respectively. Past service benefits for 1937 and later years were calculated by the current service formula and for earlier years were $1\frac{1}{2}$% of the 1937 salary times the number of years of qualified service. The minimum pension is 50% of the 1944 salary to equalize with prior treatment.

As inflation continued, the benefits became unsatisfactory. This year both the retirement benefit and the death benefit prior to retirement were liberalized.

The liberalization of the retirement benefit consists of a noncontributory supplemental allowance equal to 1% of the salary in the ten years prior to retirement, ignoring any increases during the last three years, with a limit of 25% of the basic retirement benefit. This method of increasing retirement benefits has a number of advantages: (*a*) the greater weight given to final 10 years' salary reduces the effects of progressive inflation, (*b*) the increase in benefits is proportionately greater for those with relatively short periods of service where the basic plan was particularly unsatisfactory, (*c*) the company incurred only a moderate past service liability, since only those over age 55 had any past service for supplemental allowance, (*d*) the extra annual cost to the company is stabilized by limiting the increase in accrued benefits to employees who will presumably be subject to little turnover except by death or disability, (*e*) the cost is also held down by providing no increase in the benefits which vest in those who withdraw at ages under 56.

The liberalization in the death benefit attempts to correlate the protection afforded an employee's wife before and after retirement if either of two joint options is elected. Originally this was limited to the employee contributions with interest which was of much less value at retirement than the survivor interest under a joint annuity. The current revision provides that, if the wife leaves the death benefit to buy income, the

accumulated employee contributions will be increased by one half of the company reserve. Tests indicate that this income will compare favorably with the survivor interest.

MR. B. N. PIKE reported that the John Hancock in 1951 added to the company retirement plan a noncontributory benefit equal to 1% of salary during the last ten years prior to normal retirement date, with a similar provision in certain cases of early retirement. Previously the plan provided for the purchase each year of 1% of the first $3,600 of earnings and 2% of any excess.

By using an additional benefit formula, it is possible to incorporate some of the theoretical advantages of a plan based on final earnings. This approach does not involve an open-end liability substantially increasing benefits previously funded in order to cope with salary inflation sometime in the future, but rather it offers a partial offset to inflation by granting an additional benefit based on salary in the last ten years of participation, which will rise with inflationary conditions. A regular deferred annuity plan levels inflationary and deflationary periods. This plan is a compromise between the usual deferred annuity and final earnings plans, which helps to protect an employee from the effects of an extended inflation immediately before retirement, although complete protection cannot be achieved by this means. Since 1951, several group annuity contractholders have introduced similar improvements in their own retirement plans.

Benefits based exclusively on a percentage of final earnings might be lower during deflation than those based on some form of average earnings, resulting in serious employee relations. It is doubtful if an employer could use gains in those years to offset effectively higher costs in periods of inflation, as such periods are difficult to forecast and the pressures for increased pensions above those based on final earnings during a deflation would undoubtedly be great.

This year the John Hancock again revised the company's plan, keeping the same retirement benefits, but reducing the employee's share of the cost, consistent with trends in many retirement plans which they insure. Whereas the employee previously contributed 2% of the first $3,600 of earnings and 4% of any excess, he now contributes 2% on earnings in excess of $3,600, with no contributions on earnings below that figure.

In concluding, he mentioned that a pension plan usually is designed to supplement Social Security benefits, individual insurance and savings, and that the total income from all sources should be considered when battling inflation. The reduction in the Federal income tax commencing at age 65 corresponds to a tax-free annuity of at least $11 per month.

MR. J. T. PHILLIPS, in introducing section E, expressed the opinion that the bank loan plan may be used to advantage for tax avoidance where the insured is in a very high income tax bracket and receives proper legal counsel. However, the purchaser's self-interest to get something for nothing should not be the primary motive in the marketing of life insurance.

If the plan is used indiscriminately, overselling, misunderstanding and controversies occur. The plan represents a complex selling process requiring elaborate sets of figures projecting expected results over a period of years in the future and involving assumptions that the prospect is a standard risk; that dividends apportioned will be not less than those under the current scale; that the margin required by the bank will not be increased and the bank will carry the loan indefinitely with no increase in rate; that the interest deduction will be allowed throughout a long period of years and the income tax bracket will continue at a high level.

Dissatisfaction with the financial arrangement or with any other feature of the plan may lead a policyholder to claim that his purchase of the policy was induced by fraudulent or erroneous representations and to sue to recover all he has paid. Whether such a suit is won or lost in court, the agent and the company are always losers, and commissions and premiums are not calculated to cover this additional cost.

At least one State Insurance Department, a number of local life underwriters associations and the National Association of Life Underwriters—organizations that know the details of the plan—have condemned it. They indicate a widespread view that, generally speaking, it is not a sound basis, or a commendable motive to be urged, for the purchase of life insurance. Certainly a method of selling which appears to be improper to so many people should either be discontinued completely or restricted to use in the very infrequent cases where its use is fully justifiable and where it is accepted with full knowledge of all the uncertainties.

MR. H. GORDON HURD said the Fidelity Mutual refused to accept such business, having, so far as they were aware, only two cases in force.

MR. C. G. GROESCHELL reasoned that practically every policyholder who pays his premiums in cash also borrows money for something during the life of the policy. The security for the borrowing may be his home, his car, his good name, or frequently his life insurance policy. The presence of borrowing does not affect in any way the intrinsic value or good of the life insurance policy. On the other hand, the question of whether the borrowing is good or bad depends on many individual circumstances, and the insurance industry should try to keep the two ele-

ments as far apart as possible so that any unfavorable results from the borrowing operation are not used as a reflection on the basic worth of the insurance policy.

If the policyholder has neither the cash nor the assets to pay the premiums, he must tie the borrowing to the policy. With the possibility of early lapse, it is especially important to look at what the insured pays under this scheme upon such lapse. The net cost on surrender in the early years is very high. In fact, if the borrowing is so great as to require additional collateral over and above the policy cash value, there may be a net charge upon surrender. Such a situation cannot help but breed ill will to the industry. It would seem that if all the possibilities and probabilities are presented to each prospect, there would not be many who would care to take a gamble on the bank loan plan. Rather, he would take a policy furnishing protection on a realistic pay-as-you-go basis. In this connection, it is indeed heartening to note the number of agents and agents' associations, as well as the individual companies and industry institutions, that are condemning the bank loan plan in the interest of the long range good of agents and companies.

CHAIRMAN H. F. ROOD, in asking for discussion of section F, explained that at the time the question was set there were only one or two decisions in which the Korean episode was not considered war. He understood the question was being appealed to the Supreme Court. The Lincoln National in its double indemnity rider has brought in the provision that wherever used in this rider the term "country" includes any government or coalition of countries or governments through an international organization or otherwise; "war" means declared war or undeclared war, or any conflict between the armed forces of countries; "military service" means military service in military, naval, or air forces.

MR. F. P. CHAPMAN in reporting the Metropolitan practice stated their policies do not contain a war exclusion rider affecting the regular life insurance benefit. Until very recently the double indemnity benefit used in Ordinary and Industrial policies excluded death as a result of an act of war. While they felt that this language was less subject to misinterpretation than the status type clauses generally involved in the recent court decisions, it was deemed advisable to make an appropriate amendment in the wording of that benefit. This was accomplished by policy endorsement to define the word "war" so that it includes, but is not limited to, any war declared or undeclared, and armed aggression resisted by the armed forces of any country, international organization or combination of countries. This definition follows closely that recommended by the National Associ-

ation of Insurance Commissioners and that included in the New York law. The phraseology of the war exclusion in the disability benefit was amended in the same manner.

MR. J. C. SIBIGTROTH felt the meaning of the word "war" as used in life insurance contracts has taken on a new significance because of the recent court decisions on the *Beley* and *Harding* cases holding that the military action in Korea is not a war in the legal sense. The clauses in question in both cases contained the words "in military, air, or naval service in time of war" with no qualifying phrases such as "declared or undeclared" or "any act incident thereto." These have influenced beneficiaries in other states to bring suits, particularly on the double indemnity benefit.

The decisions that have gone against the companies serve to indicate weaknesses in some clauses in current use and to point out changes that can be made so that the hazards of the Korean war and similar actions can be successfully excluded from coverage under war and aviation restrictions, the double indemnity benefit and the waiver of premium benefit.

From 1944 on, the New York Life in its waiver of premium benefit used "service in the military, naval or air forces of any country engaged in war." Since adverse decisions have been handed down in only a few jurisdictions and since the hazard of loss on account of disability is not very great, there seems no reason for prompt remedial action at this time.