

# TRANSACTIONS

MAY, 1965

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## DIGEST OF DISCUSSION OF SUBJECTS OF GENERAL INTEREST

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### *Federal Income Tax*

This topic was discussed by several members, who related actual experiences and problems in connection with federal income tax audits of company tax returns.

### *New Companies*

- A. What problems are inherent in the formation in recent years of many new life insurance companies?
- B. Is this an area requiring further legislative and regulatory controls?
- C. What issues of the public interest are presented?

MR. ROLAND F. DORMAN: The subject of formation of new life insurance companies has generated considerable discussion over the past few months. There have been several articles in trade journals regarding it, and the subject has been on the agenda of many industry meetings.

The general inference in most of these discussions is that the formation of new companies per se bodes ill for the life insurance industry. It doesn't seem to me that such sweeping generalizations are justified. While there are problems stemming from new company formations, I suspect that the new companies are merely symptoms of these difficulties rather than being the problem in and of themselves.

The problems usually mentioned in connection with new companies are:

1. Financial stability and ability to meet future obligations to policyholders.
2. The lure of stocks of new life insurance companies and the public's apparent willingness to pay virtually any price to get in on the ground floor.
3. Use of features such as stock options by the new companies to attract agents.

The question whether a company, new or old, can meet its future obligations to policyholders is certainly of considerable concern, not just to the particular policyholders and regulatory authorities, but to all responsible segments of the life insurance industry. As in any other business,

the life insurance industry will have its share of unscrupulous individuals who are interested solely in personal gain and have no sense of obligation to the public. Fortunately, the number of such individuals in our industry is probably quite small, and our system of examinations and regulations is such that the few we do have will usually be brought to light before any serious damage is done.

There seems to be a general assumption in many quarters that all new insurance companies are formed for promotional purposes and get-rich-quick schemes. While it is doubtful that any companies are formed for completely altruistic purposes of serving the public with no desire for gain, the number of purely promotional schemes is probably far fewer than generally imagined. Many of the new companies in recent years have been formed as adjuncts to already successful operations in the casualty fields, finance companies, department stores, and other industries. It is certainly doubtful that these could be classified as purely promotional schemes. Many of the other companies have been formed by people with some experience in the insurance business, often the agency side, who realize that their potential long-term gain from a sound operation will probably be much greater than could be realized from a quick promotional gain.

Perhaps the greatest problem that has been posed by the new life insurance companies has been the substantially increased competition for agents. These companies have clearly recognized that to prosper and grow they must obtain production. To get production they need agents, and to get agents they must offer something different and presumably more attractive than the established companies offer. Thus we see stock option plans being offered to lure agents from other companies as well as other inducements, such as high commissions and general agents contracts with liberal allowances. There is nothing wrong per se with stock options. By the same token, there is certainly no guarantee as to the future value of these options. Many agents accepting offers of stock options may well find that they have given up valuable commissions for options of little, if any, value.

It seems to me that the most serious problem related to new company formations stems principally from this added competition for agents. The problem, however, in most cases does not originate specifically from the new companies. The major problem today, and more importantly in the future, is the ever-reducing profit margins in the life insurance business. To combat other companies, old as well as new, in the competition for agents, many established companies have reduced rates to no more than a break-even level, particularly on term plans, and seem to ignore all sound underwriting principles on prestige cases for prominent producers.

Again, new companies in order to compete for agents must match the established companies' rates and underwriting. It becomes a vicious cycle and is one that poses a serious problem for the industry and the new companies in particular.

There seems to be a lack of appreciation, both within and without the life insurance industry, of the extent of reduction in profit margins in recent years. Many security analysts and some actuaries still commonly assign an arbitrary value of \$25 to \$30 per thousand for permanent plans of insurance, and \$10 to \$15 per thousand for term plans of insurance. It is questionable whether such value is realistic for many of the contracts being issued today. It is especially questionable when we consider the premium levels together with the acquisition costs and other operating expenses. In spite of this situation, the investing public, agents attracted by stock options, and in many cases company managements, are still guided by these arbitrary rules of thumb. Rather than decrying the formation of new companies per se, and blaming our difficulties on them, perhaps the industry, and particularly the actuarial profession, should develop more realistic measures of the profit potential of life insurance business. We need a better measure of current profitability than operating gains as shown by the annual statement. With a sounder basis for evaluation of life insurance stocks by analysts and the public, much of the current speculative appeal of new companies might disappear.

It is my personal feeling that the outlook for the industry is very bright, not only for the well-established companies, but for the well-managed, soundly-financed new companies as well. It does seem to me, however, that the life insurance industry has reached the point where a critical determination and evaluation of the many factors affecting potential profits is more essential than ever if a company is to establish and achieve realistic objectives for a good balance between profit and volume. It certainly seems questionable whether some companies have done this, since their blueprints for the future seem to have been drawn on rose-tinted paper.

MR. RICHARD V. MINCK: Bills imposing increased capital and surplus requirements for new life insurance companies have been introduced in twelve states. These bills have been passed in four states, were rejected in two states, and are still under consideration in six states.

The NAIC subcommittee, appointed to study the new company problem, is considering the possibility of legislation for increasing capital and surplus requirements for dealing with conflict of interest potential in agents' plans and requirements for promoters to advance and retain reasonable portions of capital.

**MR. BRUCE E. SHEPHERD:** Until some way can be found to eliminate the speculative atmosphere now surrounding life insurance company stocks, we cannot get at the heart of the new company problem. One way of doing this would be to devise better ways of measuring the value of an insurance company; however, this is not easy. One factor that is always involved in the determination of the value of a company's stock is the attitude of the management of that company over the next 25 years. If, for example, a company's management decided to mutualize after 25 years, the analysts would not be reaching the same conclusions about the value of that company's stock they probably would today.

If the situation gets out of hand and policyholders or the investing public gets hurt, someone will try to find a way to impose some limitations on operations of life insurance companies that we will not like. I would hope that we could find some way to curb this speculative atmosphere before someone else does.

As long as the speculative atmosphere prevails, it is relatively easy to raise money, and legislation requiring larger amounts of capital and surplus is not going to restrict the formation of new companies. I know of one company that started with a million dollars of capital and \$500,000 of surplus and within three or four years had exhausted this, plus two million dollars more and was still selling stock. Whenever they needed more money, they simply went out and sold more stock. Until these companies find it economically unprofitable to sell additional stock, capital and surplus limitations will not work.

*The Society's Spring Programs and Discussion Rules*

The Society has, in recent years, held three Spring Meetings. They have been day-and-a-half or two-day meetings scheduled on a regional basis with about the same programs so that the members attending might be somewhat fewer than at the Annual Fall Meeting and, thus, a more informal meeting might result. The programs have tended to include the following, in addition to any business of the meeting:

A. At the morning sessions:

1. the presentation and discussion of papers
2. reports by individuals on topics of current interest
3. informal discussion before all those attending of specified subjects of general interest

B. At the afternoon sessions:

1. informal discussion at simultaneous sessions of topics in a particular area of interest
2. usually a Smaller Company Forum

Are these meetings as now organized fulfilling the needs and the desires of the members? In particular, are the so-called informal discussions both before the whole meeting and at the simultaneous sessions of value commensurate with the time allotted to them? Are the rules for conducting these discussions, as set forth on page 2 of this program, satisfactory?

MR. JOHN F. B. AMSDEN: I note that this subject has been discussed three times within the past five years, and I question whether the Program Committee is getting a representative opinion simply by discussing this at our meeting. Possibly better representation could be obtained by sounding out a cross-section of the membership or even by the circulation of a questionnaire. It is significant to note that the Society's membership has increased by almost 30 per cent during the past five years, but the attendance at our meetings has not increased appreciably.

What are the needs and desires of our members? In addition to the presentation and discussion of papers, our young actuaries are interested in making new acquaintances and in gaining practical knowledge to supplement their theoretical training while the older members are perhaps more interested in keeping up to date on matters with which they are not directly involved. I believe the discussion of topics of current interest is most helpful in attaining these goals. However, I note that the informal discussions very seldom reach the informal state, perhaps due to the number of members in attendance. This is true in spite of the efforts made by a chairman of a particular session. Would it not be possible to have a half-morning session with different areas designated by signs as "Trading Posts" on specific topics at which interested members could

congregate over a cup of coffee? This would require planning and a minimum of staffing to insure that at least two or three members fully conversant with the subject are on hand at each post. Another approach is the workshop, which has been used very successfully by other associations. This would mean breaking our simultaneous sessions into smaller groups so as to make them more informal and thereby promote spontaneous discussion.

Our spring meetings seem very short considering the time and expense involved. I suggest that we continue to hold full sessions for the presentation of papers and discussion of topics of current interest; that we hold Trading Post sessions during the second half of the morning and Workshops during the remaining time available for informal discussion, including the second afternoon.

MR. WILLIAM L. FARMER: With regard to presentation and discussion of papers, I believe that we should continue to encourage formal papers and written discussions of them. On the other hand, I suggest that oral discussion of formal papers be quite severely limited. There has been some talk recently of the establishment of a separate actuarial journal in which papers not deemed to be of sufficient importance for the *Transactions* could be printed. I would be interested to learn whether any progress on this has been made. I also believe that the reports on topics of current interest are extremely valuable and should be continued. Likewise, the discussion of topics of general interest has been most worthwhile and the assignment of topics has been excellent.

The objective of our simultaneous sessions should be to make them very informal. Perhaps this could be better accomplished by providing appropriate facilities for questions and comments from the floor as well as from the speaker's stand. It might also be advisable to request members to submit questions in writing to the moderator either before or during the session. Finally, I would like to second Mr. Blair's suggestion which he made in June, 1963, that there not be a specific limit on the printed discussion. However, the editors of the *Transactions* should continue to be given a free hand in summarizing overlapping discussions.

MR. JOHN S. MOYSE: I believe it would be advantageous if spring meetings could be extended one additional day in order to permit discussion of more topics and to provide more time for meeting other actuaries. I also feel that the topics for the various regional meetings should be suited as much as possible to the membership attending that meeting. For example, the program at this meeting has been directed toward ac-

tuaries of stock companies but should also have included topics of interest to actuaries of combination companies. Also, the use of equipment such as an opaque projector and screen would facilitate the presentation of figures. The Program Committee should be commended for their continued good work in providing programs that best meet the needs of the membership.

**MR. J. ROSS GRAY:** Perhaps one of the problems the Society faces is that while they have regional meetings in order to keep the numerical size of the membership attending any one of these meetings down, they have identical programs. These identical programs seem to convey the idea that, after the first regional meeting, the others are simply going over material which has already been adequately covered. I believe it would be worthwhile to vary the program, aside from the presentation and discussion of papers, for each of the regional spring meetings. I would also like to suggest that the programs be shorter than they presently are so that speakers would have the opportunity to deal more fully with their subject and that additional speakers would be encouraged to speak rather than ruled out due to lack of time. A look at the program of this meeting suggests to me that a number of topics might more properly be discussed in a trade organization. If it is necessary to choose between two topics for discussion, select the one with an interest which is truly actuarial.

**MR. EDWARD A. DOUGHERTY:** I believe that one of the reasons so many of our discussions seem very dull, even deadly, is that the method of delivery is perfectly atrocious. I would urge that senior actuaries persuade the younger actuaries to give some thought to the method in which they communicate by means of the spoken word. I think this is a very important tool of our profession and that an actuary's effectiveness in his business is greatly reduced if he does not develop some ability in communication. We have urged our younger actuarial personnel to join Toastmasters Clubs and believe that this has had good results.

**MR. HARWOOD ROSSER:** If the Society is willing officially to recognize the proselyting that goes on at these meetings, it might save members quite a bit of time if a place were set up where those who wanted to hire someone could gather. Then at a different time and place, those looking for jobs could gather. Perhaps two places would be necessary for the latter: one for those who are genuinely unhappy and another for those who are just testing the market.

MR. ROBERT L. WHITNEY: I was very much taken with Mr. Amsden's suggestion of having truly informal discussions at a "trading post." Possibly after listening to reports on topics of current interest, we might get together in small groups at a trading post and discuss these reports. I think this would permit a truly beneficial interchange of opinions and ideas.

MR. JOHN M. BRAGG: I, too, would like to second John Amsden's suggestion to the effect that workshops and trading posts be considered. The Southeastern Actuaries Club has used the workshop technique very successfully for about five years now, as has the Health Insurance Association of America. We limit the attendance to a maximum of twenty-five people (using a round-table seating arrangement) and require that no two people from any one company can attend the same workshop. In our Southeastern Club we have been very successful with the "how to do it" topics. An example would be "How To Calculate Asset Shares." Although no minutes are kept, all participants are clearly warned that nothing is to take place in the nature of an exchange of rates or on the reaching of a consensus relative to rates due to potential antitrust problems.

MR. L. JEFFERSON STULCE: The informal discussions, I believe, are frequently the most valuable part of the Society's meetings. Yet, they can be much improved. Participants should show a higher regard for their listeners by making better preparation in advance. Even those speakers who do attempt to condense the most significant thoughts into the fewest minutes by preparing their thoughts in advance are frequently guilty of spending too much time with rudiments and then expressing conclusions in vague generalities.

However, when someone does say something significant, or quotes specific figures, don't expect to find it in "Digests" when they are published. Specifics are generally omitted, although carefully prepared in advance, on the assumption they will be useful and meaningful. Thought-provoking statements which might lead to controversy are either omitted, emasculated, or toned down.

Another area needing improvement is in the rules themselves, which tend to discriminate against prepared speakers. Those who speak extemporaneously are permitted to speak so long as they feel their remarks are "reasonable." On the other hand, those who take the time to organize their thoughts in advance and place them in writing must restrict their

presentation to the reading of a one-page summary—regardless of how complicated or vital the subject which prompted the advance preparation.

It happens that I was asked to prepare a discussion of one topic on this afternoon's program which consists of six separate questions dealing with a most complicated subject. At considerable trouble I have attempted to develop meaningful answers to these questions which might prompt further discussion or provoke better research by other members who would give us the benefit of their findings. But if the discussion on this broad topic is condensed to a single-page summary, this amounts to a limit of two sentences for each question. Following the rules, then, makes it additionally difficult to say anything of value—that is, unless one has the foresight to avoid these restrictions by *not* making advance preparation to speak!

**MR. CHARLES W. JACOBY:** Perhaps the frequency with which this topic is on the program indicates that too much attention is devoted to the specific question of what do we do with informal sessions and not enough attention is paid to the question of what are the long-range objectives. We must consider what are the total professional needs of all the actuaries and how they are to be served and by whom. These needs are served by both the Society and the local clubs. Certain of these needs are clearly in the province of the Society, and should remain there, and others can only be served well by the local clubs. Our total needs can be served well only if the clubs and the Society have sufficient communication so that a clear picture of their respective objectives can be obtained. Certainly the Society has had a noble objective in its relationship with local clubs and has bent over backward to avoid domination. However, it may have bent over so far backward that there is not enough communication between it and the clubs.

**MR. BRUCE E. NICKERSON:** Continuing education of the younger members is one of the most valuable functions of the Society. I feel that the workshops proposed by Mr. Amsden would add to this service, and I would welcome the opportunity to participate in them. Also, think that the suggestion of having different programs at the various regional meetings could help reduce the differences in size of the meetings.

**MR. CHARLES V. SCHALLER-KELLY:** With regard to workshops, from my experience in other large organizations, I believe they can be handled successfully even in very large meetings. The leader of the work-

shop has to be very carefully prepared in the technique of doing this. This is a technique that has to be acquired or, if not already acquired, has to be learned. It may also be necessary to have one or two people prepared who really know the subject very well so that they can keep the discussion going. These workshops involve a fantastic amount of organization but are worthwhile if we really care about the educational value of Society meetings, especially for younger members.

For the present format of informal discussion, perhaps the chairman could make sure that for each topic at least one individual prepares some remarks. If more than one paper is submitted, he could then review the remarks and select one paper to be read in full as a basis for discussion and ask the others to summarize their papers.

MR. JOHN H. MILLER: Mr. Gray has made a comment that touches on one of the issues that has concerned many of us for years. This is the tendency to talk like a trade association or a group of businessmen rather than a group of professional men. I think we must not overlook the fact that we are interested primarily in furthering our education. I believe the main point we have with our informal discussions is that we want to achieve something more than unilateral communication. If I simply stand up here and read a carefully prepared paper that I finished a week or two ago and then two other individuals do likewise and then all go home, we have spent a great deal of time and transportation cost to accomplish that which could have been done with a mimeograph and the United States mail. The value of meetings such as this is the interplay of comments. I also think that the place of the local and regional clubs must be one of increasing importance. While we may nostalgically look back to the more informal meetings of the past, I think we must recognize that a meeting of seven or eight hundred people cannot be conducted like a meeting of one or two hundred people. Therefore, the local clubs must and will inevitably assume a more important part in our life. I think there is a great opportunity to get more value from these local clubs. Perhaps one way to do it would be through some system of digesting their meetings and distributing or making these digests available to actuaries everywhere.

MR. BRUCE E. SHEPHERD: I was happy to hear John Miller describe the importance of interplay in making any type of panel presentation effective. Unfortunately, when panel members are asked to participate, they sometimes feel that they need to have a rehearsal in order to do a good job. I don't think this is always necessary. If you get the right kind

of people to participate in a panel discussion and let them know in advance the type of discussion that it is going to be, they will all be on the same level and will participate spontaneously. Everyone would enjoy that kind of panel discussion.

Everybody who has spoken about workshops has favored the productivity of the technique and the educational value of it. Unquestionably the big problem we would have, even in smaller groups such as this, is the organization of the workshop. This usually requires much staff work. I might say we are tentatively planning on deriving the advantages from the workshop type of organization and format by having five simultaneous discussions in two different periods at our fall meeting in Montreal. These discussions will be arranged with a small panel, probably two participants and a moderator who will kick the subject off and then swing into an informal type of discussion. In this way we hope to derive some real substantial information that can be preserved for posterity and, at the same time, stimulate this two-way interplay of ideas that many of us find both stimulating and educational.

MR. CURTIS D. GREENE: With regard to Mr. Amsden's suggestion regarding trading posts, I believe this could be done with less exacting preparation and less organizational effort if perhaps these sessions could be scheduled outside the present meeting hours in corridors or rooms. The trading post with a fixed subject could be a big help in getting people together who have a common interest and will stick to that subject while they are at that trading post. At these sessions they can get specific answers or merely expand their general information about a particular subject. Further, they would be free to move on to another trading post once they have accomplished their purpose.