PRESENT DAY LIFE INSURANCE PROBLEMS

The following excerpts from an article by Mr. E. E. Rhodes, Vice-President Mutual Benefit Life, are of considerable interest.

Mr. Rhodes, in discussing the general problem of securing a life insurance company against the general hazards to which it is exposed, said:

There cannot be security unless the assets be safely invested, and unless there be a conservative selection of insurance risks, but I shall dwell very briefly upon these phases of the problem.

Regarding investments, let me content myself with saying that in my opinion there is great need for caution. The inflated land values, the high price of labor and of building materials, the uncertainty regarding the railroads and other public utilities, the rapidly increasing needs of municipalities, and financial conditions generally, tend to disturb the equilibrium of investments. In some cases a loan of 50 per cent. of present farm values is equivalent to a loan of 100 per cent. of pre-war values. What is a safe valuation for loaning purposes? Loans on city properties present same question. It is unthinkable that the underlying bonds of the great railroad systems are not sound investments, for as they stand or fall, the country will stand or fall. We are in the position of the automobilist who, travelling a new road, instinctively becomes more careful than he is on a road with which he is entirely familiar.

The purpose of a contingency reserve is to offset fluctuations in the value of assets and in mortality and income. A contingency reserve intended to provide for fluctuations in mortality might be based upon a percentage of the tabular cost of insurance. This percentage should be equal to the difference between 100 per cent. and the per cent. of the tabular cost of insurance, which is required for the dividend scale, and for such portion of the acquisition expenses as is met out of mortality gains. In those years in which the actual mortality was less than the percentage thus determined, the difference might be added to the contingency reserve. In those years in which actual mortality exceeded that percentage, the contingency reserve might be drawn upon. In this way the contingency reserve would follow the fluctuations in the death rate, the unusual savings of one year being held to meet the unusual claims of another, thus stabilizing the dividend fund. In some cases it might not be practicable to establish a fund in this manner, and an alternative suggestion would be to maintain such a sum as will suffice to meet any reasonable temporary increase in the death rate. For example, if it be found that the actual mortality averages 75 per cent. of the expected mortality, provision might be made for a mortality of, say 80 per cent. during the three or four or five succeeding years. Under this method the fund would follow the cost of insurance, but would be subject to the same variations as the first plan. The basis of either fund may be changed from time to time as the company's experience may change. Due regard should be given to any change in the company's rules with respect to the maximum amount of insurance written upon a single life, or to any change in the standard of selection.

If this analysis of the contingencies which confront a life insurance company has any merit, it establishes the unwisdom of the laws which limit the contingency reserve to a percentage of the net reserve. It is clear that the percentage which is right for one company may be wrong for another. The percentages should not be alike for a company which has 60 per cent. of its assets invested in mortgage loans, and for another company which has 60 per cent. of its assets invested in bonds. Two companies may even have the same proportion of their assets invested in bonds, but the bond investments of the one may differ so in character from the bond investments of the other as to require a different contingency reserve therefor.

If contingency reserves are to be maintained in the manner set forth, and if the desired dividend scale is to be adhered to, it is essential that the increase in the volume of new business shall not be proportionately greater than that which prevailed during the years the experience of which served as a basis for establishing the several funds. If the future volume of new business be proportionately greater than that of the past, such increased volume will cal lfor the investment of more working capital than therefore, and such additional capital cannot be provided without depleting the contingency reserve, or reducing the dividend scale. On the other hand, if during the years of the experience of which the contingency reserve and dividend scale are based, there was a decreasing amount of new business written each year, the normal yearly earnings would have been supplemented by a certain amount of capital being released through the decreasing amount of new business. In this case a continuation of the dividend scale and the maintenance of the contingency reserve would only be possible if each year the normal earnings are increased by the working capital released through the continually decreasing new business. By "working capital" is meant the amount required for reserves, expenses and death claims on the new business in excess of income thereon.