

# PROFITS FROM THE STANDPOINT OF THE LIFE COMPANY AND THE PUBLIC.

(Percy C. H. Pappas, *Actuary Mutual Benefit Life Insurance Company, Newark, N.J., before the Insurance Institute of Toronto.*)

Whether a life insurance company is a company having shareholders and a capital stock, or one which is purely mutual in its organization, the fact that the company should be a servant of its policyholders must be recognized and kept in mind. It is out of the question for a company to be successfully managed if the sole aim of the management is the making of dividends for stockholders. The mutual interest of the policyholders of stock companies, who have elected to insure on the basis of participation in the surplus earnings, is recognized by the fact that a very large share of these surplus earnings must be returned to the policyholders, as provided in the charters under which the companies are permitted to engage in business. The success of a life insurance company depends very largely upon its treatment of its policyholders, for the life of the company depends upon obtaining from time to time a satisfactory number of new policyholders.

## NATURE OF SURPLUS.

It is unfortunate that as life insurance has developed, the vocabulary applicable to the business has not kept pace, so that to-day we have certain words which mean one thing in the general business world and quite another in life insurance. For example, the word "Reserve" as applied to a bank is a fund of arbitrary amount set aside voluntarily as a conservative provision to guard against some contingency which may never arise and is never expected to arise. A life insurance company's "Reserve" is a fund of an amount determined by actual calculation which must be held to render the company solvent and it is required to meet one of two contingencies which are bound to arise; namely, the payment of the amount of the policies at maturity or the value of the contracts which are surrendered.

Another instance is the word "Profit" which is contained in the title to this paper and which I have refrained from using. If a grocer buys goods from the wholesale merchant for \$10,000, sells them for \$13,500 and spends \$2,000 in so doing, he has made a "Profit" of \$1,500. If you send a child to the grocer with \$10.00 to pay a bill exact amount of which is unknown to you and the child brings back change of \$1.00, you would not call the \$1.00 profit; and yet this is just what is ordinarily meant by "Profits" as used in life insurance literature.

Again, the word "Dividend" as used in ordinary business, denotes the share of the stockholder in the net earnings of the business. For example, the holder of Bank stock receives a certain amount each year as dividends, which amount represents his share of the bank's earnings, after providing for possible losses. In life insurance a "Dividend" generally denotes the excess amount paid by the policyholder for insurance over that actually found to be necessary to furnish the insurance; but is in no sense a dividend as the term is generally understood.

From the above it is evident that it will pay us to consider very closely just what constitutes so-called "Profits" or "Dividends."

Although annual dividends are not so well known in Canada as dividends declared at less frequent in-

tervals, it is perhaps less confusing to study the question of what life insurance dividends really are if we first suppose an annual distribution.

Now, let us suppose that a policyholder, along with many others, pays an initial premium of \$100. At the end of the year the company finds that it has funds in excess of its liabilities. It sets aside such contingency reserves as it deems advisable, and the balance constitutes a dividend fund. It ascertains that the policyholder's share in that fund is \$10.00. His second premium is due, but all the company requires from him is the sum of \$100, and as the Company holds \$10.00 to his credit, a payment of \$90.00 in cash settles the premium.

Now, at the end of the second year, if the share of the policyholder in the dividend fund is \$12.00, he need only pay \$88.00 to settle the third premium. If at the end of the third year the Company finds that owing to some losses, the policyholder's share in the dividend fund is only \$8.00, he will have to pay \$92 to settle the fourth premium.

When a policyholder has a twenty-payment life policy, the payment of the twentieth premium makes his policy fully paid up. At the end of the twentieth years he may draw his share of the dividend fund in cash. This cash dividend represents what was not required of the \$100.00 the Company held at the beginning of the twentieth year in order to provide the insurance for the year. At the end of the twenty-first year there may be a certain amount to the policyholder's credit in the dividend fund, owing to the fact that the mortality has been less than that called for by the table, or on account of the interest earnings being in excess of the requirements. If the exact interest earnings and rate of mortality could have been foretold the reserve held by the Company at the end of the twentieth year would have been only such a sum as would have provided no surplus earnings from the mortality actually experienced or the interest actually earned. If the amount of the reserve which subsequent experience showed to be all that was necessary, could have been determined at the end of the twentieth year, the twentieth dividend would have been increased by the difference between the reserve actually held and that subsequently found to be necessary. Looked at in this way it is seen that dividends paid after a policy has become paid up are in reality but the overpayment of previous years.

When dividends are declared once in five years or at less frequent intervals the nature of such dividends is not altered thereby. It must, therefore, be recognized that the so-called "Dividends" are in reality but the over-payment of premiums which subsequent experience shows to have been unnecessary.

(To be continued).

Under the Code Napoleon in France, a man is held for fire damage to his neighbor. Each loss is investigated and the owner and tenant must show that neither is responsible for the fire. The tenant usually insures by one policy (1) his own property, (2) for damage to the building by his fire, (3) for damage by his fire to neighbors. Under the method of putting the claimant, instead of our method of putting the company, on trial, rates are low, losses nominal and profit good. The insured wagers to lose more than he can possibly win.—*Fireman's Fund Record.*