The Chronicle

Banking, Insurance & Finance.

ESTABLISHED JANUARY, 1881 — PUBLISHED EVERY FRIDAY.

Vol. XXXIII. No. 49 — MONTREAL, DECEMBER 5, 1913. — Single Copy 10c. Annual Subscription $3.00

DEPRECIATION IN LIFE COMPANIES' INVESTMENTS.

Mr. William Hutton, the general manager and actuary of the Scottish Amicable Life, in a recent address at Edinburgh as president of the Faculty of Actuaries, made references to the important question of depreciation in life companies' investments, which though concerned primarily with the circumstances of the British offices have a considerably wider interest. Referring to the rise in the rate of interest which has been generally in progress since 1897, he stated that as a result of this, the assets of the British Life companies had been written down, including transfers to reserve funds by over $50,000,000 up to the end of 1911. Possibly, he thought, a further sum of not much short of $30,000,000 may be needed to meet the depreciation which has since taken place bringing the total amount of provision necessary up to $80,000,000. While this is a very large amount, it only represents about 4 per cent. of the total assets and falls far short of the amount which might have been expected from the general trend of prices. The explanation, suggested Mr. Hutton, is probably to be found in the fact that offices generally refrained from taking credit for the appreciation in security values prior to 1897, and that many terminable securities have reached maturity in the interval.

It is to be understood that the term depreciation in this connection refers only to that which has resulted from the increased rate which capital commands and not from any impairment in the value of securities. Whatever may be the experience of other classes of investors and capitalists in this matter, in the case of life offices a certain benefit is derived by a rise in the rate of interest. A better return is secured from the investment of new funds and from the re-investment of maturing securities. At the same time the office is not in the position of others, frequently compelled to realize long-term securities at depreciated values, but is able to hold them until in the normal course of events, as the time for maturity approaches, they recover to a price level approximating that of their redemption.

The British life offices are required under the terms of the Assurance Companies' Act of 1909 to write down the value of their securities to the market price of the day in their balance sheets. The effect of this legal requirement is to create a secret reserve, which in the case of a large office would amount to very considerable proportions. It is a method of making assurance doubly sure which as an example of extremely conservative financing may be commended. But it is at least open to argument whether in the case of long-term bonds whose security is undoubted such conservatism is necessary. A life office purchased ten years ago, say, municipal bonds of 40 years currency at 98. At the moment their market price is say, 85. But the life office has no intention of selling them and there is no necessity for realisation. The bonds will be held in the company's vaults until their maturity. In such a case, it may be argued that the present value of the bonds to the insurance company is their amortisation value, and that to insist that the Company shall only take credit for the existing market value, is unfair not only to the company *per se*, but also to the policyholders since upon them is thrown the burden of the present depreciation in the company's investments, and the policyholders of the future secure an unfair advantage over the existing policyholders, through subsequent appreciation. An argument along these lines is put forward by an anonymous writer in the London *Post Magazine*, who while admitting that his views are "heretical," states that they are gaining ground. "As to terminable securities which are temporarily depreciated," he writes, "it really does seem quixotic to write them down to market value when that value is below a ten year average, and present policyholders may fairly ask what becomes later on, when the securities terminate by repayment, of the secret reserve thus materialised. Why should it all go to people who had no part in earning it?"