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Valuation of Life Companies' Securities

WHAT *is the Fairest Plan? Authorities Differ but a Canadian Actuary thinks that Subject to the Exercise of Proper Judgment the Amortization System is Preferable and Fairest to Policy Holders in Regard to Terminable Securities—Discussion of Differences Between the Various Annual Statements of Insurance Companies*

IN discussing with *The Monetary Times* the question of the valuation of securities held by insurance companies doing business in Canada, the vice-president of a life insurance company points out that so far as his company are concerned the book value of their securities, in other words, the cost price, is used. Practically all of their funds are invested in city, town, county, township and school district debentures. They own approximately 600 different lots. Their average investment in any one security is about $5,000. These funds are invested from Sydney, C.B., to Victoria, B.C.; in other words, in practically every locality in Canada. The Insurance Department's ruling is that these securities should be valued as at December 31st, and in making up the statement for the blue-book they use the market values as at December 31st, while in making up the company's statement at head office the company uses the book values. Their reason for following this plan is that they are advised by leading actuaries that it is the only fair and just basis to all concerned. For example, the market price of securities is decidedly lower this year than in former years. If one had a policy maturing in a life company this year one would suffer a large reduction in profits, and, on the other hand, one might have a policy maturing two years later, when market values may likely be restored, and, therefore, would receive decidedly higher profits.

Acting on the advice of an eminent actuary, this particular company decided it was fair play to all concerned to follow the book values, assuming always that the book values are equal to or greater than the rate of interest assumed, namely, 3½ per cent. per annum. All actuaries agree that if one invests funds to earn 3½ per cent. per annum that one will have in hand the necessary amount to pay the guarantee named in the policy at maturity. Further, the debentures of such cities as Toronto, Montreal, Winnipeg, Calgary, in fact, all the cities and towns in the Dominion, will liquidate their debentures at their face value. For example, a company has $10,000 invested in, say, the debentures of the city of Moose Jaw. The market value is $8,300; in other words, a discount of $1,700. Now, we all believe that when these debentures fall due the city of Moose Jaw will pay $10,000. Taken in at $8,300 makes it a 6 per cent. investment, for the debentures pay 5 per cent. A company has, say, city of Toronto debentures in at 91, and when they are due the city of Toronto will pay 100. Further, the fact that a company's contracts are all deferred is cited as a good reason why they should work on the law of average, not the values in any two or three years. For if one is to give each policyholder a fair share of the profits covering a period of ten, fifteen or twenty years, one must take the average rate of interest covering that period, it is contended. Apart from this, to follow market values in the conduct of a life insurance business is impracticable, for the contracts are deferred.

The insurance department at Ottawa uses the market value on the class of securities mentioned above, but so far as mortgages are concerned the department takes the book value. On this point the life insurance director quoted above says: "You know, and I know, that if you had $10,000 invested in a mortgage at 5 per cent. on a choice piece of real estate right in the city of Toronto with a 50 per cent. margin, and you wanted to use the money and offered your mortgage for sale, you would probably have to sell it to yield the purchaser 6 per cent. or 6½ per cent.; in other words, you would have to discount the face value of the mortgage. I use this illustration because the present prevailing rate of interest on first mortgages is from 6½ per cent. to 10 per cent., and investors would not loan at 5 per cent. when they can secure a higher rate. I claim that if the insurance department rule to use the market values for Canadian municipal debentures is right and proper, then it is right and proper to use the market values for real estate mortgages. Leading actuaries are of the opinion that the proper course to pursue is to follow the book values so long as it is a good security and the rate of interest is not less than the legal rate assumed."

Discussing these points with *The Monetary Times*, Mr. Arthur B. Wood, actuary of the Sun Life Assurance Company of Canada, Montreal, says: "There is much to be said in favor of the amortization plan, but there are also objections to this method. The argument in its favor is that bonds are purchased by life insurance companies for the purpose of permanent investment, and that so long as they are amply secured the company is not concerned with the fluctuations of market values, and that it is, therefore, proper to value such securities