

LOANS ON LIFE INSURANCE POLICIES.

Companies do not Encourage Loans—Function is to Pay Death Loss. Not to Act as a Bank—Interesting Remarks by Mr. James V. Barry, Commissioner of Insurance, Michigan.

That many people in Canada this year have borrowed money on their life insurance policies in order to purchase automobiles or to invest in real estate is a statement made by a well known Montreal insurance man.

Mr. James V. Barry, Commissioner of Insurance, for the State of Michigan, who has been a frequent visitor to Toronto, and who, last year, delivered addresses to the Life Underwriters' Association of Toronto, and the Montreal Insurance Institute, in his annual report comments on demand loans in life insurance contracts.

A feature of some life insurance contracts, says Mr. Barry, which has been of much more than passing interest to me during the past year or more is that which provides that the policyholders shall, after the policy has been in force for a specified period, be entitled to a loan on demand. Inasmuch as the insurance journals of the country have variously commented on the action of the National Convention of Insurance Commissioners in unanimously adopting at its annual meeting in Colorado Springs, a resolution bearing upon this subject and introduced by me, I shall no doubt be pardoned if I consider the matter at this time.

Resolution of National Convention of Insurance.

The resolution to which reference is made is as follows:—"Resolved, That in the judgment of the National Convention of Insurance Commissioners, the practice of life insurance companies obligating themselves under contract to make loans to any policyholder on demand is unwise, unbusinesslike and dangerous."

The offering of that resolution was not the result of a sudden impulse. My attention was first directly challenged to this subject a little more than a year ago. The proposition was of much interest to me and I investigated it as carefully and thoroughly as time and opportunity would permit. The more I looked into the question, the more thoroughly was I convinced that life insurance companies could no more safely provide for granting loans on demand than could the savings banks of the country provide unqualifiedly for the payment of their deposits on demand. To my mind these two important classes of financial institutions are on precisely the same footing so far as this phase of their business is concerned. No one, I think, doubts the wisdom of savings banks having a saving clause with reference to deposits and I can conceive of no valid reason why every life insurance company should not, as a sound business principle, safeguard its funds and securities from shrinkage at time of stress.

Standard Policy for Demand Loans.

I am aware of the fact that when our friends in New York sought to enact model laws a few years ago, for the conduct of the business of life insurance, they incorporated therein a form of standard policy which provided for demand loans. We know, too, that when wiser and calmer counsels prevailed this particular enactment was repealed, and there was enacted in its stead, a law embodying standard provisions, one of which permits life insurance companies to take six months' time, if necessary, for the consummation of loans and the payment of cash surrender values.

Those who doubt the wisdom of the action of the National Convention of Insurance Commissioners in adopting the resolution already quoted, should not lose sight of the fact that the investments of life insurance companies are properly and necessarily made with a view to securing the highest rate of interest consistent with safety. This being the admitted fact, these companies should not desire nor be permitted to pile up possibly hundreds of millions of obligations subject to call. I say hundreds of millions of obligations for the reason that the loan provision of the policy contracts is of comparatively recent origin and already these obligations total a surprisingly large figure.

With the practice practically in its infancy some of the companies felt the stress of the demand made upon them three years ago when the country was experiencing what some people are pleased to term a rather insignificant money panic of comparatively short duration. These companies were obliged to sacrifice some of their gilt-edge securities at a time when the scarcity of money forced the selling price to the lowest ebb, and the losses thereby sustained were by no means meagre.

My investigation of this subject shows that the loan feature of life insurance contracts has had its greatest devel-

opment during the last ten years. While prior to that time it was agreeable to many companies to grant loans upon request of the policyholder, they did not obligate themselves to do so in many instances by the inclusion of such a provision in their contracts. Even when granted, the loans were made only after the policy had been in force for several years, were restricted to a percentage of the reserve or cash value and were subject to a high rate of interest. In fact, nothing was done by the companies to encourage their policyholders to apply for loans, the marked tendency being to discourage them.

Competition worked a revolution in this respect, resulting in the inclusion in the contract of the obligation to loan, the granting in the case of some companies of the privilege to loan on demand, the gradual shortening of the time after the issuance of the contract when loans can be made and the reduction of the interest rate on loans.

Competition accomplishes many wonders in the business world, but it does not necessarily follow that all of these changes and wonders are wise and beneficent. When we consider that the loan provision of the contracts has reached its present state of development within quite recent years in connection with the fact that our real genuine panics or long extended periods of so-called hard times recur in cycles of about fifteen years, it will be seen that if the demand loan practice is not checked by the more conservative minds in the business, there is no exaggeration in the statement that the companies will have piled up, by the time the next genuine panic is due to be experienced in this country, hundreds of millions of obligations subject to call. Therein lies the danger of the practice which the National Convention of Insurance Commissioners saw fit to condemn.

Companies Function to Pay Death Losses.

In considering this question it should be constantly borne in mind that the real office or function of a life insurance company is to pay death losses. Anything else, whether it be a provision whereby the policyholder may surrender his policy for cash, or raise money by pledging it as security in time of stress or when the needs of his family or those for whose protection the contract was originally entered into have ceased to exist, or even to provide for himself means of support in his old age, are purely incidental. This being the case, the aim of the management should, at every stage of the proceedings, be to hold inviolate the real object of the contract and to permit no incidental consideration, however legitimate, to endanger in the slightest degree the certain accomplishment of that object.

From the very beginning of life insurance and especially since the States commenced to legislate on the subject of investments of life insurance companies a third of a century or more ago, stable securities or assets have been steadfastly and very properly preferred to so-called liquid assets quickly convertible into cash. The reason for this is obvious. The former class of securities involves less probability of loss and commands a more satisfactory rate of interest—two considerations of vital importance. The investments of life insurance companies should command the highest rate of interest consistent with safety if the real object and purpose of life insurance is to be accomplished in the highest degree. This object cannot be attained if the contract is to include provisions which necessitate the investment of funds in negotiable assets quickly convertible into cash or the carrying in banks at a very low rate of interest of heavy reserves or balances in order that the companies may be in position to meet the demands of their policyholders without notice.

Insurance Company Not a Bank.

To my mind, this whole question turns on what one conceives to be the true function of a life insurance company. I believe this to be, as previously stated, the payment of death losses and not the transaction of a banking business. The latter may, to some extent, be a legitimate incident of the business, but it should never be permitted either to supplant or jeopardize the accomplishment of the real purpose.

In a recent official publication, Commissioner Hardison, of Massachusetts, whose ability and foresight insurance-wise are unquestioned, was constrained to remark:—

"If life insurance companies place any large proportion of their assets subject to the demand of their policyholders without notice, they are venturing closely upon a banking business, which long experience has proved cannot be safely conducted without cash reserves proportioned to the amounts subject to withdrawal on demand."

And this, notwithstanding the fact that the Massachusetts law specifically provides that policyholders shall be entitled to loans within thirty days after making application therefor. Life insurance companies are not equipped to transact a banking business.

It must not be assumed that the presence of a protective loan clause in a life insurance policy, which gives the company the right to take time in case an emergency exists,