A Short Survey of Life Insurance with Special Reference to the United States and Canada

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PREFACE

The purpose of this thesis is to make a short survey of life insurance and its accompanying benefits. Special reference has been made to the United States and Canada, whose peoples between them own approximately seventy-five percent of the total life insurance in force in the world today.

Man has always had a tendency towards an economic urge to accumulate wealth, prestige and power. The tendency is based upon his desire for a high social status in the community. The family is next to one's egoistical desires the strongest affection that spurns one on to great efforts. Protection of man's family and his worldly goods has always been of utmost importance in achieving his desired end. Out of such circumstances man was bound to mould for himself an institution constructed solely for the purpose of administering to his needs. This institution has come to be known as life insurance and is the subject matter of this thesis.

The work is divided into five parts which try to illustrate as best possible in a limited number of pages a few important aspects of the institution.

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A GENERAL HISTORY OF LIFE INSURANCE

CHAPTER 1

In the earliest times, humanity fell naturally into groups in which the strong could help the weak and be themselves helped in turn. The children were guarded until they had grown old enough to guard; the wounded and sick were nursed and cured by those who had benefitted from their days of health. Even in their cave habitations the human race learned the lesson that one can help many; many can help one; unity is strength.

Thus even in the dark ages we find the germ of insurance manifesting itself, for the idea at the root of all plans of insurance is mutual help. The dependence of man on man, tribal and family life, community, city and state organizations are all evidences of the growth of the idea. At first, man did not combine with the thought of helping another and receiving nothing in return. He associated with others in order that he might receive for himself the benefits of their united strength, the old idea of self-preservation. But, to secure the desired benefits he had to contribute his share to the common cause. From this idea of an individual contribution (at first of service, later of money) to the collective effort in order that benefits may accrue to the contributor, should need arise, the basis of modern insurance is drawn.

To readily comprehend the growth and grasp the significance of the institution of life insurance in the United States of America and Canada, it is necessary to trace its historical background not from its first appearance in these countries but from its general beginning as a world wide organization. A cursory analysis of life insurance history preceeding its introduction into the two main countries of North America should suffice in conveying to the reader that collected and related series of facts so necessary for an intelligent and clear understanding of the position it occupies in these two countries.

The principle of insurance can be traced back ad infinitum to the beginning of mankind provided that the party making the historical analysis is really quite zealous and one of an imaginative frame of mind. Commander Frank Worsley and Captain Glyn Griffith in their book, the Romance of Lloyds, have very ably presented their conception of the possible origin of the principle of insurance. A quotation from their work should suffice to make clear the point. "In the root principle of taking a risk to gain a certain benefit, insurance began with our first parents. Adam it is said took a policy of insurance against loneliness by the reception of Eve into the Garden of Eden"(1)

Many other ancient happenings could be enlarged upon, but practically speaking all would prove quite useless and superfluous in a study of the topic under consideration. Most writers have endeavoured to trace the practice if not the principle of insurance as far back as possible, but in so doing trifles have been exaggerated into matters of consequence. Quotations from Levy, Suetonius, Cicero, Servius Tullius, Justinian and many others can all be interpreted to show that the theory of insurance was already in practice at the time of writing, but alas again to no practical avail. The evolution of life insurance some writers believe can be traced back to Rome as early as 100 A.D.[2] To corroborate their beliefs, they point out such associations as the Collegia Tenuiorum, a sect of the lower classes formed especially for the purpose of providing burial expenses for a member in good standing and who has paid his fees. Also, provision for burial expenses of soldiers killed while fighting for Rome was noted and interpreted in the light of modern group life insurance.[3] Similar organizations can also be found in England before the Norman Conquest (900 A.D.).[4] After the Norman conquest, the ancient friendly societies (from which has sprung our fraternal organizations) were established in England. Later on, guilds were formed and at their meetings the sick-man's box and the deadman's box were passed around. Still later the Tontine funds were established;[5] each member paid either a single or annual contribution and the income or accumulated fund was paid to the survivors at the end of each year. Life insurance up to this time was not recognized as a business at all, but more or less as an ethical and religious expedient so necessary for the good of the state.

The real developemnt of life insurance as a business has extended over some three or four centuries, perhaps more. It has passed through three distinct phases and its growth can best be traced by separately looking at each period. The three phases through which the developemnt of life insurance has passed, are best described by Cornelius Walford F. I. A. in his historical discussion of life insurance in Volume XXV of the Journal of the Institute of Actuaries. "1. The experimental period. 2. The speculative or transitional period. 3. The period of scientific exactitude."(6)

The main class of life insurance in use during the experimental period was that of assurance of mariner's lives, assurance against captivity and kidnapping ransom. The method of underwriting was usually in contract form between individuals taking certain portions of the risk at so much percent premium. There were also contracts for children's endowments and annuities. Rates for such types of insurance were most exorbitant and more often than not the insured's family or business associates had trouble collecting their due. Scientific methods of calculation were at this time (1200-1400) unknown and consequently thus far all had been speculation and darkness. A new period emerges with the first concentrated efforts towards establishing life tables.

It is quite remarkable, that at this time when the business could easily have moved from the experimental stage to that of partial mathematical certainty, the course of events led it into an almost purely speculative groove. The temper of the times without a doubt was the main cause of this*. During this speculative period mutual contribution societies sprung up, many annuity associations were formed and friendly societies were re-established. These institutions all lacked scientific data to work with and nothing could be fixed in the way of accruing benefits.

The earliest project of associated life insurance was made in the year 1699.(7) It was called the "Society of Assurance for

*Trade was increasing, speculation and gambling were the order of the day.

Widows and Orphans". There were to be 2000 members who were to contribute five shillings each on the death of a member, thus the total benefit fund would amount to 500£. In order to protect the association many additional clauses were inserted in the contract embodying such features as personation, soldiers killed at war, dying at sea, death by justice, poor health, specified age and waiver of claims if death experienced within six months. A second society quite similar to the first was formed shortly afterwards, but neither of them completed their plans. In 1706 "The Amicable Society for Perpetual Insurance" was formed. This society required a fixed contribution from each of its 2000 members. The appropriated sum was equally divided annually among the number of deaths e.g. if there were five deaths during the year and sum appropriated was 2000£, each of the survivors of the five deceased would receive 400£. Other companies gradually took form, but due to the speculative policies of their executives their duration was quite short. In the year 1710, the South Sea Trading Co. was formed and its stock became a favourite with the speculators. Inside a very short period of time its market price had been inflated from 100£ to 800£. When the South Sea bubble burst practically all the insurance associations suffered very heavy losses and by the time this period of wild speculation was checked by the Bubble Act in 1720, the Amicable was the only insurance company left.

Finally came the time of scientific exactitude. In 1725 De Moivre published his work, "Annuities upon Lives" with an appendix concerning expectation of life and probabilities of survivorship. In 1726, John Smart published his well known interest tables and a year later Richard Hayes brought forth a treatise on valuing annuities on lives and gives an example in it of provision for a family by a thrifty clergyman. In 1740, Thomas Simpson published his book "The nature and Laws of Chance" and in 1747, Corbyn Morris' essay towards illustrating the science of insurance appeared in print. The essential principles of life measurement were now generally understood and life insurance companies could now undertake in return for certain fixed contributions, to guarantee on the expiration of lives insured, certain specific advantages.

In order to pass from the first of the preceeding stages to the last many steps had been necessary.

Bills of mortality or death certificates were constructed and slowly but surely introduced into the town. These bills of mortality came to be regarded as a barometer to public health and from them were eventually obtained the mortality tables used in computing life measurement. Laws of chance, originally used as an aid to gaming in the 17th and 18th century, were developed and soon came to be of more practical value. The study of mathematics became more and more exact and precise and moved on to a much higher plane of reasoning. With the adoption of mortality bills in the towns and the development of mathematics, the science of life contingencies soon followed. The first mortality table scientifically constructed, by means of which the probable duration of human life could be computed, was prepared by Halley, the royal astronomer of England at the time in the year 1693. The table was computed from observations made by Casper Newman in 1691 for the city of Breslaw in Germany. Due to the fact that Halley's Tables were of foreign origin, they were not used. They were not, however, disregarded entirely for they led to the movement of constructing such tables based on English statistics. A table was computed for the central town of Northampton by a Dr. Price in the year 1769 and due to this man's influence and ability, the general adoption of mortality tables followed. From this time on life insurance was adopted for its noblest and best purposes. The confidence of the people was all that was necessary now to secure its position as a branch of domestic economy. This followed in time and with the growth of the institution in England, is seen its consequent spread to other countries of the world.

History in the United States

During the original colonizing period in America, marine was the only known kind of insurance. Life insurance was not on a really sound basis in Europe until the American colonies had been settled for about a century and a half. The majority of colonist marine insurance was contracted in England in the 18th century, but at this time some public insurance contracts handled through the medium of brokers were known to have been taken out in the larger American coast cities. These marine insurance brokers as a rule handled only extraordinary risks on a man's life. e.g. A dangerous journey to the frontier plains or to the West Indies. Companies were not formed to assume these risks until after the 1st part of the 18th century.

Previous to this time the risk bearer was usually a group of prominent business men eager to speculate on a new venture as a means to liberal profit. Five percent of the amount insured for, usually constituted the premium and the policy contract was terminated after a year had elapsed.

The first definite step in America towards establishing the modern insurance business was taken in 1752 when a fire insurance company was founded at Philadelphia.(8) The direct reason for its formation can be attributed to a large fire in London England which attracted considerable attention and tended to make marine underwriters more or less fire conscious. Life insurance followed five years later.

The first American life insurance company was organized in 1759 by the Presbyterian Synods of New York and Philadelphia. A Charter was procured for the new company and it assumed the long title "Corporation for the relief of poor and distressed Presbyterian ministers and of the poor and distressed widows and children of Presbyterian ministers." The premium rates for insurance were established on a 1 to 5 ratio basis to the amount annually paid to the beneficiary. e.g. if the yearly premium was $2.00, the amount payable to the beneficiary would be $10.00, if the yearly premium was $5.00 the amount payable would be $25.00 etc. Later, other denominations formed similar companies and because of the popularity of the scheme, the insurance company of North America was chartered by the state of Pennsylvania in 1794. As in Europe, due to epidemics and plagues, life insurance progressed and prospered very slowly. Smallpox, diptheria and yellow fever were the most disastrous epidemics and took quite a large toll of lives each visitation. Even to-day, life insurance could not prosper under such conditions.

Soon after 1800, the life insurance business began to move forward. Companies at that time prospering in England began to invade the new world. The idea was becoming more and more popular and in 1809 with the formation of "The Pennsylvania Company for the Insurance on Lives", (9) the beginning of a real institution of life insurance was marked. This company was capitalized at $5000,000 and thus a new step in the development was introduced. At this time, the life insurance business was looked upon as being altogether too profitable as can be illustrated by the fact that in the year 1818 when the Massachusetts Hospital Life Insurance Company was chartered, provision was made whereby the state should receive at least 1/3 of the annual profits. The result of this attitude was curtailing of legitimate life insurance business for a short while. In 1830, the New York Life was chartered with a capitalization of $1,000,000. These three original enterprises were all stock companies and were not as popular as the mutual companies which followed in their wake.

Following the great success of the Equitable Life in London England, a mutual company without any stock, similar organizations soon were instituted in America. The New England Mutual Life Insurance Company of Boston was the first to emulate the Equitable of London but due to a feeling of risk by the Massachusetts legislature, it was delayed from doing business until 1843, eight years after its original inception. Once started, the mutual plan of life insurance spread rapidly and the stock companies recognizing the success of mutuality began granting half of their profits to the policy holders. The time was ripe for the ramification of the mutual system and a great expansion took place. In 1842, the Mutual Life of New York was organized. In 1843, the New England Mutual took form and in 1845 the Mutual Benefit of New Jersey started business.

With the formation of these companies began the great development of life insurance in the United States. Competition for business naturally resulted from the prodigious growth of the enterprise and accompanying this new competitive spirit came greater expansion. As more life insurance was sold, people demanded more local representation which more often than not led to the establishment of local organizations as well as representatives. The real test of life insurance came at the time of the civil war and during these times of stress it stood the test and prospered.

The great development which took place in American life insurance has never been satisfactorily explained. Newness of the idea, ignorance, prosperous times and perhaps even deceit all played their parts in the expansion. Actuarial science was very poorly developed in America at the time life insurance was being introduced but the fathers of American insurance did recognize the fact that interest rates played a prominent part in deciding premium rates and declaring dividends. The interest rate was much higher in America than in England and thus lower premium insurance could be offered. Much was sold on this basis of appeal. Too, the American managers were somewhat ignorant of the importance of reserves and enormous dividends were paid to policyholders out of money on hand which should have gone to build up a reserve fund for future contingencies. Dividends as high as 80% of the premium were known to have been paid in the middle part of the 19th century. The consequence of such a plan for attracting business was inevitable. Dishonest men invaded the life insurance field, profit and greed predominated and many actual failures resulted. A decline in the amount of business in force was naturally the only outcome to be expected. In 1870, there was 2 billion dollars worth of life insurance in force in the United States and by 1880, only ten years later. less than a billion and a half.

Although many people had lost money, this decline in business was beneficial in many ways. It proved 1. that life insurance could not be secured at a small cost. 2. that dividends had to be moderate. 3. that reserves must be built up 4. that inferior lives could not be accepted as risks and 5. that investments had to be conservative.

Between the years 1880 and 1900, no new companies were organized but business underwritten by old companies materially increased. During this period of twenty years, new factors made themselves felt. These were as follows: extensive development of the agency system, liberalizing of the policy contracts, industrial life insurance for the wage earners, use of the deferred dividend system, forward strides in the mathematical field by actuarial geniuses and establishment of companies in the United States by foreign countries. Also, the hands of the state governments were not idle and the revisal of insurance laws by the legislatures was decided upon necessitating investigations into poorly managed companies. Similarly, laws were passed regulating salaries, expenses and premium rates; standard policies were provided for, the amount of insurance to be written in one year was prescribed, surpluses were limited, a method of dividend allotment was defined and the maximum amount of publicity concerning the financial conditions of companies in order to protect the policyholders was demanded. In short, in many cases the climax of state regulation was reached.

History of Life Insurance in Canada

Prior to 1847, life insurance was almost unknown in what is now recognized as the Dominion of Canada. The population was small and scattered and what policies were in existence were chiefly held by British companies. Life insurance was introduced into Canada by companies from Great Britain and the United States as a fairly well established institution. It can hardly be said to have had a distinctive origin of its own in Canada.

In 1847, Mr. Hugh C. Baker of Hamilton Ontario desired to insure his life and he was requested to go all the way to New York by stage coach to obtain a medical examination.(10) Realizing the need of a life insurance company to serve Canadians, he invested and analysed the life insurance business and in the same year founded the Canada Life. As in the United States, the people of Canada had to be educated to life insurance. This was

Mr. Baker's job and he did it well. Today it is universally recognized that Hugh Baker is the real father of life insurance in Canada.

After the federation of the provinces by the British North America Act in 1867, national consciousness and enterprise was stimulated. In 1870 the Mutual Life of Canada began business and in 1871 the Sun Life and the Conferation Life became established. Much credit for the strong positions of these three companies today must be given to Mr. William Hendry, Mr. Robertson Macaulay and Mr. J. K. Macdonald, their respective founders. In the last analysis, the history of any enterprise is the history of the achievements of great men.

In later years, the development of life insurance in Canada has been parallel to that in the United States. However, it is most noticeable that in Canada it has been a very conservative and slow development rather than a fast and somewhat speculative one as in the United States with the result that no one has ever lost a dollar through the failure of any Canadian life office.

Both in Canada and the United States great strides have been made in the 20th century in the further development of life insurance. A speculative enterprise has been replaced by a scientific business institution based not on chance but on experience and knowledge. Due to intelligent actuarial interpretation of data collected by trained men, life insurance today boasts of many new features undreamed of fifty years ago. The development of group, non-medical, disability, income and monthly premium insurance are all evidences of the new field, while a thorough analysis of annuities and the problems they present have resulted in pension and retirement income contracts for people who had at one time no thought of attaining such rewards in life. These and many other features are the reasons why life insurance has assumed such a strong position as it has in the world to-day.

Life insurance has developed from a purely profit seeking venture into a great co-operative enterprise built upon the confidence, the dollars and the character of the people. The famous quotation from Abraham Lincoln's speech at Gettysburg "of the people, for the people, by the people" is only too well exemplified if not recognized in what life insurance has come to stand for.

References for Chapter 1

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(2) Transactions of Actuarial Society - Volume XX1 - 1920

(3) "

(4) "

(5) Guilds and tontine funds came into being in the 13th century

(6) From an essay written by Cornelius Walford in 1884

(7) In London, England

(8) Yale Readings in Insurance

(9) Yale Reading in Insurance

(10) Fourteenth Annual Meeting--Association of Life Insurance Presidents - 1920.

SERVICE AND FUNCTIONS OF LIFE INSURANCE

CHAPTER 11

"All insurance is concerned with three fundamental services. 1. Indemnification of the loss of values. 2. The scientific treatment of risk bearing and the equitable distribution of the cost. 3. Avoidance of loss altogether through systematic efforts at prevention and conservation." (1) To readily grasp the significance of these services so ably performed by life insurance it is necessary to analyse each one separately.

1. The indemnification of the loss of values

Property economics have long dominated the sphere of economic activity and research and while the subject of the study has an undeniable claim to its occupied position, it has altogether been too passively received and accepted as the base from which the greater part of legitimate values evolve. The factors of personal training, skill, industry, judgement and driving force to bring about a realization of what the mind creates can best be described as the value of human life. It is this value of human life that life insurance champions for it is upon this it is based. Thus, indemnification of the loss of values of human life is its first great function.

The capitalized worth of the earning power of a human life is an economic asset. It is the financial foundation of the home which in turn is the motivating unit which binds and holds society together. All life values are subject to the risk of premature death, retirement death and living death or permanent total disability. Death, in any form results in a loss to the community both as regards an actual producing unit and a potential one. It is this loss suffered by society that life insurance should if properly managed tend to indemnify. The risk of premature death is by far the greatest for the main and simple reason that all life values are subject to it. Satatistics have shown that 4 out of every 10 workers at age 25 will die before attaining the age of 65.

If earnings could be capitalized at 5% it would be seen that the money worth of the nation's life values far exceeds the aggregate total of its material wealth. Just as fire insurance is designed to protect value inherent in material goods against loss by fire, so is life insurance designed to protect the value of the human life against loss by death. The business worth of life values can best be analysed by studying various groups of economic producers.

1. Wage earners and salary earners

This group represents the foundation of industry, that is the labour group. The dependents of this group are completely reliant upon current personal earnings for purchasing power to allow them to live decently and to maintain the standard of living to which they are accustomed. In the event of death, there is a total loss of the income producing asset. This loss unless indemnified results in a loss of purchasing power and a lower standard of living for the dependents of the deceased. For this group, life insurance protection to a reasonable amount is an absolute necessity if a high standard of living is to be maintained. Singly, the resulting loss of income seems quite neglible but taken as a group capable of accounting for at least 50%

(2)

of the nations income, the loss can assume quite enormous proportions. Life insurance is a poor family's salvation as well as a rich one's last testament. Unfortunately as yet the amount of life insurance available to this group as contrasted with income and current living costs is pitifully small. The life value of the wage earner constitutes all his business worth and should be protected and kept intact for his dependents at least until they are able to fare for themselves. Man has always aspired to the greatest heights of individualistic freedom and security for himself and his family.

2. Professions

Here again the greater part of the business worth is represented by capitalized current earning power or life value. The view is usually taken that the assets of a professional are limited to his personal property and equipment. This view is entirely erroneous however for one of the greatest assets a professional man has is the years of training and studying spent in an effort to materially increase his earning power later on in life. Life insurance can and will indemnify any loss incurred by the owner of such an asset.

3. Farmers

This group attains its earning power through both academic instruction and the school of experience. As a productive unit in the economic world its worth is measured in part by the aggregate extraction from the land it cultivates. The land in itself is an asset but without labour expended upon it, is economically worthless; as the land is protected against plagues etc., so should the labour be protected against death.

4. Enterprises involving intangible and for the time being unmarketable assets. (Entrepreneurs)

Many enterprises have been started in this world never to be completed because of a lack of purchasing power necessary to provide materials for further production. This lack of purchasing power can be attributed to the fact that all operations depended upon the life of one man. This man's good will and managerial ability while he was living were weighty enough to enable the firm to borrow and contract for materials until completion of the job. In death, the power behind the operations ceases to exist and future productivity is impaired unless some indemnification for the loss of the man's life value is provided. Life insurance can provide this in demnification.

5. Managers of productive concerns

A wisely shaped and well directed policy on the part of a manager of a company decides whether or not that company will have a high or low net worth. Good managers are scarce and provision should always be made for liberal monetary indemnification in case of a loss of such a person through death.

Life value is most decidely the cause of property value and should be regarded as such. The monetary value of a man's working life should be capitalized with evidence of worth just as propertyis evidenced to-day by bonds, stocks, warehouse receipts, etc. As an economic asset, the human life value bears a vital relation to many of mankind's greatest responsibilities. Higher education for children and old age support should be considered as personal obligations as well as state duties. Both, if properly secured will result in a much higher standard of living and general betterment for all concerned. When a man reaches the age of 65 his working energy has been spent. As a producer his days are definitely limited but as a consumer he continues to live. Thus just as the value of buildings and machinery are subject to physical depreciation so is the life value of man. In property economics, the problem is solved by means of setting up a depreciation fund to take care of and replace the worn out value. Similarly, by means of life insurance a man may provide a sinking fund depreciation reserve to replace his worn out life value at any age he deems fit. Without such a plan, it simply means that a man after reaching a certain age is more or less a liability rather than an asset to a productive world. A man who is totally disabled is economically dead and as such is a burden rather than an asset to society, but as a consumer he is still part of the economic system and thus his position connot be disregarded. Although a totally disabled man cannot produce any longer, by means of disability insurance he can at least assure himself and the world that his position in society is secured without causing too large an arrest of production.

2. Scientific Treatment of Risk Bearing and the Equitable Distribution of Cost

This service rendered by the institution of life insurance is more properly the subject of actuarial study rather than an economic one. Upon the proper handling of this service rests the future of the business and all companies have gone to great lengths in training men and women to analyse it. Research is constantly being done in order that the service rendered to the public might ever be in harmony with varying conditions and times. Life insurance has been accepted as a peoples' institution and as such, every effort must be made to provide the public with the best possible service that can be obtained.

The progress made by life insurance companies in the last 35 years has been very marked. Formerly life insurance was limited to a death clause, that is benefits were only accruing on the death of the insured. Total disability insurance, income insurance and retirement insurance are only a few of many new contracts. From the exorbitant premium of $5.00 per $100 of life insurance in the early 19th century, a gradual understanding of risk bearing has come about till to-day $1000 of life insurance on the same plan (one year term) can be purchased for the same amount of premium.

3. Avoidance of Loss Altogether through Systematic Efforts at Prevention and Conservation

Adding to the average longevity of life is of tremendous economic advantage to society as a whole. Values are values and life values should be inspected and improved upon and safeguarded as well as property values. Loss prevention in the first instance is real insurance. Every year the farmer carefully inspects his land and treats it as may seem well to do in order to derive the greatest amount of produce there from. The same farmer, although little enough does he suspect it, is a condition of the productivity of his land. Does it not seem only proper that this man should preserve and protect his own productivity as well as that of his land?

Free periodical medical examinations are offered by all life insurance companies to their policyholders. Offers like these are made with one objective in mind, that of diagnosing the health of the individuals with a view to greater conservation of health. The prolongation of the human life is an obligation that society owes to posterity. The economic significance of health promoting agencies to improve the health standards of communities and even nations as a whole, and consequent mortality reduction will be reflected in a very much higher standard of living because of the additional millions of dollars of life values that can be utilized in the furthering of productive enterprises which in turn can only result in increased wealth.

Mortality is one of the three factors that enter into the computation of the cost of life insurance. The vital relation of life conservation and rate of mortality is quite apparent. Promotion of life conservation can only result in lower cost of insurance to the public. This service of life insurance is most decidedly a creative function and should always be regarded as such.

Other Functions of Life Insurance

Man has always been and will always be actuated by a sense of personal gain. Every person wants to increase his production and create a personal estate. The great majority of people are unable to invest and save securely for themselves, and thus never realize their ambitions. Premature death in any form quite frequently breaks up a systematized savings plan which would have resulted in an estate if life had continued. Life insurance allows a man a chance to develop his initiative in pursuit of the eternal dollar and at the same time feel secure that his original objective will be reached whether he lives or dies. If life is preserved, a man can build up an estate for himself and his family through self-assumed thrift obligations imposed upon him by a life insurance contract. Thus, his personal endeavour is systematized and at the same time stimulated for his future obligations towards his family and society are accounted for and secured.

The tremendous economic progress of the North American continent in the last century can be directly attributed to private initiative and eagerness for personal profit. Worry and fear retard human efficiency and initiative probably more than any other factor. To the average thoughtful man, worry and fear act as an arresting agent in his plans for contentment and further vocational efficiency. Release from this worry and fear tends to allow a man to concentrate all his efforts on increasing productive enterprises. As regards family care, life insurance allows man to pursue his private endeavours to his utmost satisfaction. The knowledge of an assured estate for the family, the moment the first premium of a life insurance policy is paid is bound to cause the insured a greater feeling of freedom towards initiating and extending any further business plans.

Life insurance in the past has always been regarded as an altrustic and intangible service, intended solely for the protection of widows and orphans. True, this service rendered by life insurance is of great importance and needs always to be emphasized but the function of life insurance embraces more than one service. The very purpose of life insurance is to render some of the intangible elements of economic life tangible and definite. Systematized estate building by means of thrift has already been mentioned but saving in anticipation of the proverbial "rainy day" has yet not been disclosed as a service of life insurance. Life insurance savings assist in the creation of an emergency fund to protect the insured and his family against temporary or permanent financial misfortunes. The importance of this service can be recognized when the fact is brought to mind that because of available cash and loan values on insurance policies in 1930, 31 and 32, countless families were saved from the indignity of accepting state charity and at the same time saved the government much worry and expense.

There are two other services that life insurance offers to society 1. Life insurance as a will and 2. A Device for Making Philanthropic Bequests.

1. <u>Life insurance as a will</u>

The abolition of the practice of inheritance would be a great blow to private initiative. What man achieves for himself on earth, he likes to leave behind to his dear ones whether it be monetary or material wealth. To properly bequeath anything involves the making of a will which in many cases is rather confusing and questionable unless it is properly drawn up. In the case of most large wills, dissatisfaction is quite commonly experienced, resulting in large attorney's fees, executor's fees, high court costs, publicity and quite often injustice. Life insurance simplifies the matter as far as monetary bequests are concerned; the life insurance policy is the last will and testament with respect to the life value of the personal estate, the insured being the testator and the beneficiary the devisee. All possible trouble is avoided with the result that much money and labour (that might be employed more gainfully) is saved.

2. <u>Charitable and Philanthropic Bequests</u>

The average man desires to contribute in some way to some of the more uplifting social activities if it is possibly within his means. In the past, bequests for colleges, hospitals, medecine, research etc. have been derived largely from a wealthy few. To encourage the promotion of welfare organizations is doubtlessly to the value of society as a whole, but at the same time it has been hard in the past to convince the person of moderate means to contribute to such a worthy cause. By means of life insurance, a man can without impairing either his capital or the security desired for his dependents, quite easily manage to co-operate in such a progressive movement. Moreover, the universal application of family life insurance to an adequate degree would reduce enormously the need for organized charitable work.

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THE PRINCIPLE OF LIFE INSURANCE AND ITS ECONOMIC USES AND IMPORTANCE

CHAPTER 111

At the present time life insurance is broken up into three main departments, viz. ordinary branch, industrial branch and group branch. Business insurance although just an adaptation of the principle of ordinary life insurance also holds a position all of its own. Before looking at each department of life insurance it is of necessary to review the general principle upon which all life insurance is based.

Insurance may be defined as being a contractual agreement, whereby for a stipulated compensation called the premium, one party (the insurer) agrees to pay the other (the insured) a fixed sum upon the happening of some specified event.(1) Life insurance differs from other forms of insurance in one very vital respect. In other forms of insurance the contingency insured against may never happen while under an ordinary whole life policy life insurance is a hazard converging into a certainty. It is necessary therefore to provide not only for the risk each year but also to accumulate a fund sufficient to meet a claim whenever occuring and to provide for one at the ultimate limit of human life if one has up to that time been escaped. To accomplish this purpose it is necessary to have life insurance companies base their premium charges primarily on a mortality table, which indicates the yearly probability of death at various ages. This mortality table acts as a base from which all ordinary life insurance evolves. Also, by means of it, all other forms and types of life insurance are computed. The assumption is that the death rate of the future will be approximately that demonstrated by the past. Being given the age of the insured, the kind and amount of insurance desired, and the maximum rate of interest which the company will guarantee on its funds, it is possible to compute a premium from the particular mortality table in use. That premium is known as the "net premium" and is intended to cover only the actual mortality cost to the company. To this net premium the company must add a percentage to cover expenses of operation and other possible contingencies, thus giving the so called "gross premium". This is the premium that is actually charged the policyholder.

Should the premium be found to be too large owing to a more favourable death rate than was expected, or because expenses are lower or interest earned higher, the company may agree to pay back to the policyholders some of this gain in the form of dividends. When such is the case and dividends are paid, the insurance is said to be participating. Non-participating insurance does not benefit by any profits so made by the company and consequently the premiums charged are lower.

Experience has shown that life insurance in order to be most economical and practical, must be based on an uniform annual premium during the premium paying period. Such a plan requires the company during the early years of a policy to charge a premium more than sufficient to pay the current cost of the insurance. The excess portions of the annual premiums are thus accumulated in a fund known as the reserve. This will be drawn upon in later years when owing to the increasing hazard connected with increasing age, the uniform annual premium becomes insufficient to meet the current cost. When considering a large number of policies the reserve may be defined as representing a sum which together with future premiums paid by the policyholders, will just enable the company to meet its claims according to those specified requirements computed from the mortality table in use.(2) Accumulation of such a reserve fund is fundamental and essential to any sound plan of life insurance. Today this reserve plan represents the one great difference between sound and unsound companies and it is for this reason that all regular life insurance companies are required by law to operate on the so called "legal reserve basis".

All types of life insurance today are based on the foregoing conditions. It is rather hard to draw a fine line between the various kinds of life insurance. Ordinary life insurance differs from other plans such as industrial and group only in that it is based on the average of the whole population rather than a particular group. Being formulated for the whole rather than a particular group it is administered as such. The person that buys ordinary life insurance usually is able and does pay his premium annually at a rate computed in accordance with the conditions drawn up on the mortality table in use and the expenses incurred in marketing the insurance.

Ordinary life insurance is issued and sold primarily for protection but also embodies in its different policy contracts many other features which are peculiar to the needs of the classes it serves. The familiar limited payment life and endowment contracts are all in essence the same as whole life insurance but are so drawn up as to fulfill definite wants such as insurance against the old age hazard. Ordinary life insurance represents in all walks of life, an opportunity to obtain at the cost of thrift that security and happiness in life to which all people aspire, granted an income in excess of the requirements of the standard of life which one feels impelled to maintain.

Like other things that have come to the assistance of man in his effort to perfect his mortal existence, life insurance was born of necessity. It takes the place of doubtful charity and the old time community collection. From the smallest of beginnings it has grown into a huge business organization founded on a sound interpretation of mathematics and economy to provide for those dependent on a human life in case of the demise of that life. Since the dawn of civilization man has always had two distinct attributes distinguishing him from the lower order of natural beings. These two are namely sociability and economy. The latter ever urges a man forward to accumulate for the satisfaction of his desires the greatest amount of personal gain with the least possible outlay of energy. Translated in modern language, money is the means to this end. Life insurance as an individualistic means of attaining such a goal allows a man in moderate circumstances the opportunity of becoming his own lord and master in a financially harassed world. Life insurance promotes happiness for the individual; it gives one a chance to realize those fondest ambitions and dreams without at the same time endangering security of either a man's own position or his family's.

Life insurance has brought with it an opportunity for the safe investment of capital in such ways as to yield a revenue to persons who have little chance of engaging in any business for themselves. This opportunity, offered by life insurance companies, who act as trustees of billions of dollars of small savings, has induced people to save and invest, who would not otherwise have attempted to put by something for future needs. Instinctively, a man saves for his own sake but usually lying beneath the surface is that selfish satisfaction derived from servicing the needs of family affection. Alfred Marshall in his first volume of principles of economics claims "that men labour and save chiefly for the sake of their families". (3) Beneath the surface of economic individualism lies selfishenss and whether a man is only satisfying a selfish desire in looking after a family is more or less an open question. Quite often, people wish to improve the conditions of those whom they are interested in only because they shudder to think of themselves in such a position. Regardless of whether man is inherently selfish or not it is quite apparent that his individualistic desires for selfish gain or altruistic satisfaction can always be attained through the medium of a life insurance contract. The result accompanying such a plan for schieving one's desires can only be the further accumulation of saving and ultimately that of increased wealth due to a greater flow of new capital into production.

A man can have no stronger stimulus to energetic enterprise than the hope of rising in life and leaving his family in a position where they may start from a higher rung on the social ladder than that on which he began. Man is a social being and all his wants are in essence social. As is shown by the prodigious growth of wealth in America during the last fifty years, social ambition makes of a man, a mighty producer and an accumulator of riches. It is really only when a man has secured for his dependents at least as good if not better standard of living than that to which he was accustomed, that he can go forward with a clear mind to most efficiently utilize that energy given to him in order that he might further production more and more.

The main objective in the business of living is to realize some enduring satisfaction in life, for no one can be successful in the business of life if he is constantly asking "is life worth while". The things that make life worth while are those everyday necessities such as shelter, clothing, food etc. coupled with simple and sometimes extravagant luxuries according to taste. The earth is a good earth only as long as it can provide man with those things necessary to happiness.

The whole economic system is built upon the satisfaction of mutual wants of man. Adam Smith recognized that man trades for for purely selfish motives but that under all transactions lay what he so ably termed an "invisible hand" guiding (4) the promotion of a selfish end for the betterment of the whole. Life Insurance as an institution to-day represents a co-operative individualism. The term seems quite paradoxical but nevertheless it is true. Each person is given the privilege of investing at his own liberty any amount of money so long as he is physically capable of purchasing life insurance. In so doing he unconsciously becomes a member of a huge co-operative enterprise striving for financial security and betterment of society as a whole. Although all insurance companies are in the business to make a profit they so condition the affairs of their companies that the policyholders share in the benefits which they gain. The members of this great co-operative society are educated in the habits of thrift; they are schooled in the care of their health and their physical well-being; and they are provided with financial advantages which accrue from large investments which the companies are able to make for them. The policyholders are in fact shareholders in this great co-operative enterprise not only in name but in actuality.

Life insurance is not only important because it indemnifies human life values but also because it assumes the position of a source of capital funds. Capital funds are indispensable to an individualistic economy for without them production cannot go on. Huge enterprises are built from capital borrowings; these enterprises result in further production and increased wealth and greater progress of the nation.

The vast reserves of life insurance companies available to governments and individuals alike provide not only the funds on mortgage to build farmer's barns and houses but at the same time supplies much of the money with which the work of modern government is carried on. The erection of tremendous office buildings, of great hotels, of extensive factories, of homes including many for people of small income, and model apartment houses are all made possible through the investing of these vast reserves. Railroads have been built and rebuilt on money invested for policyholders and public utilities have found funds for their development from the same source. A typical Canadian life insurance company has figured out that each of its life insurance policies represents a certificate of ownership in each of more than nine thousand carefully selected investments. These include the securities of 35 national, state and provincial governments; 810 civic and rural municipalities, 397 industrial and public utility companies and about 7,700 individual city and farm mortgages.(5) Thus, the individual who saves through life insurance not only benefits through diversified savings but also is able to contribute to the creation of a large percentage of the wealth of the nation.

In endeavouring to estimate the role of importance that life insurance plays in our economic order, it would not be out of place to mention that life insurance gives gainful employment to approximately a quarter of a million individuals in the United States and Canada and that probably a million or more receive their livelihood through identity with the business.

Industrial Insurance

In order to bring the poorly paid wage earner under a system of life insurance, a special form had to be devised. This became known as industrial insurance. Under industrial insurance contracts, the policy amounts are usually small, providing only as a rule burial expenses and no more. Due to lack of education amongst the class of people for whom it is intended, collections of premiums cannot be made once a year or even semi-annually, but must and are made weekly. Not only lack of education but also smallness of wages combined with a fairly consistent price structure can be said to attribute to the average wage-earners lack of foresight and inability to save for himself. This method of collection results in increased administration expenses and consequently increased cost of protection. Industrial insurance is also higher in cost because of a high death rate amongst wage earners. Thus, where necessity is greatest the cost also is the greatest. At first glance this seems practicable enough but when it is recalled that the wage earner receives the smallest monetary return for his services the statement seems quite unjust. Industrial insurance, however, is actuarially sound and its limitations can be attributed not to the institution it represents but rather to the society in which it operates.

The total amount of industrial insurance in force for the year ending 1935 in the United States and Canada was approximately 18.5 billions of dollars. This amount of insurance in force represents 67% of the entire population of the two nations (6) in the form of 100 million policies. Anything whether it be tangible or otherwise that affects the lives of 67 percent of the entire population of two great nations must of consequence be something of real economic significance and importance to those nations as a whole.

There are tens of thousands of industrial field men covering millions of square miles on the North American continent, day in and day out. In every city, in every town and in practically every village these men have entry into millions of homes, a privilege enjoyed by no other group outside of the clergy and the medical profession. The industrial man is a trusted financial advisor, a friend and a counsellor. The people's troubles, joys, ambitions and despairs are his and it is a striking commentary on the prodigious influence that the industrial agent has, that of a total amount of insurance in force approximately twenty odd percent is carried by the so-called industrial companies.

Welfare work plays a role of no small importance in the business of industrial insurance. Many, many millions of dollars have been spent by industrial companies distributing pamphlets showing the need for sanitation and good health. Safety films, emphasizing the dangers of typhoid, diptheria and smallpox, have been shown to millions of people during the past twenty years. Numerous carefully instituted surveys have been conducted by industrial companies;[7] a survey regarding the cost of medical care in the average industrial family was made; a survey covering the cost of burials which incidentally led to a standardization of burial costs. The result of the burial survey was a great boon to working people for obvious reasons. Nursing service is carried on by the industrial companies as part of their program to better the working man's condition. It is quite reasonable to assume that no other organization is better fitted to diagnose and handle the problems of health amongst the working classes than the industrial insurance companies.

Industrial insurance has cleaved for itself a niche in the economic society of the North American continent. It not only represents the accumulation of the small savings of millions of people representing that class of society known as labour, but it also offers to that class a more secure life and a chance to progress. Industrial insurance as a means to an end simply represents a policy of world betterment. If society must progress, the part that industrial insurance is playing in fostering that progress by means of its welfare and social work is quite comparable to the mother who insists on her children's Saturday night bath.

The average person's conception of the industrial life insurance business and the industrial field man's work is that of a five and ten cent concern. However, as has been shown, industrial insurance is a big business not only as regards the huge monetary proportions it assumes but also as regards its more humanitarian attributes. Economically speaking, a million dollars represents what that money can buy on the open market in the form of tangible goods. Seemingly, from a standpoint of a life insurance company, a million dollars can only represent so much taken in, in the form of premiums or so much paid out in the form of benefits. Such is not the case, however. Life insurance is a means to an end, just as a billion dollars and the goods obtainable by means of it are means to that end of satisfying human wants, so is life insurance a means to that end of social security for all who can afford it. The late Sir

George Foster when he was minister of trade and commerce for Canada once said in an address the following about the industrial business and the industrial agent, "You are doing more than taking in premiums and paying out losses in benefits. This is one part of your work, but how inestimably small is that and how it shrinks into a mere detail when you place yourselves in the line of service that you are giving to humanity and to the aggregations of humanity, society, and government, by this widespread activity of yours." (8)

Group Insurance

One of the most interesting developments in the life insurance business in recent years is the introduction and growth of group insurance. Comparatively little known some seven or eight years, today employees of business organizations of every character are covered with this valuable protection.

The fundamental idea of group insurance is low cost protection sold on a convenient payment plan that will protect at death or disability the family of the worker and do away with the old hat passing custom to aid the family in time of need. Group insurance does have a stabilizing effect and although in itself will not correct the troubles of labour, along with its complementary plans of group sickness and accident and group pensions, it should have a most alleviating effect on labour trouble if properly dispensed and handled. Group life insurance does not compete with regualr life insurance but rather more or less supplements it while occupying a place peculiar to itself alone.

Group life insurance is that form of life insurance covering not less than 50 employees of one employer, without medical examination and written under a policy issued to the employer. The premium is paid by the employer or by the employer and employee jointly. Each group policy insures only all the employees or all of any class or classes of employees of one employer determined by conditions pertaining to the employment for an amount of insurance based upon some plan which will preclude individual selection, for the benefit of persons other than the employer. It is provided that when the premium is to be paid by the employer and the employee jointly and benefits of the policy are offered to all eligible employees, not less than seventy five percent of such employees may be insured.(9) Owing to the diffusion of risk and quantity of coverage, insurance protection can be provided for a body or group of employees at a much lower rate than could be offered to an individual.

The most distinctive feature of group insurance is that it gives protection to men and women of moderate earning capacity where the ability to pay for ordinary insurance is least. It also gives protection which it might otherwise be difficult or impossible to obtain on account of age, physical condition or family history.

The omission of the customary medical examination is inseparable from the underlying principles of the system. Although it might appear that this entails extra hazard, it is quite consistent with sound underwriting. Actuarially all life insurance is operated on the group principle which alone will secure the effect of the law of average. It would be quite safe to issue a policy of like amount on the lives of each of 500 persons casually passing an office building and to dispense with medical examinations. It is only when application for insurance is deliberately made, that precaution is necessary to provide against adverse selection. As an offset to the waiver of individual examinations, the group risk is expertly inspected with special regard to the working and living environment of the employees, provision for safety, occupational hazards and other conditions which may affect the risk, and the premium is calculated accordingly.

Group insurance is usually written on the yearly renewable term plan, the cost of insurance on each individual employee increases each year with the increase in age. The natural result would be an increasing annual cost, as the employees in the group grow older. Actual experience has shown however, that the steady withdrawal of older workers to give way to younger men tends in general to produce a more or less constant rate. The cost may be reduced by an experience rating provision which provides that if the mortality experienced in the group insurance plan is sufficiently favourable a reduction in premium rates will be made at the end of any policy year and in addition a refund will be made on the previous year's premium. This feature naturally promotes better and healthier environment, more favourable working conditions and concomitant to this will be better efforts from the employees.

Hand in hand with group life insurance goes group pensions because of the fact that both are computed from actuarial interpretations of mortality tables. Group pensions provide for specified sums to be paid monthly to the employee after a set retirement date, these payments to continue during the remainder of his life. The plan is in effect an old age pension handled by means of group insurance. The plan is usually drawn up and administered along the same lines as group life insurance. Unlike group life insurance there is a surrender and paid up value in case of discontinuance or lapse of the plan.

The life insurance companies have also associated their endeavours in the business world with group sickness and non-occupational accident insurance. These plans supplement the workmen's compensation insurance and thus allows the worker to be protected at all times. Policies are issued to only full time employees and special consideration is taken of risks involved, consequently the rates are governed accordingly. The economic consequences of all such group plans are really of great importance.

The primary object of group life insurance, group pension plans, and group sickness and accident contracts is to enable the home to carry on during the distressing readjustment period which always follows death, involuntary retirement, or sickness. The values of such plans can not always be measured in dollars and cents and this may be accounted for by the fact that such plans reach into the homes and enlist the interest of wives and other dependants of the workmen in the ultimate interests of the workmen and industry itself.

Advantages of Group Insurance

It has been found that from the employer's standpoint, group life, group pension, and group sickness and accident insurance has certain definite results. 1. It creates goodwill--emplyees realize that the employers consider not only them but also their wives and children, consequently a spirit of good-will is established which results in better work. 2. It inspires loyalty. Workmen are proud to be connected with a firm which is interested in them from a personal standpoint. 3. It reduces labour turnover. Training new employees costs money, hence any plan which will reduce the labour turnover is valuable. With concerns whose product is of unique character necessitating the training of workmen especially for particular tasks, reduction of hiring and firing is of exceptional importance. Every change in personnel involves temporary loss in efficiency while unbroken service assures familiarity with the task and proficiency in performing it. The expectation of receiving a pension will act as an inducement upon the employee to forego other advantages elsewhere and hang on to his job till retirement age. 4. The group pension plan acts as a restraining influence against strikes. Pensions are granted only to the loyal and faithful and any persons who leave the service relinquish the pension privilege and if they reenter the service must be regarded as new employees. 5. Increased efficiency. Worry and discontentment caused by lack of security naturally tends to decrease the efficiency of the worker. 6. Character of Firm is Enhanced. The character of a firm may be largely judged from the treatment it accords its employees. In business relationships it pays to have a reputation for fair and liberal treatment of wage earners. As a result of having such a reputation the company is enabled to attract and retain the most desirable types of workers.

The economic importance of group plans to the employee is that it gives him the privilege of securing his family's and his own position in society at the smallest possible outlay. The average labourer or workman saves some money through industrial insurance but the amount of insurance and saving is usually comparatively small and more frequently than not does not enable the employee to comfortably lay down his tools at retirement age, nor is it enough to adequately provide for a re-adjustment period in life for his family. The additional security created by means of group plans eliminates a certain amount of worry that enables the employee to do better work for himself and his employer. Good work is usually appreciated and appreciation is usually manifested in better hours, wages and environmental conditions and possibly advancement. It is estimated, that one quarter of the total number in any group are unable to take out and own ordinary life insurance. Thus, group insurance gives an employee a chance to protect his family to a certain extent where otherwise he would be unable to do so.

In summing up, it is to be seen that group insurance in its various forms is a creator of good-will, a bond between employer and employee, a factor in reducing labour turnover, a means to greater efficiency, a character builder, a weapon with which to alleviate economic class warfare and last but not least a method of enhancing and improving the social position of labour in this altogether too insecure labour world of ours to-day. At the time of the last United States presidential election (November 1937) Franklin Delano Roosevelt realized that what the man on the street wants more than anything else in the world to-day is security and peace of mind. More will be said about this later.

Effective March 15th, 1937, the weekly sickness and non-occupational accident benefit, payable under the General Motors group insurance policy, will be increased from $10 to $14 per week. This is quite significant, coming very shortly after one of the worst strikes in recent history was experienced by General Motors in the United States.

Ordinary life insurance has many uses and adaptations and one of the most prominent of these uses is applying it to business. All insurance finds its birth in the original ordinary insurance calculated from the mortality tables of the time. Business insurance is a very important part of our economic system to-day and should always be regarded as such. It is for this reason that a little study of the place business insurance occupies in our financial economy today would not be amiss.

Property in itself has no value; man can give it value however, and upon man is its value dependent. Net worth of a business depends upon income which has a source in the managerial and credit ability of some life or lives. The life it is true, needs some property to work most efficiently but on the other hand, the property cannot be moulded and guided into production and wealth unless a human life is present. The relationship of life insurance to the proper organization and management of business is manifold. A few of these many relations are as follows:

1. Business Interruption Insurance

The key life which furnishes the guiding force in business management may be regarded as the motivating u it so necessary for continued productivity in the enterprise. Interruption to the directing force in the form of death simply means that the business will be automatically thrown out of gear until a substitute can be found, provided that one can be found at all. Accordingly, life insurance on this key life payable to the business constitutes business interruption insurance just as would fire insurance written under property forms of coverage. Life insurance from a business standpoint becomes profits insurance covering the transition period following the death of the key man in the business.

2. Life Insurance for Credit Purposes

Life insurance assists in enlarging credit and in the securing of it on a better interest basis. Character and ability so important in credit transactions are given tangibility through life insurance in the same way that fire and marine insurance enables lenders to rely upon the property security which they accept on loans. The life of the borrower constitutes the security behind many loans, but only when there is a contract of indemnity assuring the creditor of his money in case of the death of the debtor. By thus enlarging the volume of credit and assuming that the borrowers can trade profitably on the credit thus created, life insurance becomes a great creative force in the promotion of business enterprise. Credit is really the life blo d of business and in the course of time life insurance will be utilized more and more in the creation of it. Loans borrowed on the security of life insurance are always indemnifiable in case of the death of the debtor and are therefore, regarded as being better in quality than loans secured only in time of life. The consequence of this will be reflected in a better rate of interest for the debtor and a consequential increase in the number of loans made.

3. Life Insurance as an Emergency Fund

The necessity of maintaining an emergency fund in any business is well recognized. In times of prosperity, it is necessary to allot so much cash or the equivalent to cash to the emergency fund so that when it is needed in times of stress to meet credit and expense situations, it will be there. Three methods of allotment of surplus to an emergency fund may be followed. The surplus may be plowed back into the business again, it may be invested in stocks or bonds, or it may be stored in the form of life insurance. The obvious defect with the first method is that is is more than likely that at the time when the cash is really needed the business will be in no shape to surrender anything. The second method is much better and the only fault that can be found with it is that it runs the gauntlet of the business cycle. It is possible to suppose that just when the stocks and bonds are needed and are to be marketed, their value on the open market will be deflated by 25 to 50 percent. Little comfort it is to the possessor of an emergency fund to realize that the fund has depreciated by about 25 percent or more just at the time when it is so badly needed. The life insurance sinking fund, when in charge of a sound life insurance company, always remains virtually non-fluctuating in value. Dollars have been purchased by dollars and it is known in advance exactly how much at the minimum guarantee will be realized at a particular time. Due to the insurance companies' wide diversification of investments a minimum rate of interest can always be guaranteed. Moreover the fund is freed from managerial care and thus allows more time and effort to be spent on the enterprises' own particular line of endeavour.

4. Life Insurance as Property Insurance

Quite often because of the fact that the average small business man is required to put most of his surplus back into the business to meet competition or avail himself of buying opportunities,* a terrific shrinkage of the estate due to adjustment expenses is incurred when a man dies. The burden of this shrinkage should not be placed upon the small business but should be absorbed by a life insurance policy especially designed to cover such a possibility with the view to preservation of both the business and family estate. Similarly, goodwill which nearly always appears on the balance sheets of most small businesses should be appraised and insured against possible loss.

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* This seems to be conflicting with statements made in the foregoing paragraph, but for the man owning a small business there is often no other choice.

5. Business Liquidation Insurance

Life insurance can be used as a means of establishing a sales plan for the liquidation of business interests. This service is applicable to three types of ownership namely sole proprietorship, partnership and close corporation. Because of a sales plan at a definite price surviving stockholders or partners are adequately protected against the distasteful problems arising out of the acceptance of unwanted outsiders or heirs.

Five fundamental services of life insurance have been reviewed in their relationship to business. The importance of these is unquestionable. The underlying consequences which business insurance prevents have not been elaborated on, but it is quite easy to visualize the effect that business interruption, curtailment of credit through lack of security and poorly constituted emergency funds would have on economic society as a whole. During the periods of readjustment men through no fault of their own would be temporarily thrown out of work, production would slow down and the whole equilibrium of the economic system would be temporarily out of balance.

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LIFE INSURANCE INVESTMENTS

CHAPTER IV

Investment Principles of Life Insurance

1. Security of Capital

The first and most important consideration of all life insurance investments is the security of capital. It is of utmost importance to both the integrity of the institution of life insurance and to its policyholders that the principle amount of the investment should be paid promptly at maturity and that the interest payable on all such investments should be disbrused regularly at each interval of time so contracted for, until maturity. It is the security of the portfolio of investments as a whole and not just a part which is essentail and it is to this end that all life insurance companies must strive. More will be said about this when the principle of diversification of investments is more carefully analysed.

2. Interest Return

Compatibility of a high interest return with utmost security of capital is quite impossible and for this reason life insurance companies never offer a man an enormously high rate of return on his money. Security of capital ranks second to none in the principles of investment followed by life insurance companies. The interest return, however, must be considered. The highest possible interest return consistent with the principle of the security of capital is always the objective of a well organized investment staff. The important point to be emphasized is that it is not the gross return from the investment which should be considered but rather the net return i.e. the gross return less investment expenses (including such taxes as those levied on interest income) and less an allowance for future loss where an element of risk is considered to be present. In connection with the last deduction it cannot be too strongly emphasized that the only proper way of dealing with high yielding securities, which obviously must involve a certain amount of risk, is to transfer each year in good times as well as bad a part of the income from interest on these securities to investment reserve rather than to unassigned surplus ready for distribution. In this way, provision can be made if a possible capital shrinkage should at any time become a reality.

3. Marketability

After having investigated an investment as regards its security and fairness of interest return, its next test should be that of marketability. This subject should be treated in relation to the general nature of the life insurance business. It must also be considered in the light of changing economic conditions. With regard to the general nature of the business, life insurance contracts generally speaking are written for a long period of years; the average may be fifteen or twenty years but some contracts run as high as fifty years and even more. Also, it is noticeable that the assets of life insurance companies have been steadily increasing and are continuing to do so. Accordingly, it is natural that, especially in normal times, the current receipts of insurance companies exceed the current payments for death claims, dividends, annuities, surrenders, and policy loans, by a fairly large amount each year. This has been the uniform experience of almost all well managed insurance companies. In view of this circumstance, the principle of marketability until recent years has not been emphasized or regarded as a primary characteristic of a good insurance investment. Besides, twenty or thirty years ago, people were not educated as they are today in the use of surrender and loan values. In some cases, the values were even lacking and where they did appear they were not as liberal as they are today. However, conditions have changed. Policyholders not only have become familiarized with the high surrender and loan values but also have come to the point where they regard their life insurance policies as their last and unfailing resort for money. It is a well known fact today that if all other sources of raising money dry up, the policyholders can and will receive from the life insurance companies the full guaranteed value of their policies at one hundred cents on the dollar. Insurance companies have thus assumed some of the functions of the banks and yet they do not possess the safeguards which the banks do. When banks are called upon to pay out their deposits, they in turn call on those who have borrowed from them to pay off their loans. They are also the recipient of a privilege which allows them to present specified securities to their governments and receive legal tender therefrom. Too, their investment policies involve the purchase of a great many short term government and municipal bonds, thus always keeping their assets in a very liquid condition. On the other hand, the investment policies of life insurance companies have been most preferential to the purchase of long term bonds and mortgages. In connection with mortgages, it is obvious that an insurance company could not squeeze money from a mortgagee every time money was needed to pay a cash surrender value to a policyholder and similarly foreclosure would not only mean the entailment of heavy expense but also a considerable loss on the original investment. In connection with unmatured bonds the insurance companies cannot go to the governments or other issuing corporations and ask them to repay their obligations before maturity. They must be content to accept the current market price and there is no guarantee that this will be as high as the original purchase price. Life insurance companies thus have to carry a fairly substantial portfolio of short term investments to avoid loss through inopportune selling or buying. Only experts should be employed to handle such transactions.

A new condition has thus arisen whereby insurance companies must keep themselves in a prepared condition to pay larger amounts of loan and surrender values on demand. The proper method of meeting this comparatively new development is that of adjustment of the investment policy to service the need. Liquidity and marketability should be two inseparable attributes of securities purchased by life insurance companies today and in order for the investment policy to achieve its proper end, a goodly number of life insurance assets should possess these qualities. Marketability is found in the greatest degree in government bonds, both long term and short term but more especially in the latter for they are subject to much narrower fluctuations in market price than the former.

4. Diversification

It is absolutely essential that, with the amount of money which insurance companies have to invest, a very large degree of diversification should be obtained in as many directions as possible. Government and municipal and also private corporate obligations should be represented in the investment portfolio of any company. Investments should be made in a great many sections of a country. Different types of private organizations and those under the control of different management should be included in the portfolio. The object behind such a practice of investing is to completely minimize any difficulty which might arise from adverse developments affecting one particular industry or one particular part of a country. It is the logical development of this theory of diversification which makes it important that a limit of risk for any particular investment should be anticipated by the insurance companies especially when private and not public corporations are being considered. The actuarial basis of life insurance in selecting lives for insurance necessitates a rigid limit of risk as to the maximum amount which any one company will retain on any one life. It is just as essential that the same principle should be applied in the investment departments.

5. Duration

The question of duration of an investment is quite important. There are times when it is much more advantageous to purchase long term securities i.e. bonds running for twenty or thirty years, than it is to buy securities of a shorter duration say five to fifteen years and similarly vice versa. The best time to purchase long term bonds is of course when interest rates are high, but the word high in this sense is really hard to define and the drawing of a line between various rates of interest is very difficult. It is quite impossible to accurately predict a future course of interest rates for so many factors govern and enter in to the problem. A thorough study of trends and statistical data has been in the past and will be in the future the only guide to aid in the solution of such a problem. It is worthy of note that supposedly advantageous and prudent investing (especially long term issues) should always be subject to careful investigation in order to make certain that such drawbacks as call and redemption privileges are not present. A bond may have twenty-five years to run to its maturity date, but if the issuing corporation has the privilege of redeeming it at any time at par or at a specified premium, it cannot be regarded safely as a long term security. Short term securities should naturally be purchased when interest rates are low in order to allow the investor an opportunity to re-invest at the end of the short period in longer term securities with a greater yield. It is alsoavery prudent policy at times to sell short term bonds and exchange them for long term bonds and vice versa. This way and only this way can the greatest possible yield be obtained from investments i.e. the duration of the investments should be properly scaled at all times to allow the maximum yield to accrue.

6. Legality

Every investment must clearly be within the statutes of the authority governing such investments. Governments are naturally concerned with the welfare of their people, so certain conditions and qualifications of investment policies of life insurance companies are required by law. These must be strictly adhered to or a company will forfeit its position as such.

7. Supervision

This should really come under the head of management. Maximum efficiency is necessary in the management of the investment policies of life insurance companies. Continual supervising, reviewing and research are always necessary as conditions are ever changing rendering securities which once were gilt edged much less desirable.

8. Currency

Although a currency standard does not apply to all life insurance companies it is absolutely essential for those countries doing business on an international scale. In the light of developments since September 1931 when England was forced to abandon the gold standard and subsequent changes in monetary policies of other countries i.e. devaluation of the United States dollar, gold bloc countries going off their standard etc., it would seem as if each company should pay more attention to the currency in which its policies and investments are payable. It has been proposed that the ideal structure would approximate an exact balance between the investments in each currency and the liabilities in that currency.(1) This plan, however, might not always be feasible due to unstable governmental and financial conditions in certain countries. Some standard should be decided upon by mutual contractual agreement and in my opinion gold is still the best standard. The opinion is subject, however, today to the fact that investments can not be made in gold clause securities. As gold is used as the final medium for settling countries' international indebtedness, it is only proper that it should be used as insurance companies' contractual standard, for all transactions between countries can only represent a series of trading activities whether the exports and imports be tangible or invisible. It must be said of the proposal for the ideal currency structure, however, that no matter how unfeasible it might seem it certainly propounds a condition which should be acceptable and agreeable to all for such a condition illustrates perfectly the free-traders and might, I say, the proper concept of a true balance of trade amongst countries.

Classification and Suitability of Investments

1. Government Bonds and Government Guaranteed Bonds

The number one investment in all life insurance portfolios has always been sound government bonds guaranteed and secured by the natural cultural heritage of a country and an endowed power of taxation of the people's resources. Government bonds are of necessity a type of security with a very low yield (presumably no risk being attached whatsoever).(2) Government bonds also are the most liquid of all securities and can always be relied upon to provide cash whenever needed up to the market value of the securities. Dominion or federal bonds are always rated in higher degree of safety than provincial or state bonds. This of course is much more noticeable in Canada where the federal government has much greater power than the provincial units; in the United States, the powers of the state are quite comparable to that of the federal government and much distinction should not be made between state and federal issues. The first criterion of a good investment is its power to give some return with utmost safety. This can always be found in government issues tendered to the public by a sound, intelligent governing body through a well managed market. Although the gross yield from government bonds is quite low, it is necessary to point out that the difference between gross and net yield is quite negligble. This difference always arises through expenses of purchasing, handling and through allowance for the possibility of risk. The first two expenses are at a minimum when government bonds are purchased, while the third is entirely lacking.

Investments in bonds issued by foreign countries are made to a small extent but not without some difficulty. In the case of neighbour countries like Canada and the United States where prevailing currency, language and customs are similar, no difficulties are encountered whatsoever; similarly all countries within the British Empire are usually without restraint against each other as regards inter-investment policies. It is when truly foreign countries are considered that the real difficulty arises. There is a tendency in these times when nationalism is being emphasized at the expense of internationalism, for many foreign countries to demand that insurance companies doing business in their countries, also do considerable investing in issues of securities of their countries whether the issues be privately or governmentally controlled. On the surface this seems quite fair but only if a company has enough business transacted in a foreign country to warrant it establishing and maintaining an investment office in that country for some time, is such a plan feasible. Unless a company can supervise all its investments with the greatest degree of care and efficiency, a sound policy cannot be maintained. If a company was forced to cater to the demands of a foreign country and invest all the funds collected as premiums in that country, in that foreign country's issues, complete safety of principle which should be the main characteristic of insurance investment would not be maintained because of woefully deficient knowledge of conditions and circumstances accompanying the issue. Companies investing in foreign government bonds usually do so with an eye to a higher than usual income from such bonds, but it has been proven in the majority of cases, that, as indicated by all high interest returns, the security was inferior. Compatibility between high interest return and stable security is well nigh impossible and it should always be realized that government bonds supposedly having two such attributes are never to be found.

2. Municipal Bonds

Municipalities are the various sections incorporated and otherwise of the province and state. Municipal bonds are quite similar to government bonds in the fact that their security rests on the power of taxations. They are the obligations of the entire communities which have issued them, and taxes are levied by these communities in order to meet the principal and interest payments. Due to the fact that there are a great number of municipal bodies in any one country, there is a great divergence in their size, industries, location, financial standing etc. It is therefore, obvious that there will be quite a broad range from the very best to the worst possible municipal bonds.

Careful scrutinization must be made of all possible conditions affecting the qualities of an issue before municipal bonds should be added to the portfolio of investments of a life insurance company. When purchasing municipal bonds such tests as the following should be applied to the municipalities themselves.

1. A general survey of the municipality should be made with a view to ascertaining its possibility of development.
2. A municipality's past history should be clear of defaults or other irregularities.
3. A steady but not too rapid increase in population should be looked for.
4. Assessment of property and income should be subject to taxation.
5. Total debenture debt per head of population should be ascertained.
6. Net debenture debt (being total debt less sinking funds and revenue producing debt) per head should be ascertained.
7. Tax levy per head should be computed.
8. Amount of taxes collected should be checked.
9. Amount of arrears of taxes also checked.
10. Amount of bank loans and other temporary borrowings should

be ascertained.

(3)

11. Condition of budget should be learnt.

Points 1, 10, and 11, are to my mind rather general and to them should be added such tests as methods of taxation used, management of temporary borrowings and the interest rate paid and definite characteristics of a municipality's system of government unerlying a balanced or unbalanced budget.

The experience of the last few years has shown that the greatest dangers in municipal securities arise from two causes. First, urban municipalities and districts closely surrounding such are always subject to trouble in trying to balance their budgets. The reason this difficulty is encountered can be found in the fact that the standard of living tends to constantly increase in urban centres. The city is the centre of progress and is ever clamoring for a new and better standard of living, new improvements and all those facilities needed for making life happier and easier. Sidewalks, pavements, sewers, parks, playgrounds etc. are only a few of such demands. The city population while it enjoys the highest standard of living during normal and prosperous times, finds the reaction of a depression very hard and endures much strain and poverty. A man can always eat the products he cultivates from the soil, but let him try to eat a machine he has helped to produce in a factory. Unemployment relief falls heavily upon the shoulders of those having the cities administrative power in their hands. This factor of unemployment relief can easily be turned into a monstrous financial giant which all municipalities have to fear and fight if the retention of a sound and unimpaired credit is desired.

Much commotion regarding unemployment relief has been excited in the last few years of stress when municipalities were not only forced to default some loans but in many cases were forced to have the city go into complete bankruptcy. The solution is of course the transference of the relief burden from the weak shoulders of the municipalities to the much stronger ones of the national government. Unemployment relief has proven itself to be a nation wide problem and should thus be handled by the national government. The municipalities have proven themselves unworthy and incapable of handling the unemployment relief problem mainly because of limited financial means. A national government is constitutionally not so limited in resources with which to deal with the problem. The result of such a transference could only result in the enhancement of the municipalities' credit, without a great impairment of that of the national power.

Secondly, the fact is recognized that the bonds of those towns which are limited in progress to the advancement of one particular industry, are always less secure as an investment than those belonging to a city where greater diversification is present. To protect itself fully, an insurance company should always hedge against potential failures amongst towns and this it cannot do unless diversification of industry is present. Municipal bonds thus cannot be said to have complete safety of principal. The interest returns on municipal securities naturally investments than bonds of industrial private corporations because the latter do not enjoy the advantages of necessity, monopoly and regulation. Public utility issues also are not so subjected to a change in economic conditions i.e. the use of electricity or water would not decrease to nearly the same extent in a period of depression as would the use of automobiles. Public utility bonds are a very good form of investment for any insurance company, yielding both a fairly good return and a safe one. As with municipal bonds, careful analysis of each companies financial condition at the time of investment and future potentialities should be made. Capable management, size of company, satisfactory franchises, complete monopoly, and financial statements all must be taken into consideration before a purchase is made. Where the utilities are owned and operated by governments, they really come under the heading of government securities and their desirability rests more upon the credit of the country than on their own operations.

4. Railroad Bonds

Railroad bonds in the United and Canada really are two quite different studies, for whereas there are only two railroads in Canada one of which is privately owned and the other owned by the government, in the United States there are countless privately owned smaller roads. At present the future of the railroad business in Canada is very much of a public question. Railroad bonds should be considered in the light of privately owned institutions when investments are being thought of, for otherwise they become alike to public utilities or government

5. Industrial Bonds

It is hard to set down various standards and methods of studying such investments on account of the great number of industries involved. The great majority of industrial concerns today are backed by bonds whether the product forthcoming be milk or glue or newsprint or cement. As a rule Bonds of industrial companies possess a large element of risk not found in government, municipal or public utility bonds and for this reason should be chosen with the greatest amount of care. The yields of industrial bonds are naturally much greater than that derived from government or public utility bonds. Marketability of some of these securities depending upon the issue in a period of industrial depression practically becomes an unknown quantity and if the bonds are marketable at all the prices received for them are very low. In an ever changing dynamic economic society jeopardization of the earning power of industries and thus of the security of their respective bond issues is constantly a problem to be faced by prospective purchasers of this type of bond. Before buying such bonds, it should be clearly established that the issuing company is one of growing importance and is one that occupies a particularly important position in its own industry and that it is well managed and not subject to vicious and excessive competition which might possibly retard its growth. Financial statements should show that assets have been valued at a conservative figure and that bonds do not exceed more than 40% of the net tangible assets. Reserves and surpluses should be large enough to provide adequately for low earnings or possible deficits in lean yea

6. Mortgages

From the point of view of security of principal, good bonds and good mortgages rank equally. From the point of view of interest return, well selected mortgages are much better than the highest ranking class of bonds. From the point of view of marketability, mortgages have practically none and good bonds possess this feature to the highest degree. Mortgages are quite indispensable to a life insurance company's investment portfolio for their higher earning power tends to reduce the cost of insurand to policyholders and the security of capital which they offer is quite safe. The drawback of course with regard to mortgage investments is their lack of marketability and this at all times (especially times of stress) must be compensated for by investments in good bonds. The loaning of money on mortgage by insurance companies requires a great deal of legal assistance for when a mortgage is being arranged the borrowers right and title to the property has to be investigated very carefully in order to provide the lender with security based on legal pledge. Naturally, there are various laws in different states and provinces affecting the transfer of real property and only when these are completely mastered and properly applied should a mortgage be considered well placed. Security of capital rests of course on the real property pledged to the mortgagee in case of default, but as in all cases of land, property really is worth its capitalized earning power and not what it will bring on the open market. Thus, in determining the value of mortgages to life insurance companies ultimate earning power of property should be considered. In the case of city loans the following points should be carefully investigated. 1. The potential development of the city. 2. Typicality of the property and building in relation to other properties and buildings in the same district. 3. The quality of the buildings and of the men in charge of their upkeep and 4. The purpose of the loan should be ascertained and a conservative valuation of the property be made. Whether the loans are made on private residences, apartments, stores, churches, office buildings, schools or factories, all the above mentioned points should be carefully analysed and considered before a contract for a mortgage is made.

With regard to farm loans similar points arise together with those of a nature peculiar to farming itself. A good crop growing record, condition of the soil, absence or presence of weed and blight menace, equipment used and suitability of location for quick economical marketing of products, are only a few of the more important points to be considered before contracting for a loan on farm land. In the last few years serious accumulation of arrears of interest has occurred because of difficult conditions caused by low prices and adverse crop yields. Farm values in the future should be quite good if an adjusted relationship between prices and costs can be arranged in order to maintain the earning power of the farms. One factor peculiar to the farm mortgage is that if a man does get in arrears with his interest payments, he always as the opportunity, if the creditor will allow him, to maintain his living on the farm until such a time as he can repay both his arrears and his current payments. Unemployment in the cities has no such counterpart.

7. Stocks

Stocks whether common or preferred represent ownership or equity in a company and thus stand or fall as a company prospers or meets with adversity. Capital invested in stocks is definitely not secure and thus, naturally the return is high for taking the risk. The future value of a stock may be greater or less than the purchase price and in the case of common stocks there is never a time when the investment matures. Goods stocks are marketable at all times on the recognized stock exchanges. Although some states in the United States will not permit companies to operate within their borders if common stocks are included in their investment portfolios, as a rule, a small proportion of well chosen common stocks purchased at a time when market values are much lower than the average value, are a decided asset to life insurance companies. Just recently, Canadian gold stocks paying 4 per cent on the share par value or $4 per share annually on non par stock and having done so for over a period of ten years, were accepted as a legitimate investment for Canadian companies. Considerable care should at all times be given to any such type of investment however in order that that security which is associated with the name of life insurance will always be safeguarded.

8. Policy loans

Policy loans represent a portion of the reserve on certain individual policies and for this reason the security of capital on them is the best possible. They are always deducted from cash surrender values and from death claims and thus a chance of any possible loss vanishes. As an interest yielding loan, policy loans can be equally as favourable as a good first mortgage, but they are altogether unmarketable. The only possibility of a loss of principal is when clerical errors are made, consequently clerical accuracy is one of the first things demanded of an office staff. Policy loans decrease the amount of insurance protection which the policyholders receive and more often than not culminate in the lapse or surrender of the policy. For this reason, insurance companies should not encourage such loans regardless of the safety of capital and high returns.

9. Real Estate

The amount of real estate a company can own is statuarily limited and should not be considered an investment as a means to an end but rather as an end in itself. Insurance real estate is practically limited to offices for the staffs required to manage and carry on the business transactions of the companies. Porperty acquired through mortgage foreclosure can be carried only until a satisfactory sale of the property is made.

10. Collateral Loans

A very small percentage of insurance funds go into this type of loan. Marketability and liquidity are the outstanding features of such loans but as can be expected, loans of this type are of a very temporary nature. The percentage of such loans is so small as to be almost negligble and in passing all that need be said is that this type of loan might prove profitable only in times of great need and stress when money is required in a hurry. Collateral supporting such loans should necessarily be only of the highest calibre, e.g. government bonds or the A1 common stocks of the largest corporations.

Significance of Life Insurance Investments

During the past five difficult years people have learned to regard life insurance as perhaps the most stable, reliable and satisfactory phase of the economic system. As far as mortality and the expenses connected with insurance service are concerned life insurance companies may be regarded as primary producers. Life insurance companies could not exist as they do today without interest and it is an intriguing problem to study their position in the economic system as related to the interest rate. The life insurance companies are essentially middlemen as far as the interest rate is concerned. They stand between their policyholders on the one hand and the mortgagors, industries, utilities, railways and governments to whom the policyholders' funds are lent, on the other. It is absolutely essential that they correctly interpret the attitude of each of the parties with whom they are dealing, to the other. As debtors, the insurance companies will always be looking for a fair return to their to their policyholders and as creditors that return is governed by conditions affecting their investment policy. These conditions are inherent in the financial set up of the economic system. It is the job of the life insurance companies to correctly interpret and solve this problem and make the one side compatible with the other.

In the course of the history of life insurance the companies have invested their funds in various assets the composition of which is always an indication of the trend of the times and of the interest rate. At a time of depressed business conditions a low interest rate usually prevails and a tendency towards a preponderance of sound bond issues is always seen, while in the midst of an era of prosperity stocks, corporate bonds, urban and mortgages gain in volume.(4)

At the present time, a low interest rate prevails not only on the North American continent but throughout the world. As the term normal is more or less outworn and uncertain it is best to deal with the problem of interest rates in their extremes verging towards a possible norm.

During a period of depression natural forces operate to bring about certain interest levels. Usually in consequence of the economic ills that are infecting a country governments also operate and play a great part in determining interest rates. Money management by governments is now definitely present in the economic system and from this condition it would seem that interest management is an evitable corollary. If money management has the effect of reducing interest rates below the level they otherwise would have attained it should be interesting to examine the results of such management on life insurance.

The first thing that a life insurance company has to face is the investing of new funds at abnormally low interest rates. Where short term securities are selected the yield will be in many cases below the normal basis used in computing premiums. Where long term investments are made, the low yield spread over long periods may make the results of life policies seem unattractive in comparison with the results accruing in the future from other financial enterprises dependent upon short terms and conducted when interest is higher. Always in the wake of a low interest level comes the exercising of the privilege of calls whereby interest rates which were not excessive on long term averages are reduced to a much lower level. As large holders of bonds and preferred stocks life insurance companies suffer to the benefit of the shareholders.(5) Refunding of issues by call distributes the earnings of industrial corporations in a different proportion between shareholders and bondholders from that which was originally intended.

In times of depression, there is always a feeling by the public that interest rates are exorbitant. A growing indifference with respect to interest commitments arises and all in all the public mind becomes obsessed with a low interest complex. Life insurance as a financial institution which depends in considerable degree upon fair interest returns over long periods is bound to suffer. It becomes the job of the life insurance companies to convince their policyholders that interest is fundamental in the existing economic order and can not be reduced, raised, or even wiped out at will with beneficial results. If political bodies try to determine and set the interest rates in the future it would be hard to predict a trend or the future of life insurance.

The arbitrary lowering of interest rates by governments is usually done for the purpose of saving the country money in the face of huge expenditures for relief, public works etc. The idea behind the reduction of interest rates beyond that point which would be reached if natural tendencies were allowed to function is quite sound but remains so only as long as a proper method of procedure is taken to accomplish the end in view. The basis upon which arbitrary reduction measures can be justified is inability to pay. From this it would follow that the principal of the debt has become intolerable as well as the interest. Obviously, a reduction applied to the principal could only involve general distress, and injustice with the added result of a tendency for all classes of debtors to follow suit.

An arbitrary reduction in the interest rate affects no two creditors or debtors the same way. The creditor who has an obligation that extends for a long term into the future is most noticeably affected, while in the case of another creditor where the obligation is only for a short period a reduction means little. Similarly, a debtor whose obligations mature in a few months would receive little benefit by a reduction as compared with one whose obligations do not mature for many years. Injustice is bound to result if such measures are used as a corrective for an assumed dislocation in some other part of the economic system.

A system of interest reduction by voluntary conversion is theoretically sound but as a general policy it is quite useless. Government issues are really the only ones which could be converted in such a way for most people would not have enough faith in other enterprises. Many bondholders would be willing to accept such a plan but because of their obligations to their own creditors they would feel that they could not do so. All loan, trust and life insurance companies would be in this position.

The only sound method of lowering interest rates through debt conversion is that which allows the debtor whose credit is good to retire maturing or callable obligations and refinance at lower terms. This method allows the natural law of demand and supply to work out the proper interest rate without disturbing any other factors which are important to its functioning.

Interest reduction plans are usually aimed at the wealthy, but in all probability people in moderate circumstances are just as much affected. In the case of savings banks, reduction in interest is always passed on to the depositors whether the accounts are large or small.(5)

Most of the savings of the people today are administered by trustees or other fiduciary agents. Persons looking to life insurance for support, whether they be policyholders or beneficiaries are naturally, greatly affected by a low interest rate. If the policies contracted for by these people are on a guaranteed income basis they stand to gain, but if on the other hand they are on a lump sum basis, the possibility of reinvesting looks anything but inviting. Concomitant with a period of low interest rates is usually a low price level which naturally increases proportionally the purchasing power of the monetary unit. Of course, the beneficiaries of life insurance policies and owners of matured policies gain, but persons still buying insurance find that the cost of insurance has risen unless a great improvement in mortality has occurred.

A reduction in the interest rate is followed by a shrinkage in the volume of new opportunities for investment. Issues of industrial companies become scarce; investments in mortgages are curtailed because of the fall in property values and also because of government interference which restricts the rights of mortgagees.(7) The result of this development in the investment market on life insurance is a marked increase in bond investments which is usually most pronounced in the field of government bonds.(8) Government bonds offer the greatest amount of security and as the main principle of insurance investment is safety the reasons for such purchases are quite obvious.

At a time when the economic activities of a country are depressed it is only natural that the governing bodies should be looked upon for aid. The two main ways a government has of raising money are taxation and borrowing. To place the whole burden on the ability of the people to be taxed would be governmental suicide and consequently loans are usually negotiated. Insurance companies, because of the blockade of nearly all safe and remunerative investment channels are practically forced to invest in government bonds. The sale of these bonds supplies in a period of depression, funds by which a government can try to preserve its country's standard of life and by which it can attempt to stimulate and bring back better conditions.(9)

Time and again, the banks have been the target of strong denunciation for not carelessly allowing their funds to be dissipated in unproductive loans at a time of low interest rates. Similarly, insurance companies could be criticised yet banks and insurance companies are products of staunch conservatism coupled with financial experience and both realize that although their importance in the financial is great, the part they have to play in business recovery cannot be played efficiently alone but only in co-operation with other forces. Both are just links in a long chain of factors and both are able when the proper time arrives to do their part in alleviating distressed conditions without endangering their own or their country's safety. Because of a conservative policy of operation the insurance companies are usually able to give their creditors dollar for dollar with a minimum guaranteed interest accumulation. The result of this is that confidence is instilled in the people to the extent that more and more money is reinvested in life insurance companies. In turn, the companies are able, when the time is ripe, to provide a good part of the necessary capital which will be needed to support a revived investment market in the future.

As trade revives, opportunities for investment become more numerous and demand for capital increases. The natural result of a greater demand for capital is the rising of the interest rate. Public confidence returns, money loosens up and profits can be made both more easily and quickly. The normal reaction to a speeding up of the tempo of living and business is an expansion of new projects and rehabilitation of old. Capital has to be provided to allow these new enterprises to become organized and exploited. These conditions offer to the life insurance companies an opportunity to diversify their investments. It is easy enough to retain security at a time of low interest rates but when these rates are rising the opportunities for speculation would seem most imminent. To protect the public, the governments of both Canada and the United States step in at this point and limit the amount of speculative stocks, both common and preferred, that an insurance company can own. Each stock purchased by an insurance company is subject to strict qualifications and the law pertaining to these is rigidly enforced.

As the rising tide of speculation accompanied by natural inflationary tendencies gathers momentum and swells, the insurance companies add a certain amount of impetus by investing in mortgages, stocks, and corporate bonds. The composition of the portfolio of investments changes according to the needs of the expansion. If railway development takes place to a greater degree than that of industry more insurance dollars will be invested in railroad bonds.

When business conditions begin to improve, life insurance companies find their position in the economic system rather precarious. Speculation and consequent credit inflation start slowly but gain impetus with every business transaction. Psychological factors play a great part in determining and directing the course of business and if these psychological factors coupled with natural trade tendencies become so active as to precipitate a credit inflation to enormous heights, the people who have put their money and faith in life insurance companies have to suffer.

The security market will reveal bonds making a rapid decline in prices as the banks sell their holdings and call the loans secured by them, in an endeavour to obtain liquid resources with which to finance new enterprises at a higher rate of interest on their money. Stocks will be issued and reissued, will be bought and sold at a feverish rate, and soon will assume artificially high prices. Interest rates and the general price level will rise and consequently the value of the monetary unit will decline. Life insurance companies as owners of numerous bonds and few stocks (number to be held limited by law) will suffer from lower income from their investments. The income will not only decrease but will also depreciate in value. The net result of such conditions is that people who once thought that they were secure might possibly find themselves possessed of a bare subsistence income. Depreciation in real income is bound to make itself felt. Thus, insurance in essence is a poor hedge against inflation.

Investments in mortgages might act as the only possible means for alleviation of such conditions but even here, if an insurance company is to follow its investment principles of marketability and security, too many mortgages, no matter how good they may appear or how high returns they may offer, should not be purchased.

Currency inflation, when it reaches the feverish height it did in Germany after the great world war completely obliterates all the savings of rich and poor alike. Insurance companies, banks, trust companies etc. are all undermined. Disorder and disaster are rampant. Inflation of this type is usually the counterpart of some other major catastrophe, as was the case in Germany. It is not to be expected that any such wild uprising will be experienced in the United States or Canada because 1. These countries are practically invulnerable to threats of war 2. A reasonably sane democratic government is the order in both countries. With reference to the second point, it cannot be too frequently stressed that if life insurance companies desire to maintain themselves in a fairly sound economic position, they will ever have to aid in fostering good and sound governmental policies. In Canada, roots of radicalism have already taken form in the western provinces and insurance companies should make it their job, if they are to be sure of surviving, to help in preventing further outbreaks in such directions.

REFERENCES FOR CHAPTER IV

(1) Proceedings of the Insurance Institute of Toronto - 1932-33 Suggestion with qualifications made by E. C. Gill during an address to the institute.

(2) Canadian credit has been severely injured due to the actions of two more or less radical premiers in defaulting on bond contracts. The Dominion government bonds, although still considered secure, have declined in price.

(3) These points were put forth in an address by E. C. Gill before the Insurance Institute of Toronto - March 16, 1933.

(4) In Canada, the investments by Canadian Life Co's in government bonds were in the years 1929, 1931 and 1934 respectively 6.1 million dollars, 27.7 million dollars and 75.7 million dollars. Abstract of Statements of Insurance Companies in Canada.

(5) At the end of September 1935, 91.6% of the United States legal reserve companies owned approximately 5.8 billion dollars worth of industrial bonds and preferred stocks - Life Insurance Year Book of the Spectator Company 1936.

(6) Bank interest has declined from 3% to 1½% in the past 8 years.

(7) Mortgage moratorium laws designed for debtor relief were enacted in the United States during the last depression.

(8) Approximately 5.1 billions of dollars were invested in government bonds by 91.6% of legal reserve companies of the United States in 1935. This accounted for 22.7% of the total assets. In 1929, only 7.9% of total assets were government bonds. - Life Insurance Year Book of the Spectator Company 1935-36.

(9) By means of public work campaigns, relief measures, etc.

WHITHER LIFE INSURANCE?

CHAPTER V

The present economic system came into being gradually and naturally. It did not spring from the brain of some great thinker. At all times it has expressed the innate desire of man to acquire freedom, individuality and at the same time security. The efforts of mankind have been encouraged by such rewards. The economic system has done much for man especially during the era in which it progressed and developed most rapidly, namely the last one hundred and fifty years. Comforts, conveniences, and luxuries, have been added to the bare necessities of life. Mal-distribution of such goods and services has always been a stock criticism of the system and although the methods of distributing the abundance are anything but ideal, the standard of living of all people in Christianized countries has been raised many times over and again in the last century. The masses are still not completely sure of security and peace of mind and until some definite plan is formulated whereby they will attain freedom combined with complete social security, they will not be satisfied. Some means have to be found to remove seemingly gratuitous relief measures so that reasonable opportunity can be given to every able citizen to exercise the natural desire to work and produce.

State governed social security plans seem to be a means to the required end but are they enough and can they be properly administered? Louis Waldman in an essay on Government Responsibility for Workers,[1] outlines the needs for Social Insurance and the risks to be covered. He lists five major risks that should be covered by a social security program. These are namely 1. Unemployment 2. Invalidity and illness not covered by compensation laws 3. Old age 4. Maternity insurance and 5. Death. The institution of life insurance as it exists today has the answer to at least three of these problems. Unemployment insurance is at present out of its field but even maternity insurance might be embraced in its fold if properly handled.

Since Mr. Waldman's writing, President Roosevelt has inaugurated a nation wide scheme of social insurance in the United States. Just what this plan means to the security hungry masses of the United States is quite startling and not altogether consistent with the plan Mr. Waldman would have inaugurated were he the host at Washington's famed white house. The real interest in this social insurance program from the point of view of this thesis is the effect it will have on the future of life insurance.

Under president Roosevelt's Social Security Act, unemployment, old age and life insurance are compulsory for all wage earning employees. There is to be a direct tax on payrolls, or productivity of 9 percent. Under the act there is to be a 50 billion dollar reserve fund of government bonds built up the interest on which at 3 percent will be 1 billion 500 million dollars annually.(2) This interest can only be paid by means of increased taxation and will quite possibly bring the levy on producers up to 10 or 11 percent. No one can escape taxes, whether they fall directly or indirectly. Whether this increased burden of taxation will somewhat stifle economic initiative is yet to be seen. The old age and death benefits are really the points of interest in this discussion, however, and should now be analysed.

Under the pension provisions of the act, monthly benefits will be one half of one percent of total wages with a minimum pension of $10 per month and a maximum one of $85 per month. (3) A person to secure the top pension must earn, for example, $250 per month for 45 years. Thus, workers of the present generation will receive but little benefit from the act. The average pension will certainly be less than $50 per month, not enough to insure complete economic freedom and security. A man must quit work to draw the pension even if he is hale and hearty. Hence, the scheme will be of little value to energetic men earning $15 a week or more at the retirement age.

Even if a man lives to be 65 (the retirement age) and draws his pension, he will not be a very great winner. The American mortality and life expectancy tables show, that men of 65 live an average of 11 years more. If a man has worked steadily for 30 years at an average salary of $125 per month, his pension will be $50 a month. If he lives the expected 11 years his total receipts from the government will be $6600. His direct contribution to the old age pension fund at 6 percent will have been $2700, while indirectly he will have contributed through increased taxation about another 5 or 6 percent, let us say roughly $2000. In all, his contribution will have been $4,700. If loss of interest is calculated at least $1500 or $2000 should be added to that figure. By putting his money in life insurance old age pension bonds he could actually buy much more social security. $150 a year will purchase for a man today an income of $50 per month at age 65 through any legal reserve life insurance company.

Under the new United States plan, if a worker dies before he reaches the age of 65, his estate will be paid $3\frac{1}{2}$ percent of the total wages that he had received. That represents only a little more than half of the money paid in directly, excluding interest. Since the mortality tables show that 40 out of every 100 workers die before they attain the age of 65 it means that more than 1/3 of the persons included under the scheme will leave their beneficiaries only part of what money they have paid in. For the average worker, the chances are 60 to 40 that he will live long enough to get benefits (such as they are) in his old age. Life insurance on the other hand assures payment of face value of the policy at death and in the case of pension bonds all money plus interest earned is refunded at time of death. It is true, however, that the social security act is intended for the masses and not the classes. In this respect it must be admitted that the average death benefit from an industrial policy ranges only between $225 and 250 dollars. The other side of the story is that because of the social security act, the ignorant masses are liable to assume that they are well protected and let it go at that, while with individual initiative and energy behind the sale of each privately administered policy, the only result can be to educate the people to more and more insurance till finally, it is sincerely hoped that, all industrial wage earners will be able to afford $2500 protection instead of $250. Group insurance administered by private companies is paving the way for more and more protection in the lower bracket wage earning class.

Thus, it will be seen that the United States' plan of old age pensions and life insurance will provide protection against little more than hunger and need of bare necessities. In no manner or form can the act be a substitute for individual thrift; in fact, because of the increased tax burden the need for thrift will be as great if not greater than before. The act, however, should be indeed a great educator amongst the masses in thrift, and even though the benefits are not just what they might be, they will at least keep the United States labour propulation conscious of thrift. Life insurance companies have been preaching and teaching systematic thrift for many years now, and, because of the establishment of the security act in the state, should not by any means fade out of the picture. Hand in hand they should work with the new legislative powers perpetuating as ever before that old slogan of theirs "save and be safe". Only about one half of the United States' total gainfully employed workmen are covered by the act. Owners of businesses, operators, professional men, self employed, farm labour, domestics, teachers, governmental workers, and institutional workers are not reached by the act. This type of business represents about $\frac{1}{2}$ to $\frac{3}{4}$ of the present insurance coverage and only the industrial companies will have reason for complaint. But even here, there is no reason why the companies should lose business, for proper interpretation of the act should and will most likely lead to not a lessened demand for life insurance but an increased one. The Social Security act falls short of doing a complete job when contrasted with the service rendered by life insurance. People must be made to see that life insurance is still needed to supplement and enlarge what would too often be inadequate protection derived from the social security act alone.

In Canada, social insurance legislation enacted by The Right Honourable R. B. Bennet was thrown overboard when the supreme court of Canada decided that it was ultra vires of the constitution late in 1936. Perhaps it was just as well, for after the glaring example of incompetency of a government to handle an annuity scheme for its people, the other act might easily have led to dire consequences, unless more efficiently administered.

The Canadian government system of annuities has been operating on mortality tables based upon annuities experience in Great Britain from 1863 to 1893. The life span has lengthened since then and the tables are quite inadequate, with the result that premiums charged were much below actual cost. The government has never administered the system in a proper manner and premiums have been used to defray annual expenitures and the balance treated as ordinary revenue. Mr. Watson, the government actuary advocated in 1936 a 25 percent increase in rates to make the system self sustaining.(4) At the close of the 1935-36 fiscal year the position of the government scheme was as follows:(5)

Annuities sold	29,093
Total Receipts	$78,001,491.74
*Liabilities	$66,835,000.00

* No reserve value whatsoever set up against liabilities.

Administration of this sort would hardly seem fair to that congenial fellow the taxpayer.

In the operation of life insurance today a high degree of administrative skill is combined with long experience and the funds of the policyholders are protected against unnecessary abuse by means of governmental supervision. Life insurance has developed as a voluntary, constructive form of social security within the state.

State social security, when carried to the limit, promises as much to the idle as to the thrifty. To allow a theoretical social security to replace a time tested institution means the banishment of all destinctions based on work and economy, substituting therewith a levelling down to socialism. If taxation preys on production and if existing accumulations of capital are depleted every time they change hands, then it is only a matter of waiting till private capital is a thing of the past.

Man as yet has never got beyond the need for reward in return for effort. It would seem to be the only effective way of promoting employment and achieving the highest possible standard of living. That applies to saving and investing as well as work. It is in the obvious limitations of governmental schemes, in that they usually do not aspire to more than mere subsistence levels, that one is able to find the future of life insurance. Communism has never been more than a theory and the socialistic plans have never accomplished more than a feeble redistribution of wealth. Russia is slowly wending its way back into the capitalistic order of things; citizens are being stimulated to greater efforts by extra rewards, contrasting standards of living and social status.

Herbert Hoover, former president of the United States of America is quoted as once having made this statement. "Success in life is not to be gained by leaning upon the government to solve our problems. That way leads to enervation of will and destruction of character. We must fight our own battles, solve our own problems, and endeavour to be masters of our destiny in the struggle of life". (6)

Before complete realization of the true greatness of life insurance can be accepted by all and sundry a new system of marketing its product will have to be established. The selling of life insurance will have to become a career and not a fly by night proposition. In the past, life insurance companies have insisted too much upon number of agents and quantity of business rather than on quality. To properly achieve its desired end, life insurance will have to be placed on a professional basis. A true concept of life insurance will, in time to come, be worth more to the companies, to the public and to the men selling it, than is perhaps now realized. The sooner life insurance companies can get away from a cut throat commission basis of doing business with the man on the street, the better off they will be for this type of marketing results in much illegality, misrepresentation and hard feelings. Training and education can solve the marketing problem and until measures are taken to affect such changes in the business 100 percent confidence of all of society cannot be claimed. As it is today, millions of persons place their faith in life insurance companies, but a great percentage of these are more or less ignorant as to why they do so.

Life insurance today is a sound financial bulwark of society. Its history has afforded it the trials necessary to readjustment of its course of action; its management has developed into a prudent and wide course of enterprise; its function is worthy; its principle is faultless; and its economic importance is undeniable.

In concluding, a quotation from a speech made by a Mr. Conway, in an address on "Investments of Insurance Companies" at a Toronto Convention of Insurance Commissioners held in 1929.

"The people have made a part of their lives the thought upon which they are acting in implicit confidence, that at death their insurance will be paid to their survivors without any possibility of default. They have come to believe that the payment of life insurance at death is as certain as that the sun will rise tomorrow." (7)

It is from such a statement as this, that one can deduce the fact that life insurance is today built upon the confidence of the people. As long as that confidence can be warranted and retained, life insurance should live indefinitely.

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