CODIFICATION OF LIFE INSURANCE LAWS: REPORT OF HEARING ON THE COMMISSIONER'S REPORT BEFORE THE JOINT COMMITTEE ON INSURANCE

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Codification of Life Insurance Laws: Report of Hearing on the Commissioner's Report before the Joint Committee on Insurance by Various

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HEARING.

BOSTON, Feb. 16, 1887.

The Committee met at 10.15 A. M., Senator PHILLIPS presiding.

The CHAIRMAN. The hearing this morning is upon so much of the Commissioner's report as relates to the subject of life insurance. I understand there are several gentlemen here from out of the State, and unless there are objections, the chair will give them an opportunity to be heard first. If there is any gentleman present especially representing any foreign company, or any company not chartered by the Commonwealth, we will hear him first.

Mr. PUTNAM. I appear here as counsel for the Connecticut Mutual Life Insurance Company. I have only to say that Colonel Green, my client, is here, and he can say to the committee all that I could wish to say; and I would ask the committee to hear him immediately, and to permit me to be at liberty to say anything further hereafter that I may have occasion to. May I ask if the Commissioner will be here?

The CHAIRMAN. Whatever remarks are made to the committee will be taken in shorthand, and the Commissioner will have an opportunity to look them over afterwards.

Mr. PUTNAM. It is to be regretted that we cannot have his presence, because it might save a great deal.

REMARKS OF MR. JACOB L. GREEN.

Mr. Chairman and Gentlemen: — The portion of Mr. Tarbox's report to which my own attention has been particularly called is contained in an extract from his preliminary draft, containing six sections. I do not know whether they are numbered in this draft in the way that they are in his full report or not. I have not compared them, and I do not know. But not having the report in full, and not having examined it, I will speak to this draft, which I suppose covers all that is of importance for companies of other States to consider in this connection.

The CHAIRMAN. Do you know that to be included in the new law as reported by the Commissioner?

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Mr. GREEN. I received it from Mr. Tarbox as a portion of the report, together with a circular inviting comment; and after the receipt of such comments as I made to him, he wrote me that this had been included as it stood, without change, in his report, so that I suppose it must be.

The CHAIRMAN. Of course the committee will want to be satisfied upon that before they go on and hear any remarks upon that draft.

Mr. PUTNAM. I will say for Colonel Green as to a portion of his remarks, and as to one of the sections included in this extract sent him by Mr. Tarbox, that a portion of it is to be found at the end of section 11, relating to the valuation of the assets of life companies. That, I think, cannot differ materially, although I have not seen the extract. You may take this full report. (Copy of the report handed Mr. Green.)

Mr. GREEN. On page 6 of Mr. Tarbox's report, under the head, "Valuation of Life Assets of Life Companies," his proposed draft reads:

> In valuing the assets which compose the legal reserve of a life insurance company, the real estate, the bonds and stocks shall be taken at such a value that the average annual income thereof shall be not less than four per cent. of the valuation; and if any asset or investment is conditioned upon a rate of interest, or is actually producing an average income of less than four per cent. annually, such asset of investment shall be rated at its value, considering the actual income and time it has to run, as the equivalent of a four per cent. investment; loans and credits shall not be allowed for more than their face value, nor shall any asset or investment be appraised for more than its market value. This clause shall take effect on the 31st day of December, 1889.

In other words, whatever may be the market value of a stock or a bond held by a life insurance company, it is to be valued upon a four per cent. basis, on the assumption that it is to net four per cent. to the holder, if it be a bond, if held through to maturity. This section evidently contemplates that the companies are now holding, or are coming to hold in the future, a considerable and an important amount of bonds or stocks, which will not produce as much as four per cent. interest upon the value they may have in the market. And that is, undoubtedly, if the rate of interest tends as it has for some time, a true assumption. Indeed, some of the companies already hold assets which will not net at present prices three per cent. Government bonds will not net now three per cent.; there are others which will not net four per cent. This draft proposed to cut off all market value above that which would be warranted by the earning of four per cent. interest, if the bond be held through to maturity.

This is an arbitrary reduction of the actual resources and assets of a life insurance company. The law, on the one hand, makes a quite arbitrary limitation of a company's liabilities. It requires all companies doing business here to compute their reserve upon the assumption of earning four per cent. interest; it does not allow them to take into account any margin upon their premiums, which they may have over and above expenses and contingencies, and compels them to use in their calculation only net premiums, the premiums computed with sole reference to the questions of mortality and interest, and the assumption of interest at four per cent. That is not a commercial valuation; it is not in any true sense a fair and true valuation of a company's liabilities. But we are accustomed to it, and it has so far brought no mischief, and, practically, will work none. We should not lose sight of the fact, however, that it is arbitrary and rule of thumb.

This bill proposes to introduce, on the other band, a like arbitrary element, and compel the companies to disregard so much of the value of their assets as is above a certain arbitrary basis. To show its exact operation, I will take an illustration.

Suppose a company has a reserve to-day of $1,100.000. (I take these figures because they happen to be convenient for comparison with certain other figures used in the making of the comparison.) Against this reserve is the liability of the company. Suppose against this reserve they hold bonds of the par value of $800,000, bearing eight per cent. interest, and that these bonds have now ten years to run. The company, we will say, bought these bonds five years ago, when they had fifteen years to run. and it bought the bonds on a five per cent. basis, that is, to net the holder five per cent. at maturity. The company, that is, five years ago, paid $131.40 for the bonds, or a gross sum of $1,051,200. Now, to-day those bonds will sell in the market on a three per cent. basis; that is, they will sell at $142.92, or for $1,143,300. That gives the company a surplus of $43,300 above its liability in an asset of undoubted value, which it can sell to-day and convert into other assets bearing such rate of interest as the market will warrant.

This bill as proposed would compel this company to value that asset on a four per cent. basis, and on that basis its value to-day, instead of being $142.92, would be $132.70, or, in gross, $1,061,600. So that by that valuation at four per cent., instead of the actual selling value of those bonds, the company, instead of having a surplus of $61,600, would be bankrupt by the sum of $38,400, and to be put into the hands of a receiver, under the operation of your statute. I think that statement can need no comment whatever. It certainly cannot be impeached.

But take another view of the case. If the actual rate of interest should fall below four per cent., the proper action to be taken would not be a valuation of the assets on an arbitrary basis, upon an arbitrary rate of interest, but a computation of the reserve, a computation of the liabilities of the company, upon a rate of interest which more nearly represented the actual rate. That is to say, if the companies are not going to be able to earn four per cent. interest, do not compel them to value their assets on a four per cent. basis, but make them compute their liabilities on a basis below four per cent., three and a half or three per cent.

Now, take a company representing a given amount of insurance, say ten millions of insurance, written at various ages, which shall be so distributed in kind and in age as to be what we may call a model office. At the end of five years that company's reserve at four per cent. would be $72,007. At three per cent., if it computes its liabilities on the assumption that it is only going to earn three per cent. interest, its reserve would be $81,262. That is, it would be $9,255 higher than on the four per cent. basis. Now, if instead of requiring that company to reserve at three per cent., you value its assets on a four per cent. basis, you will require, as you will see at once, that company, instead of holding $100, to hold $133.33⅓. Suppose the company's assets to be earning only three per cent., and you value them on a four per cent. basis, on the assumption that they must produce four per cent., then you compel the company to hold $133.33⅓ instead of $100, because it takes $133.33⅓ to earn four per cent. on $100.

Now, then, this bill would compel the company which had a four per cent. reserve of $72,000 to hold assets, on the arbitrary valuation, of one-third more. That is, it would have to hold $96,009 as against its four per cent. reserve of $72,000. But if the company reserved on a basis of three per cent., its reserve would be only $81,262. That is to say, valuing the assets on a four per cent. basis, instead of your liabilities on a three per cent. basis, would compel your company to hold, to meet the requirements of a four per cent. reserve, under such a valuation of assets, $15,000 more than a three per cent. reserve.

That is the absurdity of the proposition, pointing clearly to the fact that the way to treat this matter of a fall in the rate of interest is not a valuation of your assets by an arbitrary standard, but a change in computing your liabilities in the rate of interest to be earned.

Now, I will make a case directly in point. In 1882 the Connecticut Mutual changed its assumption of interest to be earned in the future from four per cent. to three per cent. on its new business. All its policies written since that time are based, as to their premiums and their reserves, upon the assumption that we are to earn three per

cent. interest. Now, our reserve on the three per cent. standard on these policies is $1,594,605. The four per cent. reserve, the liability on these policies in this State, and in Connecticut, too, is $1,366,468. That is to say, our three per cent. reserve is $283,237 higher than the four per cent. reserve. This bill would compel us to add to our assets, held to meet this four per cent. reserve, one-third of the reserve itself. That is, by this valuation of assets, in order to meet the four per cent. reserve of $1,366,468, we should have to add to our assets one-third, $455,489, making a total of actual assets against that reserve of $1,821,957, which is $272,352 more than the three per cent. reserve itself.

I can add nothing to such a statement as that except this general comment upon the proposed bill, that it seems to assume that there is no one in charge of the affairs of these companies who understands the business of investment, or who is supposed to watch their interests, and to make such changes in the investments as the times, the rate of interest, and the exigencies of the company, its liability under its contracts, would seem to warrant. In other words, it seems to me a case of socialism pure and simple, — the interposition of the power of the State, wholly regardless of what individual ability and fidelity and experience and wisdom may be able to accomplish in the management of a company's affairs. But the conclusive thing is as I have stated. The right way to meet the interest question is in computing liabilities, and not in an arbitrary valuation of assets which would require a company to hold assets largely in excess of a three per cent. reserve, in order to meet the requirements for the smaller four per cent. reserve.

The next section in this preliminary draft is section 68, on page 39 of Mr. Tarbox's report; concerning that, I will not take the time of the committee. Section 69 is not included in the preliminary draft I have, and I care nothing about it. It forbids discrimination between persons of color. I am unable to understand any reason for such an act. Certainly no company would undertake to make, or ever has undertaken to make, so far as I know, any discrimination as to premiums to be charged to persons according to color, race or condition. The only question is that of physical soundness, and color does not enter into the question of premium, but, as far as it may, and actually and properly does, into the question of physical condition, actual risk. It is not a question of premium, but a question of the propriety of insuring such persons. In other words, it is a pure question of selection, and not a question of discrimination in premium or in benefit in any way whatever.

The Chairman. That is a copy of the present law, I suppose?

Mr. Putnam. I believe Mr. Tarbox himself in his report does not favor that section, on the ground that there is a real difference between the longevity of the two races.

Mr. Green. I next refer to section 73, on page 40, of the report, and call attention particularly to the latter part of it,— the first part of the section I do not care to speak about: "The person effecting such insurance may by deed in his lifetime or by his will designate or change the beneficiary to whom the proceeds of such insurance shall be payable." That clause enables any person who is named as the original beneficiary in a policy to create in some third person an interest in that policy, a legal estate in it, which is in contravention of the principle of indemnity, and may make a purely speculative contract. We know it is the principle which has been always followed very closely in fire insurance, and almost as closely in life insurance, that no person should have an insurable interest where he was not liable to damage by the happening of a particular event insured against. One is not allowed to have a pecuniary interest in the burning of a house, unless he stands to lose by the burning; nor to have a pecuniary interest in the cessation of a life, unless he stands to lose by the cessation of that life. Otherwise there is a direct pecuniary temptation of benefit to accrue from the destruction of the property, or the destruction of the life, which is contrary to public policy and to public morals.

This clause would allow the beneficiary of any policy to assign it to a wholly indifferent person, one who had no interest whatever in the life insured, and who would thereafter have a direct interest, a direct pecuniary gain, depending on the cessation of that life. As the law now stands everywhere one can assign policies, which are by their terms properly assignable, to secure a debt due from the person whose life is insured, and if the debt be transferred the assignment can be transferred; that is to say, the indemnity follows the danger. And that principle, I submit, should never be lost sight of, should never be departed from in any degree. This clause is, I think, a clear departure; it is a complete divorce from that principle of indemnity, and admits at once the element of speculation upon lives in which one has no insurable interest whatever, because standing to lose nothing by their termination.

The Chairman. Have you any amendment or suggestion to propose to this section?

Mr. Green. By my recollection of your Massachusetts law I should say that it required no change whatever in this respect. I have not examined the first part of this section to see how it compares with the present law; my impression is it is the same. But the clause which I have read, and all that follows it, I would strike out entirely.