Assets of U. S. Life Insurance Companies

March 31, 1959

bil. $

40

35

30

25

20

15

10

5

0

U. S. Corp. Stock

Real Estate

All Other Govt. Securities

Policy Loans

Other Assets

U. S. Government Securities

Mortgages

U. S. Corporate Bonds

Life Insurance in Force in the United States *

bil. $

500

450

400

350

300

250

200

150

100

50

0

Credit

Industrial

Group

Ordinary

1940

1945

1950

1955

1958

* With legal reserve companies.

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200 Years of Life Insurance

". . . in this world nothing is certain but death and taxes." So wrote Benjamin Franklin 170 years ago, and few people have had cause to quarrel with his observation. Life insurance companies are prepared to go even further and argue that the time as well as the certainty of death is predictable.

A NEW TWIST TO AN OLD ADAGE Here's how their version of Mr. Franklin's principle works. They know, of course, that they can't pinpoint the date any particular policyholder will die, but they have found that they can estimate quite accurately from mortality tables how many policyholders of each age will die every year. Consequently, they know in advance about how large their total benefit payments will be. The time of death—a major uncertainty for an individual—thus becomes a certainty for an insurance company.

All a company has to do is set premiums at levels that enable it to cover these predictable risks. Policyholders who die prematurely get their insurance at a bargain. Those who live a long time pay part of the insurance costs of those who are not so lucky. The group as a whole about "breaks even" if the mortality assumptions are correct.

In the process of providing death benefits, life insurance companies accumulate vast amounts of "policy reserves" by charging premiums that exceed the cost of benefit payments during a policy's early years. These reserves—which are not needed until the benefits fall due—are invested, and the income is used mainly to reduce the net amount of premiums a policyholder must pay. Such earnings represent "interest" on the policyholder's savings—the amount of reserves back of his policy.

Each class of policy involves different degrees of saving for the policyholder. Endowment insurance—the kind that matures at death or at the end of a specified period if the policyholder still lives—is mostly savings since provision must be made for pre-death benefit payments. Twenty or thirty year limited pay life also has a high percentage of savings since premiums can be collected for only a few years. Straight life represents still less, and so on down the line to term insurance—the kind that lapses at the end of a designated period. Even term insurance is partly savings, however, since its equal or "level" premiums more than cover policy benefits during early years.

A REAL SUCCESS STORY Only 200 years have elapsed since the nation's first life insurance company, "The Corporation for Relief of Poor and Distressed Presbyterian Ministers and of the Poor and Distressed Widows and Children of Presbyterian Ministers," opened its doors for business. The number of companies has since skyrocketed to over 1,300, assets have climbed to \$109 billion, and investments have topped \$104 billion. Measured by total assets, life insurance companies are now half as large as all commercial banks, twice as large as all savings and loan associations, and three times as big as all mutual savings banks. Sixteen life companies have resources exceeding \$1 billion, and eight of these have more than \$3 billion. The largest—the Metropolitan—has \$16 billion and holds down the runner-up spot among the nation's largest corporations. The Prudential's \$15 billion makes it the country's third largest business.

As indicated in the accompanying chart, Americans at the end of last year had nearly half a trillion dollars' worth of life insurance with legal reserve companies—the ordinary type of insurance company. Insurance with fraternal societies, the U. S. Government, mutual savings banks, mutual aid groups, burial funds, and the like, totaled another \$55 billion.

WHERE DOES THE \$109 BILLION COME FROM? Such success naturally raises this question: Where do insurance companies get such tremendous sums of money to invest? The answer is quite simple. Practically all comes from one source—policyholders' savings in the form of policy reserves. At the end of 1958, such reserves totaled nearly \$90 billion—82% of all company liabilities. Net worth—typically unimportant for life insurance companies as for most other savings institutions—was just 8% of liabilities. Companies also obtain limited funds from such sources as bank loans, dividends accumulating at interest, and amounts set aside for policy dividends.

WHO BORROWS FROM LIFE COMPANIES? Because benefit claims are fixed in dollars, safety of principle must be the companies' prime investment objective. Certainty and stability of income come next since a fixed return is assumed in computing premiums. Within these limits, companies aim for maximum investment income compatible with sufficient liquidity to meet maturing claims.

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These sorts of objectives dictate that companies lean heavily upon fixed income obligations. Their favorites are U. S. corporate bonds and mortgages, as indicated in the accompanying chart. Together these total nearly 73% of assets—much, much more than their 7% in Government bonds. Investments also include municipal bonds, foreign stocks and bonds, real estate, corporate stocks, and similar investments, but none of these runs as much as 4% of assets.

HIGHER EARNINGS HELP POLICYHOLDERS Last year U. S. life companies netted 3.85% on their invested funds before Federal income taxes—the highest rate earned since World War II. Earnings have now risen for eleven straight years as a result of the general uptrend in interest rates and heavier emphasis on higher yielding investments.

No matter how you figure it, high income spells good news for the companies' 112 million policyholders. The more earned on company investments, the less a customer must pay for death protection. He gains either through a lower initial premium or through a premium kickback in the form of larger policy dividends. It's that simple.

COMPANIES, POLICIES, AND POLICYHOLDERS Life insurance companies come in all sizes but in only two basic types. About 38% of the $494 billion of life insurance in force is with stock companies—ordinary business corporations owned and controlled by regular stockholders. The rest has been sold by mutual companies—corporations in which ownership and control is vested in the policyholders themselves. Most of the largest companies are mutuals, but stock companies at mid-'58 outnumbered mutuals 1,158 to 156.

Policies are either "participating" or "nonparticipating." Participating policies—the kind usually associated with mutuals—frequently carry higher initial premiums but return part of the premium as policy dividends based upon actual mortality and investment experience. Stock companies almost always write nonparticipating insurance—policies that fix the premium in advance and pay no policy dividends. A few companies sell both types. In some cases, nonparticipating insurance turns out to be cheaper; in others, a participating policy is a better buy for the same coverage. No one can tell at the time of purchase.

Policies come in all shapes and sizes. Basically, there are four types: ordinary, industrial, group, and credit. Ordinary—the kind most people have—is the typical $1,000, $5,000, or $10,000 term, straight life, limited pay life, or endowment policy with monthly, quarterly, semiannual, or annual premiums. Industrial insurance comes in small denominations with weekly or monthly premiums usually collected at the insured's home by an agent. Group insurance covers a number of people—usually employees, union members, or similar groups—under a single policy issued without medical examination. Credit life insurance is individual or group term insurance sold borrowers to cover loan payments in event of death.

John Q. Public is very much life insurance-minded. At last report, he was sinking nearly 4% of his after-tax income into premiums—the highest percentage since 1941. Over 70% of the population was insured at the close of 1958, and it is estimated that six out of every seven families had one or more members owning insurance. Average policy sizes ran: industrial, $380; credit, $610; ordinary, $3,220; and group, $3,740.

SOME ASPECTS OF REGULATION Life insurance companies are regulated from head to toe. The Supreme Court has defined the sale of insurance over state lines as interstate commerce, but so far most regulation has been by the states.

Regulation covers the licensing of companies and agents, incorporation, business practices, methods and assumptions used in calculating reserves, permissible investments, and many other phases of insurance operations. Life insurance companies must file detailed reports of operations, and their records are periodically examined by representatives of the insurance supervisors of the states in which they sell insurance.

SOME JOHNNY-COME-LATELY DEVELOPMENTS Congress has just hiked companies' Federal income taxes by about 60%. The regular 52% corporate tax rate still applies, but a higher percentage of companies' investment income and about half of their previously exempt underwriting profits are now subject to tax.

A recent New Jersey law permitting the sale of variable annuities also has the industry in a stir. Variable annuities—touted as a form of inflation hedge—offer a holder payments fluctuating with the value of stock investments back of his policy instead of the fixed dollar payments of an ordinary annuity. A few small companies are already legally selling such policies in scattered states but without specific legislative sanction. One fairly sizable organization—The College Retirement Equity Fund—has been selling variable annuities to college and university employees for several years.

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