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Article abstract

Comme suite à une très intéressante étude sur la nouvelle loi fédérale des assurances, parue dans le numéro de janvier 1978 de notre Revue, M. Colin E. Jack a bien voulu faire une recherche spéciale permettant de voir la portée des dispositions nouvelles sur l'actif, le passif, les placements et le calcul de la valeur mathématique d'une douzaine de sociétés d'assurances sur la vie d'allégeance fédérale. C'est son travail que nous donnons ici. Nous l'en remercions. G.P.

Life company statements under the new federal law

by

COLIN E. JACK, F.S.A., F.I.C.A.[1]

Comme suite à une très intéressante étude sur la nouvelle loi fédérale des assurances, parue dans le numéro de janvier 1978 de notre Revue, M. Colin E. Jack a bien voulu faire une recherche spéciale permettant de voir la portée des dispositions nouvelles sur l'actif, le passif, les placements et le calcul de la valeur mathématique d'une douzaine de sociétés d'assurances sur la vie d'allégeance fédérale. C'est son travail que nous donnons ici. Nous l'en remercions. G.P.

1. Important amendments were made to Federal Insurance legislation in 1977; an article by the author concerning them appeared in the January 1978 issue of "Assurances". Although passed in 1977, the amendments were not, for the most part, effective until 1978; they are however reflected in the reports to policyholders and shareholders of the companies as of the end of 1978. The purpose of the present article is to compare a number of 1978 reports with corresponding 1977 reports, to observe what effect the amendments have had.

2. The reports of the thirteen largest federally registered Canadian companies (measured by assets) were examined; the amounts of assets at the end of 1978 ranged from approximately $600 million to ten times that figure. All companies, of course, referred in their 1978 reports to the extensive accounting changes required by the new legislation. In many reports this was done at considerable length and with great lucidity. One chairman was critical of the legislation objecting:

   a) to having to show essential safety margins as surplus;

   b) to the concept that part of unrealized gains be treated as income;

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c) to the way in which gains from currency fluctuations are shown as income.

3. In order to obtain an overall view, three combined balance sheets were prepared, one for 1978, and two for 1977 — one restated on the 1978 basis, the other as originally published. As one of the thirteen companies did not restate its 1977 balance sheet, the combined figures cover only twelve companies.

4. There is a belief in some quarters that all life insurance companies are alike. A study of thirteen annual reports will soon disabuse anyone of such a belief. Reports may be of one sheet or twenty pages or more; some are plain, others feature works of art, pictures of Canadian flora and fauna, or portraits of smiling directors, keen-looking senior executives, and happy policyholders and employees. In particular, there is great variety in the way in which they analyze their assets and liabilities. Some adjustments have therefore been made in combining the balance sheets. For example, in cases where mortgages on property were shown as liabilities, the balance sheet has been amended, before inclusion in the total, so as to be presented in the more usual way, that is, with mortgages deducted from the value of real estate. Moreover, care has been taken to try to remove any inconsistencies among the three combined balance sheets caused by companies reclassifying assets or liabilities; any that remain are probably quite small as a percentage of the combined figures.

5. It is of interest to note, when comparing the 1977 and 1978 reports of a number of the companies, that there has been considerable simplification. Most companies do not show separate figures for government and corporate bonds, for common and preferred shares, or for office premises and income-producing real estate. In the combined tables, it is of course, necessary to use very broad groupings, because of lack of a particular detail in one or two cases.

COMBINED BALANCE SHEETS OF TWELVE LIFE COMPANIES (in millions)

	1978	1977	
Assets		Restated	Original
Bonds	\$ 7,423	\$ 6,604	\$ 6,477
Stocks	1,726	1,432	1,402
Mortgages	8,686	7,797	7,807
Real Estate	1,372	1,240	1,271
Cash & Short Term	365	227	227
Policy Loans	1,505	1,399	1,399
Segregated Funds	3,009	2,487	2,487
Other Assets	684	600	538
Total	\$24,770	\$21,786	\$21,608
Liabilities			
Actuarial Liabilities	\$15,729	\$13,947	\$14,836
Segregated Funds	3,004	2,483	2,483
Other Liabilities to Policyholders	2,620	2,281	2,253
Miscellaneous Liabilities	756	675	659
Total Liabilities	\$22,109	\$19,386	\$20,231
Capital	8	8	8
Surplus:			
Appropriated	1,101	1,003	467
Not appropriated	1,552	1,389	902
Total	\$24,770	\$21,786	\$21,608

6. It will be seen that in the course of restatement of the 1977 figures, \$178 million has been added to the assets, a considerable sum, but less than 1% of the total.

   Actuarial liabilities have been reduced by \$889 million (6% of such liabilities or 4% of assets). Other liabilities to policyholders were up by \$28 million and miscellaneous liabilities by \$16 million. The net decrease in liabilities was \$845 million.

   The result of an increase of \$178 million in assets and a decrease of \$845 million in liabilities is an increase of \$1,023 million in surplus, of which \$536 million was appropriated and \$487 million not appropriated.

7. Having reviewed the restated balance sheets very broadly, it may be of interest to look at some of the items more closely. Bond values and stock values are both up about 2%. The extent to which values increased for individual companies depended on how much they wrote down assets as a safety margin, and how much they relied on investment reserves. In most companies values were not changed or changed by very little, but in others there were more substantial changes, as high as 8% for bonds and 10% for stocks.

   Most companies did not change values of mortgages or real estate but revaluations resulted in an overall decrease of about 1% for mortgages and 2% for real estate. There was an increase of \$62 million (11%) in "other assets". This arose from inclusion of certain assets previously not admitted. In this connection, most companies mentioned furniture and fixtures; other categories mentioned are leasehold improvements, advances to agents, loans to staff, and premiums in arrears more than 90 days. Some companies did not change the figure at the end of 1977 indicating that the new policy would take effect from 1978. In one company furniture, fixtures and leasehold improvements are still being written off in one year although computer equipment is written off over a period.

   Among the liabilities actuarial reserves were reduced by almost exactly 6%; the range was from 3.2% to 8.6%. Some companies included provision for excess cash values in the actuarial liabilities while others made provision by appropriating surplus. Further, in some companies, the liabilities include a mortality fluctuation reserve. Other policyholder liabilities were generally unchanged but some changes were made in the provisions for future dividends, and unpaid claims. Much of the increase noted was caused by the establishment in one company of an item of provision for group experience refunds; probably it was previously carried as part of the actuarial reserves.

As regards miscellaneous liabilities, the increase of $16 million seems to be due principally to changes in the method of calculating liability for income tax.

8. From the Annual Reports used, it was not possible to determine the purposes for which various appropriations of surplus were made. Some companies gave detailed information; others gave very little.

It was, however, possible to obtain some very interesting information from figures presented by Mr. R.M. Hammond, F.C.I.A., F.S.A., Assistant Superintendent of Insurance in Ottawa, at a meeting of the Canadian Institute of Actuaries. His figures relate to the 59 Canadian companies registered, with total assets at the end of 1977 (before restatement) of $29,005 million and, at the end of 1978, of $33,276 million. The totals for the twelve companies are about 75% of his figures; the breakdown of the liabilities is quite similar as between the twelve companies and the 59.

9. Mr. Hammond shows that appropriated surplus at the end of 1978 was divided as follows:

Required appropriations		
For investments	10.8%	
For negative reserves and cash value deficiencies	14.6%	
Total required appropriations		25.4%

Voluntary appropriations		
Additional investment reserves	39.4%	
Contingency reserves	15.9%	
Special reserves for foreign requirements	9.8%	
Currency reserve	5.5%	
Group mortality fluctuation reserve	1.9%	
Miscellaneous	2.1%	
Total voluntary appropriations		74.6%
Total		100.0%

Had it been possible to break down the figures for the twelve companies, the percentages would probably have been very similar.

10. The twelve companies had gross income from premiums, investments, etc. of \$6,891 million; net income after payment of benefits, policy dividends, expenses and taxes, but before taking account of non-recurring items was \$242 million.

    Of the twelve companies, which, it wiil be recalled had assets at the end of 1978 of \$24,770 million, four, with assets of \$11,859 million (48% of total) restated their 1977 income in their 1978 reports. Three, with assets of \$4,676 million (19% of total) recalculated 1978 income on the 1977 basis. The remaining five, with assets of \$8,235 million (33% of total) did not provide any comparison, possibly because in the words of one president "the time and effort required seemed better spent on other endeavors".

11. The income of the four companies which restated their 1977 income may be analyzed as follows (in millions of dollars):

	1978	1977 Restated	1977 Original
Premiums	$2,243	$1,854	$1,854
Investment income	888	753	746
Other income	33	27	20
Gross income	$3,164	$2,634	$2,620
To: Policyholders	$2,560	$2,119	$2,143
Expenses & taxes	481	424	420
Net income	$ 123	$ 91	$ 57

Comparing the two sets of figures for 1977, we observe an increase of $7 million in investment income. There is also an increase of $7 million in other income, attributed almost entirely to one company.

There is a decrease of $24 million in amounts paid or credited to policyholders; this is, of course, due to the change in the basis of actuarial liabilities, a smaller amount being established for new business.

The amount of expenses and taxes increased by $4 million. This is the net result of a number of items. In one company, head office expenses were considerably higher, due apparently to the accounting charges for furniture and fixtures; in another, commissions were reduced but operating expenses increased. Provision for income tax was increased in one company but reduced in two. The increase in net income ($34 million) is small compared to the gross income but over one-half of the original net income.

In the three companies which recalculated 1978 income on the 1977 basis, the gross income for 1978 was $1,595 million and the net $62 million. Had it been calculated on the 1977 basis, it would have been only $40 million. Thus again there is an increase of over 50% of the figure on the former basis.

12. Although the new basis for calculating actuarial liabilities has resulted, for 1977 and 1978, in a reduction of amounts credited to policyholders, and thus to an increase in net income, it does not

follow that net income under the new system will always be higher than it would have been had the old system remained in effect. In the first year of a policy the amount put aside is less than was required in the past, but in each subsequent policy years, a little more must be put aside to make up the difference. Further when a policy terminates, the liability released (which is an addition to net income) will be less than under the old system. The effect depends on the mix of business; in inflationary times new business is high relative to business in force; thus, at present, the effect is to increase net income.

13. The investment policy of the companies was expected to be affected by the changes in the law in two ways. First, the accounting and valuation changes reduce the effect of market fluctuations and of sales on company surplus; second, there were some changes in eligibility requirements for portfolio investment, in rules concerning investment in subsidiaries, and in regulations and percentages applicable to investment in real estate.

14. Little can be learned from the comparative balance sheets about the effects of these changes. Time must pass before effects will become apparent. One may note that during 1978, the value of investments increased as follows:

Bonds	12%
Stocks	21%
Mortgages	11%
Real Estate	11%

Thus, except for an increase in the stock portfolio, proportions remained practically constant. In individual companies however, there were some notable changes; one company's stock portfolio increased by 33%; in real estate, two had increases of over 25%.

15. A number of senior investment offices were good enough to give their observations on changes to date and opinions on the future effect. These may be summarized as follows:

Bonds: The accounting changes have stimulated increased trading activity. In one case, it was mentioned that the company is lengthening its portfolio, which, formerly, it was less willing to do, because it did not like to accept losses on sales.

Stocks: Increased purchases are probable but more because of the change in the Income Tax Act than of changes in insurance legislation. An interesting comment was from one company which has for many years related its stock holdings to its capital and free surplus. With a marked increase in free surplus, it will have to modify its position and, although it will probably increase its holdings, they will be a smaller percentage of capital and free surplus than in the past.

Mortgages: It was observed that the requirement of a market valuation and an investment reserve were adverse features but unlikely to have marked effect.

Real Estate: There is agreement that real estate holdings will increase. One comment is that it is now possible to land bank real estate for future development. Another, that joint ventures and co-tenancy agreements with non-financial corporations may be the area of greatest change in the future. Investment in real estate by the medium sized companies may not increase quickly because of the need to acquire "in house expertise". It appears to be probable that companies which have not yet established departments for managing real estate portfolios will be moving to set them up.

16. The author is grateful to those who assisted him by providing reports, in giving their opinions, and in other ways. He hopes that their kindness will be repaid by their finding interest in the information developed.