Assurances

Assurances

Life Insurance and the Problem of Dependency

Arthur Pedoe

Volume 9, numéro 2, 1941

URI : https://id.erudit.org/iderudit/1102963ar
DOI : https://doi.org/10.7202/1102963ar

Aller au sommaire du numéro

Éditeur(s)

HEC Montréal

ISSN

0004-6027 (imprimé)
2817-3465 (numérique)

Découvrir la revue

Citer ce document

Pedoe, A. (1941). Life Insurance and the Problem of Dependency. *Assurances*, *9*(2), 45–55. https://doi.org/10.7202/1102963ar

Assurances

Revue trimestrielle consacrée à l'étude théorique et pratique de l'assurance au Canada

Enregistrée à Montréal comme matière de seconde classe.
Les articles signés n'engagent que leurs auteurs.

Prix au Canada:
L'abonnement: $1.00
Le numéro: 25 cents

Directeur: GÉRARD PARIZEAU

Administration:
Ch. 21
84, rue Notre-Dame ouest
Montréal

9e année MONTRÉAL, JUILLET 1941 Numéro 2

Life Insurance and the Problem of Dependency

by
ARTHUR PEDOE, B.Sc., F.I.A., F.A.S.,
Actuary for Canada, The Prudential Assurance Co. Limited,
Montreal

Much is heard nowadays of the essential democratic nature of the present organization of life insurance in Canada, the United States and Great Britain. The voluntary nature of the system is emphasized. Much stress is laid on the billions of dollars of sums assured representing the provision made by the people for their dependents in the event of early death and for their own old age on survival. The totals are impressive but on analysis there is little cause for such complacent satisfaction. One of the dangers of oratory is that the critical faculties of the mind are dulled by the high sounding phrases.

How much life insurance should be carried by a representative family, in the various income groups, to meet the problem of dependency due to the death of the wage earner. How closely does practice approach this theoretical amount? It is remarkable how little attention this problem has received. Perhaps it is because, until the depression of the nineteen-thirties, the increase of life insurance year by year was as much as the existing companies could handle and in such circumstances little time is spent on "market analysis". The amount of life insurance in force in Canada tripled itself from 1910 to 1920 and more than doubled itself from 1920 to 1930. In the United States business in force increased two and a half times from 1910 to 1920 and again in the same ratio from 1920 to 1930.

Even in agency publications the problem of fitting the life insurance needs of an applicant with the amount applicant can afford to pay is generally settled by a *reductio ad absurdum argument*: namely that it cannot be done. From this point the line is taken that the applicant may as well take what he can get for his money as that is better than no life insurance at all. This must have some relation to the agitation for social security schemes to be financed by the government. What efforts have been made by the companies to meet the problems?

One of the very few scientific studies and possibly the only published one on the availability of income for life insurance and savings, is that by Dublin and Lotka, entitled "The Money Value of a Man" (Ronalds, 1930). Three representative groups of families are taken; their living expenditures analysed and thus the amount the family can afford to spend on insurance and other savings is determined.

The first typical group of families are those where the father attains maximum earnings of $2,500 per annum. Families in this income category could be assumed to cover those earning between $1,500 to $3,000 a year and represent, I would estimate, well over a quarter of the total population. Messrs. Dublin and Lotka quote those with expert knowledge of budgeting that families in this category can afford to put aside $250.00 a year for dependency due to death and old age of which not more than $150.00 a year can be spent on life insurance on the father. The suggestion is made in the book that from $5,000 to $6,000 life insurance on the ordinary life plan could be purchased and the settlement option chosen which would give the minimum income necessary to maintin the family for as long a period as possible in case of the death of the father.

From the budget analysis given in the book, I would estimate $75.00 a month as the minimum income, assuming two dependent children, and on this basis (3% settlement options) the income could be provided for about seven years. The only solution offered is a minimum income for seven years. What after that ?

Let us take the family in the next higher social grade with income from $3,000 to $7,500 a year. Dublin and Lotka give figures for a typical family attaining maximum earnings of $5,000 a year when the father is age 50. At 35 the father's earnings are only $3,068 a year and his total savings given as available for all purposes, only $375.00 a year. The authors suggest $17,000 ordinary life insurance be purchased which would give an income (principal and interest combined) of $165.00 a month for a period of ten years. In this type of family, where public charity would be avoided as a plague, the family is assumed to be destitute after ten years. No other solution is offered by the authors.

In these two groups of families we include about one-third of the total population where the income of the family lies between $1,500 and $7,500 a year. This range includes the skilled worker, the white-collar worker, the shopkeeper and the great bulk of the essential men behind the industry and commerce of the country including a large proportion of its professional classes. In fact it excludes only the highest paid people, representing less than 2% of the total population and at the other extreme it excludes the laboring classes. Yet the life insurance companies according to these eminent statisticians in the service of one of the largest American life insurance companies appear to be able to offer this most important section of the community — its veritable backbone — only the barest minimum subsistence of their dependents in the event of the death of the head of the family, and that only for a very limited period. After that period has expired destitution faces the dependents.

The Family Income Plan

It has been difficult for life insurance to shake itself free from the obsession that its purpose is to create an "estate", the income from which could be enjoyed during the lifetime of one beneficiary and then passed on to be enjoyed by the next in succession without touching the principal. It is the association of independence with landed property and a landed aristocracy — which has no relationship to present day life in Canada or the U. S. A.

The problem of dependency is the provision of an income during dependency and no longer. This idea has been carried to an extreme in the U. S. Social Security Act where a widow without children under age 18 receives no income benefits following her husband's death while she is under age 65. But the principal is an important one. No class of *rentiers* is to be created, capable of work not yet obliged to add to the fund of economic goods and services on which the standard of living of the country depends. It follows that a married man with family need made provision for his dependents in the event of his death only for such period as his dependents would have been dependent on him. The needs of the widow should be recognized by providing for her on a smaller scale after the children have become independent.

In the past ten years a plan of life insurance has been developed in the English speaking countries of the world which meets these needs. It is called the Family Income Plan. It is an additional benefit which can generally be added to any regular plan of life insurance which is called the basic" plan. Consider the benefits granted by the Family Income to 65 Plan when added to an Ordinary Life Policy of $5,000. On death before age 65 an income of $50.00 a month is paid for the period until the insured would have attained age 65 when the sum insured of $5,000 is paid out and the policy terminates. If the insured is living at age 65 the Family Income benefit terminates and the policy may be carried on as Ordinary Life policy for $5,000 which sum would be paid in one amount on death.

An insured can generally depend that his children will have become independent by the time he would be age 65. The Family Income to age 65 Plan thus provides an income in the event of his death until the time when he would have attained age 65 when the sum insured is paid out. Note that the $50.00 a month is at the rate of 12% per annum on the $5,000 basic sum insured or, three to four times what could be obtained if it were invested. Further, at the end of the income period the basic sum assured could be used by the widow to provide an income for life for herself of approximately half the income she had been receiving until then.

Let us reconsider the first typical family group studied above (income $1,500 to $3,000) in relation to the Family Income to 65 Plan. The $150.00 a year available for life insurance could be used to purchase, at age 30, say $5,000 Ordinary Life with Family Income to age 65 attached. This policy would procure for the family on his death, $50.00 a month for the whole period of what would have been his normal working life and an annuity of approximately $25.00 a month for life to the widow at the end of the period. If the father survives to age 65 he has the substantial cash value of a $5,000 Ordinary Life Policy to apply to his own dependency problem.

It will be pointed out that the $50.00 a month provided is below the minimum income of $75.00 a month which was stated to be required for a widow and two infant children, say. But in practice life insurance is not the sole means of support and if it were, it could be arranged that the income in the early years would be increased and the reduction to $25.00 a month take place at an earlier date.

By means of the Family Income to 65 Plan a closer approach can be made to the dependency needs of these two important sections of the community, than under any other plan or combination of plans. A criticism can be made that by provididng as much as possible for dependency due to early death we reduce the margin available for dependency due to old age. There is a choice here. One is an immediate need and can be assured immediately; the other is subject to all the vagaries of a lifetime of accumulation with the uncertainty of living to enjoy it. The outstanding position of life insurance on this Continent may be ascribed, to a large extent, to the emphasis laid by the companies and their agents on protection rather than short term savings.

This approach to the problem of dependency presents nothing new on the North American Continent. The most popular and successful approach in life insurance sales on this Continent has been by means of the Ordinary Life Plan

— maximum protection for the premium paid in the event of early death with some provision for retirement as represented by the cash value of the policy at age 60 and 65.

Origin of the Family Income Plan

The Family Income Plan was originated in 1930 by the late Philip Burnet, founder and president of the Continental American Life Insurance Company of Wilmington, Delaware, U. S. A. The publicity given to it in American Insurance journals attracted the attention of the British Insurance press and never in insurance history has any American idea swept through Great Britain as rapidly as the Family Income Plan. Mr. Burnet's original policy provided for a maximum "fixed" period of 20 years, presumably to cover the period of minority of existing children. The Family Income to age 65 is a newer development and may be said to cover the minority of both existing children and the children still to be born. The deferment of the payment of the basic sum insured to an age when the widow would require such an amount for pension purposes is also an advantage over the 20 year plan.

The Family Income Plan has not attained the popularity in the U. S. A. which one would expect. A recent questionnaire I addressed to the forty-four largest American Life Insurance Companies showed that only thirty were then writing the Family Income Plan and as far as I could ascertain only one of these issued a plan with a "fixed period" to ages 60 to 65 for the younger ages at entry. Of the ten largest Canadian Companies I ascertained that eight issued the Family Income with fixed periods to ages 60 or 65.

Opposition to the Plan

There has been much opposition to the plan in the U. S. A. and much of it still exists. Whether its origin in one of the smaller companies in a small town and not in New York or Hartford is one reason, it is hard to say. It would not be the first time that the cry has been raised: "Can there any good thing come out of Nazareth?"

One objection to the plan is said to be that it lends itself to misrepresentation. Life Insurance companies are vulnerable here. The tendency in the past quarter-century has been to adopt more and more complicated policy forms. A life insurance policy, which originally, was a simple promise to pay has become a formidable legal document with so many "provisions" as to call forth the joke that one life insurance policy would provide sustenance for shipwrecked sailors for many a moon! The latest "planning" craze whereby agents tie up the settlement options of several policies into a wonderful pattern which breaks down at the first minor disturbance in the policy holder's life is another cause of increasing complexity and a possible source of infinite misrepresentation, misunderstanding, confusion and trouble in years to come. The Family Income Plan can be "muddled about" and misrepresented just as any other plan, but in its simplest form it is as free from objection as any other form of life insurance.

Another objection which is much aired is that the benefit is decreasing term insurance! The additional benefit is a temporary one and the longer the insured lives the less is the amount payable on death until the end of the "fixed period" when the insurance is that payable under the basic plan to which the Family Income benefit has been added.

The insurance needs of the great majority of people do decrease with age. When only a negligible proportion of the public can afford adequate insurance protection for their families or the "estate" plan that is, setting up a permanent inheritance for generations yet unborn, is it not reasonable to adjust our plans to our practical needs? In a discussion on this point, one insurance executive exclaimed that it was wrong to sell the Family Income Plan, for every prospect should be approached with the idea that his "estate" should increase as he got older whatever his insurance needs. This executive overlooked the sad fact that most prospects cannot look forward to receiving greater remnueration at age 60 than at age 30 say, irrespective of the quality of their work at those ages.

Negative Reserves

One great practical objection to the Family Income Plan in the U. S. A. from the company's angle is that the use of an old mortality table like the American Experience is universal and in many States it is compulsory. With regular plans of life insurance this use of obsolete tables has little practical significance. But owing to the peculiar actuarial properties of the Family Income Benefit the use of the American Experience Table complicates the adoption of the plan by making the rates higher and the reserves (and hence cash values) lower. It introduces what are called "negative reserves". However when modern tables of reserves are used these objections to the adoption of the plan are reduced in effect and may be ignored. A joint committee of actuaries of State Departments and representatives of the American Actuarial bodies recently published the new modern Mortality table "Table Z" having as its aim the replacement of the American Experience Table (now over seventy years old). This shows the present trend.

Mortality

The Family Income Plan might be said to introduce a problem to the home office underwriters. On death at age thirty under a Family Income to age 65 plan the value of the death claim to the Company (at 3% discount) is $14,880 for a $5,000 policy. The benefits payable under the claim would be $50.00 a month payable for 35 years with $5,000 payable at the end of the period. The extra premium payable for the extra benefit may be only one half of that of the basic plan yet the discounted value of the benefits are nearly three times as great as would be paid on the basic plan alone.

However, so great has been the improvement in mortality since seventy years ago when the American Experience Table represented the current mortality that the initial risk taken by the Companies at the present time for entrants up to age 35 is actually less than seventy years ago. The importance of this reduction in mortality at the younger adult ages is of great significance in the Family Income to age 65 Plan. The "net extra premium" as indicated by the new Table Z for the Family Income Benefits to age 65 is approximately one half to two-thirds of that indicated by the American Experience Table from ages 20 to 40 at entry. This has a portentous social significance. The present generation of young married men can make provision for their dependents by the Family Income Plan and through the life insurance companies in a manner and at a cost not available to former generations.

The Agent

One possible reason why the Family Income Plan has not progressed to the extent one would anticipate is the attitude of the companies on the question of remuneration to the agent. Many companies have discourages term insurance. With costs based on a certain average rate of premium any increase in plans with a lower rate as term plans would introduce special problems. However when the Family Income Plan or any term plan is only sold as *part* of a regular plan of insurance it is quite another matter.

Agents are very quick to appreciate the purpose of their companies' rulings and rates. Where a plan is introduced which, in comparison with others of the same company's plans, the rates appear high and the remuneration to the agent, low, it is obvious that the new plan will not become popular.

One must respect the suspicion with which new plans of life insurance are received. There has been too great a tendency to shuffle together the elementary life insurance benefits and draw them out in some new combination of benefits generally with the sole object of stimulating the agency force temporarily — as a "shot in the arm" so to speak. These newfangled schemes are detrimental to the real purpose of life insurance and life insurance executives may be excused from any criticism for proceeding cautiously.

However with the Family Income Plan and particularly when the "fixed period" is extended to age 65 I feel that we have a form of insurance, the development of which would be to increase the beneficence of life insurance on this Continent. This was the object of Mr. Philip Burnet to whose pioneering efforts the use of the Family Income Plan throughout the English speaking world is due.