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INVESTIGATION OF CONCENTRATION OF ECONOMIC POWER

TEMPORARY NATIONAL ECONOMIC COMMITTEE

A STUDY MADE UNDER THE AUSPICES OF THE SECURITIES AND EXCHANGE COMMISSION FOR THE TEMPORARY NATIONAL ECONOMIC COMMITTEE, SEVENTY-SIXTH CONGRESS, THIRD SESSION, PURSUANT TO PUBLIC RESOLUTION NO. 113 (SEVENTY-FIFTH CONGRESS), AUTHORIZING AND DIRECTING A SELECT COMMITTEE TO MAKE A FULL AND COMPLETE STUDY AND INVESTIGATION WITH RESPECT TO THE CONCENTRATION OF ECONOMIC POWER IN, AND FINANCIAL CONTROL OVER, PRODUCTION AND DISTRIBUTION OF GOODS AND SERVICES

MONOGRAPH No. 28-28A

STUDY OF LEGAL RESERVE LIFE INSURANCE COMPANIES

Printed for the use of the
Temporary National Economic Committee

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Monograph No. 28

STUDY OF LEGAL RESERVE LIFE INSURANCE COMPANIES

Submitted by
THE INSURANCE SECTION OF THE
SECURITIES AND EXCHANGE COMMISSION

II

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This monograph was written by

GERHARD A. GESELL

Special Counsel, Insurance Section
Securities and Exchange Commission

and

ERNEST J. HOWE

Chief Financial Advisor, Insurance Section
Securities and Exchange Commission

The Temporary National Economic Committee is greatly indebted to these authors for their contribution to the literature of the subject under review.

The status of the materials in this volume is precisely the same as that of other carefully prepared testimony when given by individual witnesses; it is information submitted for Committee deliberation. No matter what the official capacity of the witness or author may be, the publication of his testimony, report, or monograph by the Committee in no way signifies nor implies assent to, or approval of, any of the facts, opinions, or recommendations, nor acceptance thereof in whole or in part by the members of the Temporary National Economic Committee individually or collectively. Sole and undivided responsibility for every statement in such testimony, reports, or monographs rests entirely upon the respective authors.

(Signed) JOSEPH C. O'MAHONEY,
Chairman, Temporary National Economic Committee.

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LETTER OF TRANSMITTAL

Securities and Exchange Commission,
Washington, D. C., July 24, 1940.

Senator Joseph C. O'Mahoney,
Chairman of the Temporary National Economic Committee.

Dear Mr. Chairman: As the Commission's representative on your committee in charge of the matter, I have the honor to transmit herewith a factual report of our staff, based on the study of life insurance which the Insurance Section of the Commission undertook at the request of the Temporary National Economic Committee pursuant to Public Resolution No. 113 of the Seventy-fifth Congress.

This study was headed by Gerhard A. Gesell, special counsel, and Ernest J. Howe, chief financial advisor of the Commission's Insurance Section. Collaborating with them on the actual preparation of the report were Helmer R. Johnson, William S. B. Lacy, James W. West, Jr., Joseph Wolpe, and Michael H. Cardozo IV, together with other members of the staff of the Insurance Section. Herbert Blomquist was responsible for immediate supervision of field investigations. Donald H. Davenport acted as special economic consultant for the study.

No recommendations, legislative or otherwise, are made herewith.

Very truly yours,

Sumner T. Pike, *Commissioner.*

SECTION I

Introduction

On July 7, 1938, pursuant to Public Resolution No. 113 of the Seventy-fifth Congress, the Temporary National Economic Committee requested the Securities and Exchange Commission to conduct a study of insurance.

The Commission's study and this report have been confined to legal reserve life insurance. There has been no examination of life insurance as sold by fraternal societies or assessment companies. Furthermore, no attempt has been made to investigate the operations of fire and casualty insurance companies or to include any discussion of these forms of insurance in this report. The tremendous scope of the insurance business and the limited funds available to the Commission have made it necessary to restrict the study in this manner.

Even in the field of legal reserve life insurance the study has been limited to those general topics outlined in the message of President Roosevelt,[1] as delineated by specific assignments from the committee which has been primarily concerned with the broad problem of the concentration of economic power.

Although it has been impossible to make an exhaustive individual study of each legal reserve company, the Commission has been able to examine a sufficient number of representative companies to obtain a cross-section of the business as a whole.

The development of the life insurance business in this country represents an outstanding achievement. Life insurance provides the channel through which millions of American people accumulate savings to gain for themselves and their families a larger measure of security and financial independence. The confidence which the business justifiably commands in the eyes of the public is indicated by the continually increasing numbers of people who take out life insurance policies. There can be no question of the soundness of the basic principles upon which the institution of life insurance is founded.

At the very outset of the insurance study it was stated by Justice William O. Douglas, then chairman of the Securities and Exchange Commission, that no policyholder need have any concern that the hearings would jeopardize the protection which he counts upon receiving through his insurance policy. This statement was subsequently reaffirmed on several occasions in the course of the hearings. In this comprehensive report covering all phases of the insurance inquiry it can again be stated that nothing has been presented which justifies altering the initial statement of the Commission's chairman.

As has been indicated, it was the function of the insurance inquiry to explore those areas of the business under review which were of

[1] Message from the President of the United States transmitting recommendation relative to the strengthening and enforcement of antitrust laws, S. Doc. No. 173, 75th Cong., 3d sess., April 12, 1938. It was this message which led to the creation of the Temporary National Economic Committee.

particular significance to a study of the concentration of economic power. Where certain practices were disclosed in the course of investigation which might be considered contrary to the best interests of policyholders or the general public, those practices were naturally given special attention both in the hearings and this report. The staff of the Commission does not consider the practices disclosed as being so fundamental or so little subject to change that they undermine the soundness of the basic principles upon which the institution of life insurance is founded.

Among the principal topics considered in the report are the great size of the legal reserve companies, their enormous growth and present possibilities for future growth, the concentration of economic power and influence which rests in the hands of the five largest companies all of whose offices are located in the New York area, the absence of any effective policyholder control over the activities of the mutual life insurance companies with the consequent self-perpetuation in office of insurance directors, and the tangled web of interlocking directorships which binds the principal life insurance companies with the country's major banks and industries.

Prevailing attitudes in the business toward the responsibilities of life insurance company directors are examined and discussed in a special section. In this connection particular reference is made to the attendance record of some directors at board meetings, and the use of their positions by some directors for personal gains through the institution of preferential business transactions and loans, or the initiation of changes in the basic plan of company operation designed to promote their private interests.

Considerable attention is also given to the experience of life insurance companies during the depression. The withdrawal of 188 life insurance companies from the business which has occurred since 1930 is examined with special respect to those retirements which resulted in losses to policyholders. Causes for life insurance company failures are also examined in the light of case histories of reinsurance deals and other promotional activities. Special sections are also devoted to life insurance company lobbying activities and to the nature and effect of numerous anticompetitive arrangements arrived at through inter-company conferences which established agreements fixing policy rates, agents' commissions and uniform policy provisions. Detailed studies of policy net costs and of lapse and other forms of policy terminations are presented.

Two of the most important sections of the report deal with agency practices and industrial insurance, respectively. In the first of these sections the company drive for new business and the emphasis upon size for the sake of size alone are examined and the resulting dislocation in agency activity exemplified by inadequate training of agents, poor selection of agents, high turn-over, and the seriously low compensation of agents are explored. The discussion of industrial insurance draws upon material developed before a subcommittee as well as upon a field survey of insurance distribution to low-income families conducted by the Commission in cooperation with the Work Projects Administration and analyzes the effects of over selling and high-pressure methods frequently typical of this form of insurance. Facts are presented demonstrating the resulting maldistribution of

policies, and the excessive lapse and the high cost of industrial policies. Factors leading to the confusion of the industrial policyholder and his inability to obtain proper service are set forth. The inadequacy of company reports to policyholders is mentioned briefly as preliminary to a detailed discussion of deficiencies in life insurance accounting practices which will be found in one portion of the report.

In many respects the most significant sections deal with the operating and investment features of the business. After presenting background information on the nature of life insurance company investments and the different problems which the companies encounter in acquiring and managing these investments, the report takes up certain general investment considerations. The increasing amount of money passing through the hands of the life companies is shown to have brought about serious investment problems which in turn have become more acute due to the diminishing supply of bonds and mortgages (which are the companies' principal outlets for investment) and the steadily declining interest yields on such securities. On the one hand, the companies are admittedly unable to get a large part of their money invested. Industry, on the other hand, is obliged to take into account this insatiable appetite of the insurance company for bonds. The net effect is that judgment as to the type of security best suited to a particular corporate structure is often affected by the ease with which bonds may be marketed. The frequent long-term advantages of equity financing are obscured by the vogue for bond financing. Common-stock financing has gone increasingly out of style with resultant serious effects upon the sources of capital of those portions of American industry where bond financing is either inadvisable or unavailable. The desirability of insurance companies investing in common stocks is considered and significant developments which may be expected to occur in the absence of these investment channels becoming open to insurance companies are indicated in terms of the broad-range economic considerations involved.

This report assembles the significant facts revealed by the Commission's inquiry. The report is based primarily upon facts developed by the Commission in hearings before the committee. The record of these hearings, which were held from time to time between February 6, 1939, and March 1, 1940, consists of approximately 3,900 pages and contains testimony of 131 witnesses and 560 exhibits.[2] Additional

[2] Section 3 (b) of resolution No. 113 states that the Securities and Exchange Commission is "directed to appear before the committee or its designee and present evidence by examination of witnesses or the introduction of documents and reports."

Under specific authority contained in section 3 (a) of the resolution, an insurance subcommittee was appointed and this subcommittee heard a part of the testimony, that bearing principally on the subject of industrial insurance and retirements. (See pp. 101 to 135 and 248 to 305, *infra*.) The hearings before the Temporary National Economic Committee or its insurance subcommittee are printed in pts. 4, 10, 10A, 12, 13, and 28 of the Hearings Before the Temporary National Economic Committee, Congress of the United States, 76th Cong., 1st and 2d sess., pursuant to Public Resolution No. 113 (75th Cong.), authorizing and directing a select committee to make a full and complete study and investigation with respect to the concentration of economic power in, and financial control over, production and distribution of goods and services. For convenience all subsequent citations to the testimony printed in these volumes will be stated in abbreviated form, e. g., pt. 4, R. 1391-1405. Likewise, all citations to exhibits admitted in evidence will be similarly abbreviated, e. g., pt. 4, Exhibit No. 233. Since pt. 28 is still in galley proof, references to testimony in this part will be by name of witnesses and hearing dates, e. g., pt. 28. testimony Winthrop Aldrich, February 26, 1940.

facts presented in the report have been taken from replies to seven questionnaires [3] issued by the Commission, the published reports of the companies themselves, and manuals or digests generally accepted and relied upon in the conduct of the insurance business.

[3] The Commission sent out seven questionnaires as follows: Preliminary questionnaire to 406 life insurance companies on September 6, 1938; investment questionnaire to 26 largest legal reserve life insurance companies on January 31, 1939; supplemental investment questionnaire to the 26 largest legal reserve life insurance companies on August 11, 1939; letter questionnaire to 357 legal reserve life insurance companies requesting copies of sample policies, rate books, annual statements, and similar material on May 20, 1939; sales questionnaire to 67 largest legal reserve life insurance companies on October 18, 1939; questionnaire to State insurance departments on October 24, 1939 (replies to this questionnaire were optional); and letter questionnaire to approximately 5,000 life insurance agents on February 9, 1940.

SECTION II

Size and Growth of Legal Reserve Life Insurance Companies

At the present time life insurance companies control more assets, receive more premiums, and have more policies in force than at any time in the history of this country. There are approximately 365 legal reserve life insurance companies,[1] whose total assets exceed $28,000,000,000, operating in the United States. These companies have over 124,000,000 policies outstanding with a face amount of approximately $111,000,000,000.[2] This insurance, which represents over 60 percent of the life insurance in force throughout the world, is owned by over 64,000,000 policyholders and is equal to $900 of life insurance protection per capita of the Nation's population.[3]

The life insurance business is national in scope and is conducted on an interstate basis. Life insurance is sold in every State of the Union, and in no State are there less than 50 life insurance companies licensed to do business. One-third of the companies, which account for only about one-half of 1 percent of life insurance company assets, operate within the confines of a single State, whereas 46 percent of the companies, representing over 90 percent of the assets, operate in five or more States.[4]

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[1] A legal reserve life insurance company is a life insurance company which agrees to pay a definite sum or benefit that cannot be scaled down, which charges therefor a definite premium that cannot ordinarily be increased, and which is required by law to establish, in respect to each policy issued and in force, a reserve as defined by law based on the type of contract, age of issue, and mortality and interest assumptions involved. The reserves in the aggregate constitute a fund which on the basis of actuarial computation is deemed exactly sufficient to guarantee that the company will be able to meet its obligations under its outstanding policy contracts as they fall due.

Fraternal orders and assessment associations do not meet all the requirements implicit in the definition of a legal reserve life insurance company. Originally companies of these types wrote insurance on the assessment or step-rate plan, and even though virtually every fraternal order of importance and even some assessment associations now use the level-premium plan and actuarial reserves, they still have the right of unlimited assessment and are not in all cases subject to the same laws imposed on legal reserve companies.

About 95 percent of the life insurance in force in the United States has been written by the 366 legal reserve companies. The remaining 5 percent is written by fraternal orders and assessment associations. According to The Spectator Life Insurance Year Book, 1939, there are 243 fraternal orders with admitted assets of $1,134,000,000, $6,348,000,000 insurance in force and 7,000,000 policies outstanding. Assessment associations number 60, with admitted assets of $23,000,000, $214,000,000 insurance in force and 784,000 policies outstanding.

[2] Compiled from The Spectator Life Insurance Year Book, 1939, Best's Life Reports, replies to Commission questionnaires and Convention Form Annual Statements. Unless otherwise indicated, all statistics cited in this report are as of December 31, 1938.

[3] Pt. 4, R. 1165, 1171, 1196. Life insurance in force in the United States is more than 6 times as great as the amount in force in Great Britain, the second largest life insurance country. For information as to insurance in force in principal foreign countries (1937), see pt. 4, exhibit No. 215.

[4] The smallest number of companies operating in any State is 51 (Nevada, New Hampshire, and Vermont), and the largest number is 132 (Texas). The average number operating in a single State is 82, while 17 companies operate in over 40 States (Spectator Life Insurance Year Book, 1939).

The 5 largest life insurance companies, ranked in order of size, are Metropolitan Life Insurance Co., New York City; the Prudential Insurance Co. of America, Newark, N. J.; New York Life Insurance Co., New York City; the Equitable Life Assurance Society of the United States, New York City; and the Mutual Life Insurance Co. of New York, New York City. Each of these companies is licensed in every State of the Union except New York Life and Mutual Life, which are licensed in all States except Texas (pt. 4, R. 1170). The 75 largest legal reserve life insurance companies, which include all companies with assets in excess of $20,000,000 as of December 31, 1938, are listed in appendix A, which also gives the location of each company's home office, its admitted assets, its total insurance in force, its plan of operation, and the number of States in which it is licensed.

The purely dimensional aspects of the life insurance business are so staggering, the statistical aggregates themselves so enormous that it is difficult fully to appreciate the significance of life insurance in our national economy. Today it may be said that every other man, woman, and child is insured by a life insurance policy. Every fifth man, woman, and child in the United States carries a life insurance policy with the Metropolitan, and that company insures in the first year of life about one-fifth of the number of children born.[5]

Life insurance companies have an annual income totaling over $5,000,000,000, an amount slightly less than the receipts of the United States Government and equal to about 8 percent of our national income in 1938.[6] Of this amount almost $4,000,000,000, or over 70 percent, is received annually from policyholders in the form of premiums. The assets of these companies exceed by over $11,000,000-000 the combined assets of mutual savings banks and building and loan associations in this country and are twice as much as the savings deposits in State and National commercial banks combined.[7]

In the course of the hearings, particular studies were presented showing the operations and investments of the 26 largest legal reserve life insurance companies which account for, roughly, 87 percent of the assets of the life insurance business. It appeared that in 1937 these 26 companies owned 11.6 percent of the long-term debt of the United States Government and owned substantial percentages of all principal classifications of long-term private debt.[8] In addition, the companies owned more than 1½ billion dollars of farm and city real estate.[9] Additional facts concerning these 26 largest companies may aid in an appreciation of their size and the important part which they play in the national economy. In the 10-year period from 1929 to 1938, inclusive, the companies had a total premium income of $30,390,464,000 and in the same period made gross investments totaling $26,189,870,000.[10] These investments were so substantial that in addition to purchasing large blocks of Government bonds and investing in sizable amounts of farm and urban mortgages, these companies purchased 47.7 percent of all corporate bonds and notes issued in 1938.[11] In that year alone the 26 companies invested about $4,000,-000,000, which was comprised, roughly, of $2,500,000,000 returned to them through the maturity, sale, and redemption of their old investments and $1,500,000,000 of new money receipts. Stated in another way, it may be said that into the hands of the officials of these life

[5] Pt. 12, R. 5955. Mr. Frederick H. Ecker, chairman of the board of the Metropolitan, stated (pt. 4, R. 1238):

"* * * in some cities, like St. Louis, for example, more than half of the population are insured, so it might be said that in such cities every other man, woman, and child one meets on the street, in the home, or in the cradle is insured in the Metropolitan."

[6] Pt. 4, exhibit No. 218. The percentage ratio of life insurance income to total national income rose from ⅒ of 1 percent in 1880 to 11.6 percent in 1932 (pt. 4, R. 1182). For more complete information on this subject see pt. 4, R. 1180–1184 and R. 1641–1643. Figures for 1938 national income from U. S. Department of Commerce.

[7] From schedule entitled "Principal Savings Institutions in the United States, 1920–1938" (pt. 9, exhibit No. 601).

[8] Pt. 28, exhibit No. 2259.

[9] Pt. 10 A, R. 180, 217, 255, 258.

[10] Pt. 10 A, R. 6, 94.

[11] Pt. 10 A, R. 125. In 1934 these companies purchased 23.7 percent of new corporate bonds and notes issued; in 1935, 24.8 percent; in 1936, 24.5 percent; and in 1937, 48.9 percent. Id.

insurance companies there was an average daily flow of over $10,000,000 which they were obliged to invest.[12]

Though the life insurance companies have only small investments in stock, it is not surprising to find that when default in their investments occurs they interest themselves in the operating problems of various industrial enterprises in order to protect their interests as principal creditors. As of December 31, 1938, these same companies were represented on 65 bondholders' committees which had been organized to protect their substantial interests in securities of corporations experiencing financial difficulties.[13] Furthermore, particularly in recent years, the companies have been active in operating farm and city real estate. In the management of their farm properties, they have come to be among the largest farm landlords in the country and have developed complicated methods for carrying out proxy farming on a large scale involving the establishment of crop rotation plans, soil erosion prevention, and similar activities which have a deep effect upon the life of the farming communities.[14] Similarly in the field of city real estate, the companies appear as the landlords managing properties which include one- to four-family houses, apartments, hotels, stores, office buildings, theaters, banking houses, schools, and various business properties.[15]

Since most of the assets of life insurance companies are liquid, the companies exert far greater influence on our capital markets than do many great industrial corporations a good part of whose assets are represented by plant and equipment. In 1906 a committee of the New York State Legislature, known as the Armstrong committee, conducted a comprehensive investigation of the principal life insurance companies.[16] The Armstrong committee noted this special nature of life insurance assets, stating:[17]

> No tendency in modern financial conditions has created more widespread apprehension than the tendency to vast combinations of capital and assets. But while in the case of railroads and industrials these vast amounts are mostly fixed in particular productive activities, the larger part of the huge accumulations of life insurance companies consists of assets readily convertible into money and susceptible of application to varied uses. It is this fact which has placed the officers and members of finance committees of life insurance companies in positions of conspicuous financial power * * *.

Not only is it clear that a comparable condition exists today, but it is also apparent that the financial power of life insurance executives

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[12] Pt. 28, Opening Statement, February 12, 1940. Indeed, to use the words of a recent editorial in the Wall Street Journal as quoted in the opening statement:

"It would be hardly an exaggeration to say that the assets of the life insurance companies as a whole represent a first mortgage on the country's business and industry."

[13] Pt. 28, exhibit No. 2339.

[14] For testimony concerning farm real estate, see pt. 28, testimony of Norman J. Wall, William G. Murray, Ralph C. Limber, and Glen E. Rogers, February 15, 16, and 19, 1940.

[15] Pt. 10 A, R. 161, 184, 220; also pp. 350 to 355, infra.

[16] Report of the joint committee of the Senate and Assembly of the State of New York, appointed to investigate the affairs of life insurance companies transmitted to the legislature February 12, 1906, vols. I to X. The recommendations of the committee, printed in vol. X, urged remedial legislation much of which was adopted and the report has been recognized as an outstanding contribution. The report considered the activities of 17 companies in detail, and discussed such matters as: Organization of life insurance corporations; control of the rights of policyholders in the election of directors; retirement of stock; investments; limitation of new business; political contributions; lobbying; expenses; valuation of policies; rebates; surrender values; ascertainment and distribution of surplus; forms of policies; publicity and State supervision. Charles Evans Hughes, Esq., (now Chief Justice of the United States Supreme Court) was counsel for the committee. Hereafter this report will be cited Armstrong Report, vol. —, p. —.

[17] Armstrong Report, vol. X, p. 389.

has grown enormously since 1906 with the increasing size of their companies.

This situation becomes more obvious when it is recognized that there is a high degree of concentration in the life insurance business and that the bulk of this economic power rests in the hands of relatively few companies. Six companies, namely, Metropolitan, Prudential, New York Life, Equitable, Mutual Life, and Northwestern Mutual Life Insurance Co. of Milwaukee, Wisconsin, each had assets in excess of $1,000,000,000 at the end of 1938. Of these, the five largest companies accounted for 54.2 percent of the total assets of all life insurance companies in the United States and the two largest companies, Metropolitan and Prudential, with assets totaling $4,942,900,000, and $3,800,787,000, respectively, accounted for about 32 percent of the total.[18]

In reaching its important position life insurance has experienced spectacular and continued growth. By 1906, the date of the Armstrong committee investigation, the period of rapid growth was already under way.[19] There were at that time approximately 138 legal reserve life insurance companies whose aggregate assets totaled slightly less than $3,000,000,000.[20] Several of the now largest companies had already been organized and at least three companies, Mutual Life, Equitable, and New York Life, had accumulated approximately one-half billion dollars of assets apiece. The Armstrong report, evincing alarm at the size and potentialities for future growth of these companies, stated:[21]

> The growth of the three companies has long been a matter of grave concern to students of insurance conditions. No useful purpose will be served by their

[18] Calculated from Spectator Life Insurance Year Book, 1939. See pt. 4, exhibit No. 222 for 1937 figures. A similar concentration exists in respect to the geographical location of the home offices of the life insurance companies. Six companies whose assets account for 56.9 percent of the total have their home offices in New York City or Newark, N. J., and an additional group of 10 life insurance companies with assets representing 17.2 percent of the total as of December 31, 1937, have home offices in the New England area.

The Metropolitan is the largest life insurance company in the world and, except for the American Telephone & Telegraph Co., is the largest American corporation, having aggregate assets greater than any other single industrial or banking concern, not excepting such corporations as United States Steel Corporation, Pennsylvania Railroad, General Motors Corporation, New York Central Railroad or the Chase National Bank (pt. 4, R. 1194).

[19] The Armstrong report recommended that a limitation be placed on the writing of new business (pt. 4 exhibit No. 223, Armstrong Report, vol. X, pp. 392–396). Having determined that "The prohibition of the issuance of new policies whenever the assets of the company reach a prescribed volume is impracticable" (ibid.) the report recommended that companies be permitted to write insurance in amounts graduated to the amount of life insurance in force at the beginning of a given year. Legislation based on this recommendation became effective in New York State in 1906. This legislation limited expense and provided specifically that no company with more than $1,000,000,000 of insurance in force could write more than $150,000,000 of new business during any given year (Public Laws, 1906, p. 794, ch. 326, sec. 96). This law was amended in 1910 (Public Laws, 1910, ch. 697) to permit companies latitude in the writing of new business. Subsequent amendments in 1911, 1913, 1916, 1917, 1920, 1927, and 1929 liberalized the law to give companies even greater latitude for growth and to make restrictions on the writing of new business, if any, a matter more within the discretion of the superintendent of insurance. The amendments lifted the $150,000,000 unconditional limitation upon the amount of new business which could be written by the larger companies and in addition repeatedly changed the formulae designed to limit expense. The present law (ch. 28 Consolidated Laws (1940) sec. 212) permits such a company to write $150,000,000 of new business or in the alternative to write within the limitations of a complicated first year expense formula an amount which is no more than 15 percent greater than the largest aggregate amount written by the company during any 1 of the previous 3 years. There is no evidence that the recent statutes have impeded growth and in fact Mr. Thomas I. Parkinson, president of the Equitable, when examined concerning the New York law stated that his company "* * * had no trouble with the limitation in past years" (pt. 13, R. 6541; see also pt. 4, R. 1252, 1253). Only one other State, namely, Wisconsin, has any statute limiting first year expense or designed to place some ceiling upon the writing of new business (secs. 206.26–206.30, St. 1937).

[20] Pt. 4, R. 1163.

[21] Pt. 4, exhibit No. 223; Armstrong Report, vol. X, pp. 392–396.

becoming larger. Their membership is so large and their resources are so vast as to make the question of responsible control and conservative management one of extreme difficulty, and their magnitude if permitted to grow unrestricted will soon become a serious menace to the community.

The assets of life insurance companies have increased from 1906 to 1938 by over 800 percent.[22] During the same period New York Life and Equitable increased in size many times over and now each has assets in excess of $2,000,000,000, while the Metropolitan and Prudential have come to head the list with their combined assets totaling close to $9,000,000,000. Some measure of this growth may be found by comparing its rate with that of the Nation's population. From 1890 to 1937 our population approximately doubled in size while in the same period life insurance in force increased 2,500 percent or at a rate 25 times as fast as that by which population increased.[23]

The steady accumulation of assets and insurance in force during the period since the Armstrong Report is indicated in the following table:[24]

Year:	*Assets*	*Insurance in force*
1910	$3, 876, 000, 000	$16, 404, 000, 000
1915	5, 190, 000, 000	22, 797, 000, 000
1920	7, 320, 000, 000	42, 280, 000, 000
1925	11, 538, 000, 000	71, 690, 000, 000
1930	18, 880, 000, 000	107, 948, 000, 000
1935	23, 216, 000, 000	100, 730, 000, 000
1938	27, 755, 000, 000	111, 055, 000, 000

There were many factors responsible for this growth. To some extent it was due to the broadening of the insurance services offered including the development of new policy forms such as those designed to cover substandard or impaired risks, double indemnity benefits, and disability and group protection. Some new markets were developed, one of the most important of which was among women who had become employed in gainful occupations and thus entered the economic life of the country. Another important factor was the establishment of the War Risk Bureau of Insurance under the auspices of the United States Government.[25] Insurance officials were quick to seize upon the fact that the Government had, in insuring soldiers and sailors during the first World War to the amount of $10,000, placed a valuation upon a human life and to make use of it as a sales device to sell new insurance as well as to increase coverage on existing

[22] The number of companies included in this calculation increased from 138 to about 365 during the period.

[23] Pt. 4, R. 1170–1173. In 1910, population was 92,000,000 while insurance in force was $16,400,000,000. By 1937, population had increased to 129,300,000 while insurance in force had increased to the staggering amount of $109,600,000,000 (pt. 4, exhibit No. 217).

[24] Compendium of Official Life Insurance Reports. Replies of the 10 largest companies to the Commission's preliminary questionnaire indicate that in no instance is a substantial portion of the growth since 1906 attributable to acquisition of life-insurance companies through merger, consolidation or reinsurance. Four of these companies, Prudential Insurance Co. of America, Mutual Life, Travelers Insurance Co., and John Hancock Mutual Life Insurance Co. reported no company acquisitions. The greatest number of companies acquired through merger, consolidation or reinsurance were acquired by the Metropolitan and Equitable. Metropolitan in the period from 1853 to 1916 acquired 18 companies by merger and 8 additional companies as a result of receiverships. These latter acquisitions were undertaken by the Metropolitan in the nature of salvaging operations at the urging of regulatory authorities. Equitable Life acquired 7 companies by merger and 1 by result of receivership. It should be pointed out that for the entire 10 companies only 3 companies have been acquired in any of the indicated manners since 1906.

[25] See an act to authorize the establishment of a Bureau of War Risk Insurance in the Treasury Department, as amended by 40 Stat. 398, ch. 105, October 6, 1917.

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policyholders. At about the same time the influenza epidemic, according to Mr. Thomas A. Buckner, chairman of the board of the New York Life,

> * * * frightened the people of the country into a realization of the uncertainties of life as no amount of ordinary argument could ever do.

and as a result gave added impetus to the growth of the companies.[26]

Over and above these important considerations it is apparent that company policy was a substantial contributory factor to this unprecedented growth. In the past, to say nothing of the present, companies all to frequently measured management efficiency in terms of the amount of new insurance on their books at the close of a given year. Methods of compensating agents made the writing of new business and the consequent growth "inherent in the business" [27] and it cannot be disputed that by and large life insurance managements constantly strove to develop devices to push sales and increase the size of their companies. This "human desire to grow" or, as it has been called, this "philosophy of the institution of life insurance" [28] probably arose from the belief of many insurance men that it was sociably desirable to extend the services of life insurance to the greatest possible portion of the population. In its practical application, however, it frequently reflected itself in a race between companies, each striving for size for the sake of size alone, and bred socially undesirable sales practices which forced growth beyond that attributable to normal demand. As one competent observer has remarked in speaking of the period from 1919 to 1929.

> Undoubtedly some of the growth of this period was forced and unhealthy. There was a good deal of high-pressure salesmanship and over-insurance * * *.[29]

In connection with any consideration of growth it should also be recognized that through the very operations of the business itself life insurance companies increase in size even without adding to insurance in force. Reverting for a moment to the principal companies to which reference has already been made, it will be observed that during the period from 1929 to 1938, the total amount of insurance in force in these companies increased 18.3 percent while life policy reserves increased 40.6 percent.[30] The much more substantial increase in reserves results from the normal yearly additions to legal reserves required to protect persistent business already on the books.[31]

It should also be pointed out that in the period 1929 to 1938, the assets of the principal companies increased 61.9 percent as contrasted with the considerably smaller increase of life policy reserves and insurance in force.[32] This disproportionate asset increase suggests one further development which is of much importance in analyzing causes for the spectacular growth of the life companies—namely, the emphasis upon banking features of the business. Essentially, this emphasis, which will be considered in more detail in a subsequent

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[26] Pt. 4, R. 1420. See generally pt. 4, R. 1418–1421.

[27] See testimony of Frederick H. Ecker, pt. 4, R. 1252, 1253.

[28] Pt. 10, R. 4325, 4326.

[29] See Life Insurance (5th ed.), p. 544, by Joseph B. MacLean, associate actuary, Mutual Life of New York. Present day sales methods are considered in subsequent portions of this report. See pp. 192 to 234, infra.

[30] Pt. 10A, R. 4, 99 excluding Pacific Mutual, which is included in these tables only for the years 1936 1937, and 1938.

[31] For a fuller discussion of the actuarial aspects of the life insurance business, see pp. 177 to 184, infra.

[32] Pt. 10A, R. 5.

section of the report,[33] has resulted in encouraging policyholders to make larger initial payments to their companies and to leave funds with their companies after the maturity of the policy contracts to be administered as trust funds for their beneficiaries. In the period from 1929 to 1938, annuity reserves have increased 565 percent, premiums and rents paid in advance have increased 186 percent, dividends left with the companies have increased 89 percent and supplementary contracts not involving life contingencies, that is, contracts for the gradual rather than immediate disbursal of policy proceeds, increased 390 percent.[34] There are no indications that this growth has ceased. Practically all factors which have brought the companies to their present position are still at work.[35]

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[33] See pp. 363 to 378, infra.

[34] Pt. 10A, R. 99.

[35] The testimony of Mr. Thomas I. Parkinson is illustrative. When questioned concerning the futur growth of his company, he stated (pt. 13, R. 6539-6541):

"Mr. PARKINSON. * * * What we are trying to do is to give the widest possible and the fullest possible coverage to the greatest number of people at a cost which they will stand.

"Mr. GESELL. So that though your company now is over the two-billion-dollar mark in the point of view of size, and could maintain that position through the efforts of this 25 percent of the agency force who write 64 percent of the business, you feel that you have a mission to carry the service of your company to persons who are not yet policyholders?

"Mr. PARKINSON. That is a question that I can answer happily and enthusiastically, yes.

"Mr. GESELL. So that if you are entirely successful from the point of view of your present management policies, you will still continue to increase at the same rate you have been going, both from the point of view of assets and insurance in force?

"Mr. PARKINSON. I think that is true.

"Mr. GESELL. It would look as though if you succeed in your present program that your company may reach the five-, six-, seven-, eight-, ten-billion-dollar mark in time?

"Mr. PARKINSON. That is possible.

"Mr. GESELL. Now there is a point here somewhere, is there not, where the society must consider whether the advantages to the new policyholders who are brought into the business are equal to the disadvantages which may accrue to the existing policyholders because of the increase in size and the other complexities which arise?

"Mr. PARKINSON. Yes.

"Mr. GESELL. You feel you have not yet reached that point?

"Mr. PARKINSON. By no means.

* * * * * * * *

"Mr. GESELL. You see you have likened your activities, and I am sure of your sincerity, to an educational or religious program.

"Mr. PARKINSON. Yes.

"Mr. GESELL. You take even, though, a minister or a preacher or anyone else who is interested in putting forward an idea, there must be at some stage where he stops and works with the group who are subject to his influence. Your continual desire to bring more and more people into your society would indicate that to some extent you have no confidence in the fact that those people will be taken care of by other companies writing insurance, preaching the same gospel, and working in other areas?

"Mr. PARKINSON. No; that is not so. I should dislike nothing more than that all of the life insurance should be in my company.

"Mr. GESELL. Where are you going to stop?

"Mr. PARKINSON. That is an exceedingly difficult question. As you have indicated, if we did not take another member of our organization; that is, did not sell another policy to a nonmember, if we did not allow an existing member to take any additional interest; that is, did not sell any additional policy to an existing member, the development, assuming that the existing policyholders remained in the institution, would necessarily add to our assets, add to them even faster, I am told by the actuaries, for the next few years than if we do go on doing business.

"Mr. GESELL. And we have then, don't we, both in the very nature of your business and from the point of view of the management policy which you have just expressed, the very present possibility of your company continuing to grow larger and larger and larger, accumulating more and more of the assets and investments of the country.

"Mr. PARKINSON. And it gives us a continuing problem which varies as other things about us, population and other factors grow in this great country?

"Mr. GESELL. Have you set any ceiling as to your size from the point of view of assets or insurance in force?

"Mr. PARKINSON. No; because it is so difficult to do it without using a dollar value, and who can say what dollar value used today would be a reasonable estimate in the future?"

It would appear in fact that due to the operation of many factors including forces inherent in the character of the policy contracts written and the impetus of management, continued growth of life-insurance companies is certain. The companies are certain to accumulate more and more assets and they will become increasingly important in our economy. In view of the fact that an 800 percent increase in assets has been attained since 1906 the prospects of further accumulation of assets in the future gives some cause for concern. On the basis of past experience it is reasonable to expect that by 1950 the 26 principal companies will have increased their assets anywhere from 54 to 60 percent, reaching the unprecedented size of from $37,000,000,000 to $40,000,000,000.

SECTION III

Control of Legal Reserve Life-Insurance Companies

Legal reserve life-insurance corporations are organized on one of three plans—the mutual plan, the stock plan, or the mixed plan. The relative importance of companies for which information is available operating under these three plans is indicated in the following table:[1]

Plan	Number of companies	Assets	Insurance in force
Mutual	74	$22,229,000,000	$81,999,000,000
Stock	216	5,307,000,000	28,317,000,000
Mixed	7	219,000,000	739,000,000

From the table it can be seen that though the stock companies far outnumber the mutuals, the latter companies control more assets and have more insurance in force than the stock or mixed companies combined. Of the 10 largest companies, which companies command over 70 percent of the total assets, only one company is a stock company.[2]

Basically the difference in these plans of operation lies in the nature of the groups given theoretical control under the company charter.

The mutual companies are cooperative enterprises, which return to the policyholder all profits resulting from their operations and which theoretically place management control, i. e., the right to elect directors, entirely in the hands of the policyholders themselves. Directors of stock companies, on the other hand, are elected by the stockholders exclusively. Policyholders have no voice in their selection or election. Mixed companies, as the name implies, are managed by a board of directors elected jointly by the stockholders and policyholders or partially by each group.

It should be noted that plans of company organization do not determine the type of life insurance a company may write. Generally speaking, however, the mutual companies sell participating insurance and the stock companies nonparticipating insurance. The policyholder who purchases participating insurance usually pays a slightly higher original premium and receives a return of premium or "dividend" representing the difference between what he paid in and the amount necessary to meet all requirements of the business. Holders of nonparticipating insurance on the other hand receive no dividends, all excess premiums and operating profits of the business being drawn

[1] Spectator Life Insurance Year Book (1939).

[2] The Travelers Insurance Co. of Hartford, Conn., which ranks seventh in size (pt. 10A, R. 5). One other company in this group of 10, the Prudential, still has stock outstanding by reason of the fact that it is completing mutualization proceedings. To all intents and purposes this company is mutual (pt. 4, R. 1191; pt. 12, R. 5913-5925, exhibit No. 1011).

off by the stockholders as dividends, or used to build up surpluses in which the policyholder has no divisible interest. It is not infrequent that stock companies issue both nonparticipating and participating insurance. Mixed companies invariably have both types of insurance in force.

A. SELF-PERPETUATION IN OFFICE OF DIRECTORS OF MUTUAL COMPANIES

Since the mutuals account for 80 percent of the assets of all life insurance companies operating in the United States and include 9 of the 10 largest companies, the extent to which their policyholders have a voice in the selection and election of directors presents a question of paramount concern in any study of the concentration of economic power.[3] On the basis of the evidence adduced, it cannot be said that the policyholders have any control over the management of the mutual companies. The putative rights of the policyholders to select and elect directors are of no practical value. The directors are completely self-perpetuating.

Four of the five largest mutual companies are governed by the law of the State of New York with regard to the election of their directors.[4] The complete inadequacy of this law in providing a proper medium for the expression of policyholder viewpoint was demonstrated. Under its terms every policyholder of a mutual company is entitled to one vote in the election of each director of his company irrespective of the number of policies or the amount of insurance which he holds as long as his policy is in force and has been in force for one year at time of the election. Provision is made for a so-called "administration ticket" which, as the name implies, constitutes a slate of directors selected and nominated by the existing board of directors; provision is also made for independent nominations by policyholders who desire to nominate one or more persons not designated on the "administration ticket." In order to nominate someone independent of the "administration ticket," 25 policyholders must first petition the superintendent of insurance for a list of policyholders which is to be made available to the petitioning policyholders at the discretion of the superintendent.[5] Thereafter, in all corporations with over 100,000 policies in force one-tenth of 1 percent of the qualified voters must certify to the independent nomination, which must be filed with the superintendent at least 5 months prior to the election.[6] That this, in itself, is a sizable undertaking is indicated by the fact that in the case of the Metropolitan approximately 24,000 signatures would be required to bring about an independent nomination.[7] If an independent nomination is perfected, the company at its expense must

[3] Mutual companies account for 80.1 percent of the admitted assets of United States life insurance companies, stock companies, 19.1 percent and mixed companies, 0.8 percent. Computed from Spectator Life Insurance Year Book, 1939.

[4] Sec. 94, New York State Insurance Law; pt. 4, exhibit No. 232.

[5] In a letter addressed to the Securities and Exchange Commission dated January 10, 1939, the New York Insurance Department stated, "The superintendent certainly would not make any arbitrary refusal when a request of at least 25 policyholders appeared legitimate and when there seemed any likelihood of an independent ticket being named" (pt. 4, R. 1399, 1405, 1406).

[6] The "administration ticket" is required to be filed at least 7 months prior to the election. *Id.*

[7] Contrast Wisconsin Law printed at pt. 4, exhibit No. 288. This law specifically prohibits proxies and provides for independent nominations by as few as 100 policyholders. Compare also with recommendations of Armstrong Committee. (Armstrong Report, vol. X at p. 41.)

mail every policyholder a ballot containing the names of those directors nominated by the board and those nominated independently. In the event an independent nomination has been made, the law contains strict provisions governing the conduct of that election. These, however, may be waived in the absence of an independent nomination by compliance with such rules and regulations as the superintendent of insurance may prescribe. If no independent nomination has been made, no votes may be cast except for the "administration ticket" and a single vote is sufficient to elect that ticket for the ensuing term.[8]

Thus it may be seen that from the outset there are obstacles in the way of policyholders desiring to nominate to the board of their company persons other than those selected by the existing board of directors. The expense of petitioning the superintendent and then soliciting a list of policyholders for the necessary nominators' signatures is too obvious to require discussion.[9]

Even in the case of companies operating under a law as restrictive as New York's, policyholders might achieve some participation in the management of their companies were it not for the fact that the companies themselves do little to acquaint their policyholders with their voting rights or to encourage them to exercise the same. In view of the inaction of the companies in this respect it is not surprising that following the hearings, the Commission received many letters from policyholders of mutual companies indicating their surprise in learning that they were eligible to vote in the election of directors in their companies.[10]

An analysis of replies to a Commission questionnaire disclosed that 65 percent of the mutual companies did not mail special notices of elections of directors to their policyholders.[11] Furthermore, of the 80 mutual companies examined, as many as 19 announced the meeting for election of directors only by notice on the policy or policy jacket, and in the case of at least 65 percent of the companies the notice given was definitely of questionable value.[12] In most instances the notice

[8] Since the passage of sec. 94 of the New York Insurance Law in 1906 there have been only 5 contested elections of which 2 were directly attributable to the Armstrong Committee revelations. Of the 3 remaining, 2 elections involved the unsuccessful efforts of a single nominee to obtain a place on the board of the Mutual. In only one instance was an independent slate elected and that was in the case of the Buffalo Mutual Life Insurance Co., a relatively small assessment corporation where policyholders' dissatisfaction resulted from an increase in rates due to unfavorable mortality experience. With the exception of the Buffalo Mutual instance there have been no contested elections in New York State during the last 15 years (pt. 4, R. 1405).

[9] Pt. 4, R. 1311. It should be pointed out that the statute is so drawn as to prevent policyholders obtaining a list more than 8 months in advance of the election. This, coupled with the requirement that the nomination must be filed not less than 5 months before the election leaves only 3 months within which to obtain a list, circularize the same, and corral the necessary signatures. The situation is further complicated in the case of industrial companies organized under the laws of New York. The law does not contain any provision whereby policyholders interested in bringing about an independent nomination may secure a list of industrial policyholders though as far as numbers of policyholders are concerned, the industrial policyholders are far more important than the ordinary policyholders. In the case of the Metropolitan, which as of 1937 had 24,821,000 policyholders eligible to vote, from 22 to 23 million of these policyholders held industrial policies and their names would not have been available to anyone initiating an independent nomination (pt. 4, R. 1311: exhibit Nos. 232, 255; pt. 12, R. 5955). The Metropolitan does not keep a list in its home office of its industrial policyholders by name but only by policy number (pt. 4, R. 1305).

[10] Pt. 4, R. 1403.

[11] Pt. 4, exhibit No. 257. Out of 67 mutual companies for which information was available only 15 sent proxies to their policyholders. Contrast with stock life insurance companies. Over 88 percent of the stock companies replying to the same questionnaire sent special election notices to their stockholders. Replies to Commission's Preliminary Questionnaire, question 10.

[12] Pt. 4, exhibit No. 256.

was cryptic, adequate to meet minimum statutory requirements but far from sufficient to apprise the policyholder of his voting rights.[13]

An examination of votes cast in the elections of the 12 principal mutual companies during recent years indicates the ineffectiveness of the notice given and the resulting apathy of policyholders.[14] In the 1937 elections of these 12 companies, which at that time accounted for 72 percent of the assets of all companies,[15] an average of only 0.55 percent of the eligible votes was cast. It will be noted from the following table that the ratio of votes cast to the eligible votes was found to range from a low of 0.01 percent in the case of Northwestern Mutual to a high of 2.51 percent in the case of Prudential.[16]

Company	Estimated number of policy-holders	Number of possible votes	Number of votes actually cast per director	Percentage ratio of vote cast to possible votes
1. Metropolitan	27,111,000	24,821,000	437,804	1.76
2. Prudential	21,300,000	12,200,000	306,675	2.51
3. New York Life	2,000,000	1,850,000	318	.02
4. Equitable	1,149,500	1,072,000	532	.05
5. The Mutual of New York	865,000	805,000	177	.02
6. Northwestern	635,000	635,000	74	.01
7. John Hancock	5,170,000	5,250,000	1,169	.02
8. Penn Mutual	367,674	1,651,678	12,480	.76
9. Mutual Benefit	364,004	(1)	8,364	----------
10. Massachusetts Mutual	363,696	486,000	288	.06
11. New England Mutual	253,950	278,500	531	.19
12. Provident Mutual	189,000	189,000	2,395	1.27

1 Not supplied.

Three of the four large New York mutuals admittedly do nothing to encourage policyholder voting. The Equitable, New York Life, and Mutual did not advise their policyholders of their right to initiate independent nominations and in the absence of such nominations none of these companies mail ballots or proxies to their policyholders or undertake to encourage their participation in the voting. It appeared that the votes cast were largely votes of employees of the companies who also happened to be policyholders,[17] and that in at least two recent elections of Mutual directors, for example, all votes, with the possible exception of one or two which could not be identified, were cast by employees of the company.[18] With such a procedure in vogue, it is small wonder that policyholders become apathetic and managements become entrenched.

In the Metropolitan and Prudential a slightly different situation is present. As these are the two largest American companies, a more

[13] It is significant that practically only a single instance, that of the Acacia Mutual Life Insurance Co. of Washington, D. C., was a system of notice used which approximated adequate disclosure to the policyholder of his franchise rights (pt. 4, R. 1378–1387). This company was one of the few companies found to encourage its policyholders in initiating of independent nominations for the Board. In its case such nominations are frequently made and the policyholders are given an opportunity to vote thereon. Approximately 25 percent of the policyholders eligible to vote participate in the elections (pt. 4, R. 1384).

[14] Pt. 4, exhibit No. 255.

[15] Pt. 4, R. 1400.

[16] Pt. 4, exhibit No. 255.

[17] Pt. 4, R. 1373, 1391.

[18] Pt. 4, R. 1392.

detailed discussion of their elections is in order. The Metropolitan has adopted a unique procedure. Its effect is to stir up policyholder interest in the election after it is certain that the "administration ticket" will be reelected. No notice is given to the policyholder of his right to initiate an independent nomination.[19] The "administration ticket" is nominated 7 months prior to election and certified to the superintendent of insurance according to law.[20] No publicity is given the composition of the slate, however, until much later, after the time for independent nominations is past.[21] At this juncture one affirmative vote will assure election of the entire ticket. For reasons which were not made clear it is precisely at this juncture that the Metropolitan undertakes to interest its policyholders in the election—after the result cannot be changed.[22]

The elections are usually held the second Tuesday in April of every odd numbered year, at which time the entire board stands for reelection.[23]

In the case of contested elections the New York law prohibits agents from soliciting policyholder votes during business hours. In uncontested elections, however, this provision is waived by the superintendent at the request of the Metropolitan in order to permit such solicitation by the company's agents.[24] Accordingly, during the month of January of each election year over 1,000,000 ballots and proxies are printed and distributed among the company's agents and managers [25] on a pro rata basis with instructions to obtain policyholders' signatures thereon.[26]

Completed ballots and proxies are usually sent in by the office manager.[27] They are opened and sorted prior to election date by Metropolitan clerks.[28] No signature comparison is made at any

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[19] Pt. 4, R. 1297.

[20] Pt. 4, R. 1297, 1298.

[21] Pt. 4, R. 1297, 1298. There is a notice which appears on Metropolitan policies, premium receipts, and premium receipt books to the following effect (pt. 4, R. 1298):

"An election of directors of the company is held in New York on the second Tuesday in April of every odd year. The holder of this policy while it remains in force after 1 year from its date of issue will have a right to vote either in person or by proxy or by mail. For full particulars how to vote, apply to the secretary, No. 1 Madison Ave., New York City."

Formal notice to the same effect as the foregoing is given through a policyholders' magazine (pt. 4, exhibit No. 256). Statutory newspaper notices are placed in New York City newspapers at intervals for 2 weeks prior to the actual voting but these notices fail to mention that the policyholder has a right to vote (pt. 4, R. 1299, 1300).

[22] A former superintendent of insurance for the State of New York, W. T. Emmett, stated in a letter to the president of the New York Life, dated January 3, 1913 (pt. 4, R. 1398):

"* * * there being no contest, the law does not contemplate that your company incur the expense of mailing ballots to its policyholders or require it to take any action for the purpose of bringing out the vote, for by the express requirements of the law, itself, the election could have but one result."

[23] Pt. 4, R. 1295.

[24] Pt. 4, R. 1296.

[25] Pt. 4, R. 1301.

[26] A circular letter written to the Metropolitan agency force stated: "These ballots are not merely for distribution, but are intended for use. As soon as an agent has exhausted his first installment of ballots and proxies, he should be given another lot and encouraged to exert every reasonable effort to have them used" (pt. 4, exhibit No. 248).

Agents are under pressure to get the ballots signed (pt. 4, R. 1317, 1324, 1362). One agent testified that his manager told the men that they would be disloyal if they did not bring in completed ballots within a certain time and a week's deadline was set (pt. 4, R. 1324). Another testified that the obtaining of proxies was part of the "detail work" and that his pay would have been held up had he not obtained the necessary signatures, i. e., completed detail work by the end of the week (pt. 4, R. 1362).

[27] Pt. 4, R. 1302.

[28] Pt. 4, R. 1304.

time.[29] The final count, a mere formality, is made in the presence of representatives of the New York State Insurance Department.[30] In the 1937 election, 437,804 votes out of a possible 24,821,000 were cast.[31] The great majority of votes were cast by mail. Only 40 policyholders voted in person. These were all home-office employees, and the Metropolitan's assistant secretary in charge of the voting laconically reported to the president that "No outsider called." [32]

Thirteen agents of the Metropolitan were subpenaed and testified regarding the practices of the company in soliciting proxies and ballots from policyholders.[33] These agents all worked for the Metropolitan at the time and were employed in nine different branch offices of the company located at Philadelphia; New York City; Paterson; Boston and Somerville, Mass.[34] Without exception, the agents testified that it was common practice for them to sign names of policyholders to the ballots without the knowledge or authority of the policyholders. It appeared that where resistance of policyholders was met or where for various reasons the agents did not wish to approach the policyholders with regard to the ballots they would exchange the proxies with each other asking fellow agents to sign names of policyholders to the proxies.[35] This signing frequently took place openly in the district offices of the Metropolitan and in the presence of the assistant managers.[36] Though no agent was able to testify that any assistant manager knew of the existence of the practice many indicated that it was their belief the assistant managers did know and one agent pointed out [37] that proxies were turned in to the assistant manager in his office "before the ink was dry." A former assistant manager testified that he had known of the practice when he was an agent

[29] Id.

[30] Pt. 4, R. 1302, 1303. As further indication that the election is a mere formality, attention should be called to the fact that packages of completed proxies and ballots are occasionally shipped by express from the managers to the company's home office. Since the New York law requires that the proxies and ballots be received by mail, a representative of the office takes the package to a local post office and the company mails the ballots back to itself (pt. 4, R. 1302). Similarly, the instructions issued by the Metropolitan to the clerks counting the ballots instruct them to void any ballot which does not state a policy number. These instructions were issued in the face of subsec. 16 of sec. 94 of the New York insurance law which states that failure to state or correctly state a policy number shall not render a ballot void (pt. 4, R. 1303).

[31] Pt. 4, exhibit No. 255.

[32] Pt. 4, exhibit No. 245.

[33] Pt. 4, R. 1313–1369.

[34] One agent had been with the company for 20 years (pt. 4, R. 1350), and the average length of service for the 13 was 9 years. Pt. 4, R. 1313, 1323, 1332, 1338, 1342, 1346, 1350, 1352, 1355, 1357, 1359, 1361, 1363.

[35] Pt. 4, R. 1316, 1317, 1328, 1333, 1337, 1343, 1347, 1351, 1352, 1355, 1360, 1361, 1364. Most of the agents testified that they met objections from the policyholders when they attempted to obtain the signatures. For testimony on this point, indicating the nature of the objections raised, see pt. 4, R. 1314, 1321, 1324, 1332, 1333, 1346, and 1358.

One agent testified as follows (pt. 4, R. 1356):

"They hesitated to sign. They either didn't want to sign the ballot because they didn't feel they were fully acquainted with the practice, or if they did really attempt to understand the mechanics of elections and examine the names on the ballots, they either didn't want to because they didn't know the people or in some cases because they did know some of the people."

Another testified that many of the policyholders were illiterate and signed with an "X" and that (pt. 4, R. 1324):

"It wasn't an easy job to sign them because most people objected for no good reason; they didn't want to bother signing because they didn't know what they were signing for; some of them were very leery about signing something they didn't understand."

[36] Pt. 4, R. 1317, 1323, 1333, 1336, 1337, 1338, 1343, 1353, 1357, 1358, 1360, and 1364.

[37] Pt. 4, R. 1343.

and participated in it.[38] He stated that the practice of signing policyholders' names was common. Referring to this practice he said:[39]

When I was sitting with agents together I would see it, but as an assistant manager I shut my eyes.

He indicated that he and the other assistant managers avoided discussion of the question.[40]

A representative excerpt of the testimony from one agent relating to this matter is noted below:[41]

Mr. GESELL. Is the practice in your office the same as the practice in the office concerning which the previous agents have testified?

Mr. PETTINELLI. Yes, sir.

Mr. GESELL. Is it the practice in your office to exchange ballots among the agents and for the agents to sign policyholders' names to those ballots?

Mr. PETTINELLI. Yes, sir.

Mr. GESELL. Was that practice in effect in your office when you came to work?

Mr. PETTINELLI. I went to work with the Metropolitan in the year of 1936 and the week of June 29.

* * * * * * *

Mr. GESELL. Tell us what was the practice.

Mr. PETTINELLI. Well, the practice was that the ballots were distributed to the agents by assistant managers, and they were requested to take the ballots out and get them signed by the policyholders. So naturally when I was given the ballots, I went out on my debit and asked people to sign the ballots. In many cases, as a matter of fact, at that time my debit was a 98 percent foreign debit.

Senator KING. I didn't get that.

Mr. GESELL. What do you mean by foreign debit?

Mr. PETTINELLI. Italian people, and most of them, naturally, in many cases, they didn't know what they were signing, and in many cases people had never heard of the company having an election, and when the ballot was presented to them, they kind of resented it because they didn't know what they were signing for. In other instances people didn't know how to write their name. They made cross marks, and naturally they weren't going to attach a cross to something that they didn't know what it was.

Mr. GESELL. They couldn't read, in other words.

Mr. PETTINELLI. Positively, they couldn't.

Senator KING. They could perhaps read the Italian language but not the English, is that what you mean?

Mr. PETTINELLI. That is right.

Mr. DOUGLAS. The ballots were in English?

Mr. PETTINELLI. Positively.

Mr. GESELL. So what happened after that?

Mr. PETTINELLI. So the next morning when I first was given the ballots, I took in as many as I had signed by policyholders, and naturally an agent's time is limited. He has no time control; he must go out and do a day's work, and with all that he had to get these ballots signed, so naturally we didn't have very

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[38] Pt. 4, R. 1351.

[39] Pt. 4, R. 1351.

[40] Id. Various estimates were received from the agents as to the percentage of ballots cast in their respective branch offices which were signed in this unauthorized manner. Estimates ranged from 20 to 98 percent of the total ballots cast (pt. 4, R. 1339, 1344).

[41] Pt. 4, R. 1346, 1347.

much time to get all our ballots signed, and one morning when I was sitting there, the first thing I know, I saw some ballots stuck in front of me, so a man said, "Go ahead and sign them for me."

Senator KING. Was he an agent?

Mr. PETTINELLI. Yes, sir. So the first thing you know ballots were floating all over the office.

Mr. GESELL. And you saw then it was the practice in the office for the agents to do the signing themselves?

Mr. PETTINELLI. Yes, sir.

Mr. GESELL. And was that practice continued in the following elections?

Mr. PETTINELLI. It only took place in the one election in 1937.

Mr. GESELL. That is the only one you have been in?

Mr. PETTINELLI. Yes.

Mr. GESELL. Was it the general practice in the office for you to sign that?

Mr. PETTINELLI. Yes, sir.

Mr. DOUGLAS. What percentage of the ballots going out of your office in that election would you estimate were forged?

Mr. PETTINELLI. Why, I should say the majority.

Mr. DOUGLAS. Over 50 percent?

Mr. PETTINELLI. Positively.

Mr. GESELL. How many men were working in your office?

Mr. PETTINELLI. At that time there were approximately 46 men.

Mr. GESELL. Was any of this signing done in the presence of the assistant managers?

Mr. PETTINELLI. Well, the assistant managers were in the agents' room.

Mr. GESELL. When the signing was going on?

Mr. PETTINELLI. Yes, sir.

Mr. GESELL. Do you know whether or not they saw what was going on?

Mr. PETINELLI. That I can't say.

The Commission was prepared to present further testimony on this general question but the committee ruled that such testimony would be cumulative and prevented the calling of additional witnesses. Subsequently numerous agents appeared at the hearings, including a Mr. Roth, who stated he represented 1,800 Metropolitan agents who desired to refute the testimony of the witnesses on this subject and to deny the existence of the practice. No further testimony was taken, however, the committee stating that further evidence would constitute an unnecessary burden on the record. It was assumed the testimony would be contrary to that already given.[42]

It should be pointed out that this unauthorized signing in no way affected the result of the election. The result was certain under the law before the ballots and proxies reached the agents' hands. This fact was evidently partly responsible for the attitude of the agents who recognized the procedure as pure window dressing.[43]

As further indication that the policyholders of the Metropolitan are given no bona fide opportunity to participate in elections of directors, the company's treatment of policyholders who inquire concerning their franchise rights is pertinent. First, it is clear that such policyholders are not advised of this right to participate in the

[42] Pt. 4, R. 1367–1369, 1409–1410. All ballots and proxies are destroyed by the Metropolitan 4 months after they have been counted (pt. 4, R. 1305). Such destruction is permitted by law. (*Id.*)

[43] See e. g., pt. 4, R. 1357.

filing of an independent nomination.[44] Furthermore, several cases appeared in which the Metropolitan investigated policyholders who wrote in to inquire concerning their right to vote.[45] One such case, that of Mr. C. L. Fontaine, of Kansas City, Mo., is in point. Mr. Fontaine wrote the following on a postcard to the Metropolitan under date of September 29, 1936:[46]

> Kindly advise me as a policyholder how to vote. Is there one vote for each policy, one for each holder or is the vote regulated by the amount of insurance carried?
>
> Yours very truly,
>
> C. L. Fontaine,
> *Kansas City, Mo.*

This inquiry resulted in the Metropolitan making surreptitious investigation of Mr. Fontaine. The manager of the Kansas City district office of the Metropolitan was asked to find out about Mr. Fontaine's business and general standing in the community and was instructed as follows in a letter from the home office:[47]

> There is no need for you to send one of your men to question him. Casual inquiries of the agent or of others in the neighborhood of his business should enable you to give us a pretty good line on him and his interest in the company.

As a result, an inquiry into Mr. Fontaine's background was made and a report filed.[48] Mr. Cletis Tully, assistant secretary of the Metropolitan stated, that this investigation was for the purpose of obtaining correct information as to the amount of insurance carried by Mr. Fontaine and the policy number of his policy. He was unable satisfactorily to state why this simple information could not be obtained directly from the policyholder and his explanation appears meaningless in view of the fact that file was closed without his receiving the information which he says was desired.[49] Mr. Tully stated that the reason he took the trouble to make the investigation in this case was "just poor judgment" and he denied that he was alarmed or had any desire to determine whether Mr. Fontaine might be interested in initiating an independent nomination.[50] It is difficult, however, to find any other explanation for his activities in this regard.

There has never been a contested election in the Metropolitan since its mutualization in 1915.[51]

In the light of the foregoing, it is interesting to examine the testimony of Mr. Frederick H. Ecker, who steadfastly maintained that the chief advantage of the mutual form of company was that it gave policyholders the right and the practical opportunity to oust directors

[44] It is interesting to note that in the case of one policyholder who wrote for full information a reply was sent which did not advise the policyholder of his right to make an independent nomination and that a tab on the letter to Mr. Cletis Tully, assistant secretary of Metropolitan, from a member of the legal division of the Metropolitan stated (pt. 4, R. 1310):

"This letter has had the consideration of Messrs. Lincoln and Ecker who don't want any further explanation given." See also pt. 4, R. 1307.

[45] Pt. 4, R. 1307–1310.

[46] Pt. 4, R. 1308; exhibit No. 250.

[47] *Id.*

[48] *Id.*

[49] Pt. 4, R. 1309.

[50] Pt. 4, R. 1309, 1310.

[51] Pt. 4, R. 1295.

when those directors were not conducting the company in accordance with the desires of the policyholders.[52] He stated:[53]

> If there were an abuse and it was publicized, there would be votes by our policyholders that would put out of office any unsatisfactory board of directors.

It was this right of the policyholders which Mr. Ecker indicated gave his company an advantage over companies operating under the stock plan.[54]

An officer of the Prudential made no such claim in describing the elections of directors in his company, and admitted frankly that he could not tell whether there was any possibility of an independent nominating succeeding.[55] In the case of the Prudential, which it will be recalled is in process of mutualization, elections are held once a year, at which time 4 of the company's 16 directors are elected for a term of 4 years.[56] Although the elections are conducted under a New Jersey statute,[57] which differs somewhat from the New York statute, the directors remain in an equally impregnable position. Any policyholder, industrial or ordinary, whose policy has been in force at least 1 year and who is 21 years of age or more may cast a vote.[58] Policyholders are notified of their right to vote by advertisements inserted in newspapers published in the capital of each State in which the Prudential does business and by notices delivered to the policyholders through the agency force. There is no provision in the New Jersey law for an "administration ticket" as such and no time limit within which independent nominations must be filed. In one sense of the word, each election is a contested election; that is to say, anyone can be elected a director of the Prudential if he receives sufficient proxies on his behalf to carry the vote, and it is not until this final vote at the policyholders' meeting that it can be definitely determined whether persons selected by the existing directors or persons designated by someone else have been chosen.[59] As a practical matter, however, no one in recent years other than a nominee of the existing board of directors has ever received more than 4 votes.[60] The company prints and distributes, through its agency force, two types of proxies; a white proxy which contains the names of the four directors selected and nominated by the existing board and green proxies, upon which a policyholder may designate a nominee of his own selection.[61] The number of white proxies is always greatly in excess of the number of green proxies.[62] When executed proxies are received, no signature comparison is made.[63]

As in the case of the Metropolitan, election irregularities were discovered. Representatives of the Commission selected at random 110

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[52] See Metropolitan advertisement, pt. 4, exhibit No. 231.

[53] Pt. 4, R. 1275.

[54] Pt. 4, R. 1250 to R. 1252, inclusive.

[55] Pt. 12, R. 5961.

[56] Pt. 12, R. 5914, 5915.

[57] Revised Statutes of New Jersey, 1937, sec. 17:21-1.

[58] Pt. 12, R. 5915. In the 1937 election, 12,200,000 policyholders out of a total of 21,300,000 policyholders were entitled to vote. Of this number 306,675, or 2.51 percent actually voted. Pt. 4, exhibit No. 255.

[59] Pt. 12, R. 5915–5917; exhibit No. 1005.

[60] Pt. 12, R. 5920.

[61] Pt. 12, R. 5917.

[62] Pt. 12, exhibit No. 1008. In the industrial division of the company for the 1938 election, 569,000 white proxies were printed and only 29,500 green proxies were printed. *Id.*

[63] Pt. 12, R. 5919, 5920.

proxies cast in recent elections and compared signatures thereon with signatures on the applications for insurance signed by the policyholders purporting to have signed the proxies. These proxies were cast during the elections of 1934, 1936, and 1937 by policyholders residing in St. Louis, Detroit, New York City, and Chicago. It was found that 21 proxies could not be compared because the policy number written on the proxy did not correspond with the true policy number; that 5 proxies were signed by minors and hence invalid, and that 44 were signed by unauthorized persons contrary to the certification on the proxy that the policyholder had personally, in the presence of a witness, appeared and signed the proxy in question.[64] Mr. William W. Van Nalts, secretary of the Prudential, who stated that he was familiar with all elections held in the Prudential since mutualization proceedings were commenced, testified as follows:[65]

Mr. GESELL. * * * can a policyholder of the Prudential call at the home office or write and get a copy of the list of policyholders of the company?

Mr. VAN NALTS. I don't know that anybody can get a list of the policyholders of the company. It would be a tremendous job to do that.

Mr. GESELL. In other words, if I happened to be a policyholder of the company and decided I wanted to put someone of my own choice on the board of directors and decided that I would undertake that venture and attempt to get a policyholder's list I couldn't even find one at your company?

Mr. VAN NALTS. We couldn't make up a list without a tremendous amount of labor and expense. It would be of no benefit to the policyholders.

Mr. GESELL. If I were attempting to put someone of my own choice on the board of directors it might be of some benefit to me.

Mr. VAN NALTS. No; we wouldn't care about that.

Mr. GESELL. So as a practical matter anybody who wants to really get under way and move to put on someone other than that person selected by the board of directors hasn't a possible chance of doing so?

Mr. VAN NALTS. I don't know.

The VICE CHAIRMAN. What is the answer?

Mr. VAN NALTS. I don't know what the chance is.

Mr. GESELL. You don't think he has any?

Mr. VAN NALTS. I don't know whether he has.[66]

Opportunity for policyholders of mutual companies actually to take part in the management of their companies is even less than the foregoing would indicate. The absence of provision for cumulative voting, the occasional use of perpetual or long-term proxies, the staggering of directors' terms, the failure of companies to bring their management face to face with the policyholders at annual meetings similar to stockholders' meetings,[67] and the policyholders' lack of legal authority to gain access to the books and records of their companies or in many

[64] Pt. 12, R. 5924, 5925.

[65] Pt. 12, R. 5921.

[66] In one instance where a policyholder did make inquiry and request a list of policyholders, the Prudential conducted an investigation from which it appeared that representatives of the office of the chief inspector of the Prudential had examined exhaustively into the family and background of the inquiring policyholder (pt. 12, exhibit No. 1010). Mr. Van Nalts testified (pt. 12, R. 5923):

"* * * it is only a natural thing to want to know who a man is who makes an inquiry."

The investigation appears to have been made for the purpose of determining whether the inquiring policyholder was one who was interested in initiating a plan to make an independent nomination for the board of directors. Id.

[67] The laws of Connecticut, New York, Massachusetts, Ohio, Illinois, New Jersey, and Pennsylvania, for example, contain no requirement for policyholders' meetings except such meetings as may be necessary for the purpose of voting for directors.

States even to obtain a list of their fellow policyholders [68] are all factors tending to disfranchise the policyholder and to entrench management.

1. *Cumulative voting.*

The usual practice is to permit each policyholder of a mutual company one vote for each candidate to fill each vacancy on the board of directors. Thus if there are 10 directors up for election, a policyholder may cast 10 votes but must not vote more than once for any candidate. Cumulative voting permits a policyholder to lump his votes in favor of a single candidate. There can be no doubt that the general availability of cumulative voting privileges would afford policyholders greater opportunity to secure representation on boards of mutual companies. Only 3 States, Arizona, Pennsylvania, and Wisconsin, have statutes which require mutual policyholders be given cumulative voting privileges. An analysis of the charters and bylaws of 73 mutual companies disclosed only 1 company, a company incorporated in Pennsylvania, which granted cumulative voting privileges to its policyholders.[69] Except for companies incorporated in the 3 States indicated above, cumulative voting by policyholders of mutual companies is nonexistent. In contrast, the laws of many States provide cumulative voting rights for stockholders of life insurance companies.[70]

2. *Perpetual or long-term proxies.*

Under this form of proxy the policyholder authorizes representatives of the management to act as his proxy so long as he remains a policyholder in the company or until the authority given is specifically revoked.[71] These proxies are sometimes presented to the policyholder

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[68] Under New York law, policyholders' lists (excluding names of industrial policyholders) can be obtained under the restricted conditions previously indicated, p. 14, supra. No provision in this regard is found, however, in the laws of other principal insurance States, including Connecticut, Massachusetts, New Jersey, Illinois, or Ohio. In none of the above States, including New York, does the policyholder have the right to examine the books or records of his company. Stockholders on the other hand have had this right for many years and indeed it is a rare exception that the right is not guaranteed both by statute and by bylaws or charter provisions as well. The failure to give similar rights to policyholders, either through statute or by law, is not explained.

[69] Replies to Commission's Preliminary Questionnaire, item 3.

[70] The laws of as many as 19 States contain mandatory provisions in this respect: Arizona, Arkansas, California, Idaho, Illinois, Kansas, Kentucky, Mississippi, Missouri, Montana, Nebraska, North Dakota, Ohio, Pennsylvania, South Dakota, Washington, West Virginia, Wyoming, and South Carolina. An additional 17 States have permissive statutes: Colorado, Delaware, Florida, Indiana, Louisiana, Maryland, Michigan, Minnesota, Nevada, New Jersey, New Mexico, Rhode Island, New York, Tennessee, Virginia, Maine, and Utah.

[71] The form of proxy used by the Home Friendly Insurance Co. of Baltimore, Md., is set forth below (pt. 12, exhibit No. 1073). This is typical of the type of proxy mentioned herein.

"Policy No. ——

"Know all men by these presents: That the undersigned member and policyholder of the Home Friendly Insurance Co. of Maryland, hereby constitutes and appoints, for such period as I shall remain a member of said company, Chas. H. Taylor, D. F. Zeigler, F. Chase MacCubbin, George W. Kelley, Berlin F. Wright, Daniel B. Chambers, George S. McKindless, and E. T. Westervelt, or the survivors of them, with full power of substitution, and with full power for a majority of them to appoint a successor to any proxy who shall die or resign, vested with the same power and authority as that possessed by the one so dying or resigning, my true and lawful attorneys and proxies, in all matters and things as the majority of them shall determine and direct, to act for me and in my place and stead to fully represent me at the annual meeting of members or policyholders, and at any and every other meeting of members or policyholders of said Home Friendly Insurance Co. of Maryland, and for me and in my place and stead to vote for the election of directors and upon all other matters presented at any such meeting or meetings, the number of votes that I am entitled to cast at any such meeting or meetings, as fully and to the same extent that I might do if I were personally present.

"Witness my signature and seal this —— day of —— 19—.

"[SEAL] —— ——.

"Debit No. ——

"Proxy must be witnessed and dated."

when he first joins the company and indeed one company uses a proxy form which requests signatures at the same time that the receipt for the first premium payment is delivered.[72] This form of proxy was condemned by the Armstrong committee and though subsequently outlawed in some States is still used by at least five mutual companies.[73]

3. *Staggered directors' terms.*

Of 73 mutual companies examined in this regard, 41, including such important companies as Prudential, New York Life, and Mutual Life, provide that all directors shall not stand for election at the same time.[74] This staggering places policyholders in a disadvantageous position if they seek to elect a majority of directors since they must prevail not in one election but two and more frequently three elections in order to place a majority of directors of their own selection on the board. This doubles or triples the effort required and results in great delay, particularly since it puts the existing board on notice of opposition at the time of the first election and thereby enables it better to marshal forces to put down subsequent attempts. Presumably this staggering of directors' terms results in part from a desire for continuity of management. It has repeatedl been stated by life insurance officials and other observers that the boards of insurance companies should not be so readily removable as to lay the management open to continual attack from unscrupulous individuals anxious to gain control of the company and not motivated by a bona fide desire to protect the policyholders' interests. This point was well stated in the Armstrong report as follows: [75]

> While it would be plainly unwise that the management of a life insurance company should be rendered unstable or that its personnel should be frequently changed, it is of the first importance that officers should realize their direct responsibility to those whom they represent and should rely for their continuance in office upon proved efficiency and not upon a practical inability of the policyholders to depose them.

In the light of the discussion contained in this section, however, the opportunities for policyholder representation on the board appear to be so slight as to raise some question whether the absence of provisions for the staggering of directors' terms will lead to unstable management. Presumably policyholder interest is at its greatest in times of emergency. At such times immediate reversal of management policy will probably more often than not be desirable.

In summary, it may be said that there are many legal and practical obstacles in the way of policyholders of mutual companies which

[72] Pt. 12, R. 6094. Reply to Commission's preliminary questionnaire, item 10, American United Life Insurance Co.

[73] American United Life Insurance Co., Columbian Mutual Life Insurance Co., Minnesota Mutual Life Insurance Co., Pathfinder Life Insurance Co. and Home Friendly Insurance Co. Replies to Commission's preliminary questionnaire, item 10.

The Armstrong report stated (vol. X, p. 369):

"* * * it is the judgment of the committee that proxies should not only be revocable at pleasure, but should be required to be given within 2 months of the election and should be valid only for that election."

[74] Mutual Life changed to a staggered system in 1939 (pt. 4, R. 1393).

[75] Armstrong report, vol. X, p. 367. See also Life Insurance, extract from Eighty-first Annual Report of the Superintendent of Insurance to the Legislature of the State of New York, p. 11 et seq.

Charles Evans Hughes also acknowledged the desirability of isolating the managements of mutual companies from "the intrusions and insincerities of politics or the fantasies of dreamers." While recognizing that policyholders must have "real" power to exercise final control, he indicated in 1926 his general approval of the New York law governing elections of directors, pointing out the undesirability of policyholders managing the affairs of their companies directly (pt. 4, R. 1258).

prevent them from electing directors to the boards of their companies. Not only is the original selection of board members in the hands of the managements rather than the policyholders,[76] but policyholders are found to have no effective recourse against directors whose actions they may deem inimical to their best interests.

The great expense which mutual policyholders must undergo in initiating and perfecting an independent nomination, the apparent unwillingness of managements to educate their policyholders in the advantages and use of their franchise privileges,[77] and the many factors which assist entrenched management when it deals with the widely distributed and highly unorganized interest of the policyholder have but one possible tendency, namely, to foster irresponsibility in management.

The Commission's inquiry into the election procedure of mutual life-insurance companies has revealed a condition almost identical with that disclosed by the Armstrong report in 1906. In this connection, the Armstrong report stated.[78]

> Notwithstanding their theoretical rights, policyholders have had little or no voice in the management. Entrenched behind proxies, easily collected by subservient agents and running for long periods, unless expressly revoked the officers of these companies have occupied unassailable positions and have been able to exercise despotic power. Ownership of the entire stock of an unmixed stock corporation scarcely could give a tenure more secure. The most fertile source of evils in administration has been irresponsibility of official power.

The situation has also been noted by others interested in the problem including the Pujo Committee in 1913 and Mr. James A. Beha, former superintendent of insurance for the State of New York, in his report to the legislature for 1927.[79]

This undemocratic situation becomes even more a matter of concern in view of the tremendous growth of the principal mutuals which has taken place since the days of the Armstrong report. As the size of the mutual companies increases, it would seem that it is more and more desirable that policyholders be assured a definite voice in the management of their companies. It is a serious question whether a system, under which the accumulation of large amounts of policyholder savings are administered by a self-perpetuating group of individuals who have no direct responsibility to the policyholders and whose activities are not even subject to threat of a possible policyholder review, should be permitted to continue. True, it is the directors who have the ultimate obligation for management and they

[76] Vacancies on the board of directors do not always occur on the expiration of a specific term of office. Rather, vacancies result from sickness, death, withdrawal from active business, or other similar reasons. The selection of an interim successor to the withdrawing director is, therefore, made by the board and on the next election the director so selected appears along with other directors of longer service as an established member of the board standing for reelection.

[77] Following the hearings on this subject before the Temporary National Economic Committee, the superintendent of insurance for the State of New York on March 6, 1939, issued requests to companies under his jurisdiction designed to bring about more effective notice to policyholders in matters affecting the election of directors. These requests suggested that policyholders be notified by statement on their premium receipts, of their right to nominate an independent ticket 5 months prior to the election.

The department now also requires that within 30 days after the filing of the administration ticket, the name and affiliation of each director on the ticket be published in two daily newspapers in New York State and one or more newspapers published in the larger cities of other States in which the company does a substantial business. (See Life Insurance, extract from Eighty-first Annual Report of the Superintendent of Insurance to the legislature of the State of New York, p. 16.)

These slight modifications will not materially change the situation revealed by the Commission's inquiry.

[78] Pt. 4, exhibit No. 258. Armstrong report, vol. X, pp. 366, 367.

[79] Pt. 4, exhibit No. 258. See also statements of Elizur Wright and other statements therein set forth.

are in the eyes of the law trustees charged with a duty to carry out the affairs of their companies in the interest of the policyholders. When it is said that the directors of mutual companies are acting in the interest of the policyholders, however, it should be noted that they are not selected by the policyholders, elected in fact by the policyholders or subject to immediate removal by the policyholders in the event their actions are considered inimical to the policyholders' best interests. There are admittedly great practical difficulties which must be overcome before any true enfranchisement of the policyholders can take place, but until substantial steps are taken in this direction, the management of the mutual life insurance companies will continue on an autocratic basis, and the mutual companies will not have achieved the status of the democratic institutions it was conceived they would be and which they should be if the policyholders' interest is to be best served.

B. DIRECTORS OF STOCK COMPANIES

No special studies were made of the machinery by which directors of stock life insurance companies are elected. In the main it is clear that these elections follow the usual corporate procedure, the directors frequently being in a position to perpetuate themselves in office both by reason of their access to the proxy machinery [80] and because they themselves may represent a substantial stock interest in the company.

Shares of life insurance companies are seldom traded on any National Securities Exchange. The over-the-counter market is often thin and trades few and far between.[81] Furthermore, in many cases the shares are not widely distributed. The Commission's studies reveal that frequently a majority of the outstanding shares are held by officers and directors of the companies and in almost all cases it appeared that at least a substantial minority interest was owned by such officers and directors.[82] Among larger stock companies, shares of which are widely distributed, there is a continuity of management similar to that found in the case of the large mutual companies. This continuity of management is in itself some measure of the ability of the management to control the situation as far as election of directors is concerned.

A study of the seven largest stock companies discloses that all but one company [83] have both participating and nonparticipating insurance in force and in all but two companies,[84] both participating and nonparticipating insurance is being issued at the present time. In several cases, the amount of participating insurance on the books of the companies is substantial and in the instance of the Equitable of Iowa, the participating insurance accounts for all but 16.7 percent

[80] Many stock companies, including the following, use perpetual or long-term proxies: Conservative Life Insurance Co. of America, Great Southern Life Insurance Co., Knights Life Insurance Co. of America, Midland National Life Insurance Co., Mammoth Life & Accident Insurance Co., Northern Life Insurance Co., Ohio State Life Insurance Co., Pan-American Life Insurance Co., Santa Fe National Life Insurance Co., Southern Life Insurance Co. of Georgia, Standard Life Insurance Co. of Indiana, Union Central Life Insurance Co., Western Reserve Life Insurance Co., American Central Life Insurance Co. Replies to Commission's preliminary questionnaire, item 10.

[81] Pt. 13, R. 6462. This situation prevails in the case of the common stock of Travelers Insurance Co. See pt. 13, R. 6454, 6455.

[82] See p. 98, infra.

[83] Western and Southern.

[84] Western and Southern and Travelers.

of the total. Furthermore, it is of interest to observe that reserves, i. e., the savings of policyholders, constitute a large proportion of the assets of these companies. The ratio of policyholders' liabilities to total assets in these stock companies ranges from 81.8 percent in the case of the Western and Southern to 95.1 percent in the case of the Union Central.[85] The fact that stock companies issue participating insurance and are to a large extent reservoirs for the accumulation of policyholder savings suggests the desirability of policyholders having some right to select and elect directors. With the exception of mutual savings banks, in hardly any other type of business enterprise is such an important contributor to the funds of the enterprise excluded from representation on its board.

Reference to a subsequent section of this report entitled, "Company Retirements—Reinsurance and Failures" demonstrates the ease with which stock companies are bought and sold or traded back and forth for personal profit between dominant proprietary groups, frequently without regard for the interests of the policyholders concerned. Furthermore, it is undisputed that the directors of stock companies which carry both participating and nonparticipating insurance on their books are faced each year with the delicate job of apportioning the profits of the enterprise between the shareholders on the one hand and the participating policyholders on the other. In matters of management policy it would appear that policyholders who contribute the bulk of the assets of the enterprise might well participate.[86]

This problem was one of long standing. As early as 1906, the Armstrong Report recommended that the New York law be amended:[87]

> * * * so as to confer upon the directors of stock life insurance corporations an unmistakable authority to grant to policyholders the right to vote for directors, and thus to have that voice in management to which their preponderate interests justly entitle them. It may not be necessary, as a matter of law, but it would more accord with the general sense of equity that such a change should be acquiesced in by a majority of the stockholders, and the committee believes that with an enlightened public sentiment it will not be difficult to obtain such assent.

The desirability of giving policyholders voice in the management of stock life insurance companies has been recognized by statute in Canada; where it it provided that each stock company shall determine by bylaw the number of directors to be elected by stockholders and the number of directors to be elected by the participating policyholders, respectively, subject to the provision that the number of policyholder directors so determined shall constitute at least one-third of the total number to be elected.[88]

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[85] Liabilities here shown include reserves, dividends left with the companies, supplementary contracts not including life contingencies, unpaid claims and amounts reserved for policyholders' dividends. Pt. 10A, R. 101.

[86] It will be recalled that there are seven companies accounting for only 0.8 percent of the assets where both policyholders and stockholders can participate in the election of directors. See discussion of mixed companies, p. 13, supra.

[87] Armstrong Report, vol. X, p. 379. This recommendation was not adopted.

[88] Revised Statutes of Canada 1917, sec. 93, subsec. 7, Insurance Act of 1917.

SECTION IV

Interlocking Directorships

In the field of life insurance where the economic power in the hands of directors is unusually great, interlocking directorships have particular importance.[1]

A special study was made of the business affiliations of the 135 directors who serve on the boards of the 5 largest companies. Among this group of 135 directors are directors of 100 other insurance companies, 145 banks or other financial institutions, and 534 industrial, real estate, or other miscellaneous corporations. Thus the 5 largest companies interlock with approximately 780 corporations while each director is on the average a director of 6 other corporations.[2] Included among these directors are many of the more prominent bankers and industrialists of the country. In addition to the chief officers of practically all the largest eastern banks, both commercial and savings, principal executives of such companies as the following may be found serving as directors of 1 of the 5 largest insurance companies: Western Union Telegraph Co., Crowell Publishing Co., Bethlehem Steel Corporation, United States Steel Corporation, Pacific Telephone & Telegraph Co., the Great Atlantic & Pacific Tea Co., National Biscuit Co., Johns Manville Corporation, International Nickel Co., Ltd., Baltimore & Ohio Railroad Co., the Yale & Towne Manufacturing Co., Air Reduction Corporation, Inc., R. H. Macy & Co., Inc., Canron Mills Co., and Radio Corporation of America.[3]

As the above indicates, the interests of the interlocking corporations are varied, covering practically every line of business enterprise from banking and finance on the one hand to publishing, real estate, manufacturing, communications, transportation, and merchandising on the other.[4]

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[1] In his message of April 29, 1938, on Strengthening and Enforcement of Antitrust Laws (S. Doc. No. 173, 75th Cong., 3d sess.) which was incorporated into the joint resolution creating the Temporary National Economic Committee, President Franklin D. Roosevelt suggested that the Committee should include an examination of interlocking directorships within the scope of its studies and indicated that possibly "more effective methods for breaking up interlocking relationships and like devices for bestowing business by favor" were desirable. The President referred to the "close financial control, through interlocking spheres of influence over channels of investment" and stated, "Interlocking financial controls have taken from American business much of its traditional virility, independence, adaptability and daring—without compensating advantages. They have not given the stability they promised." Ibid.

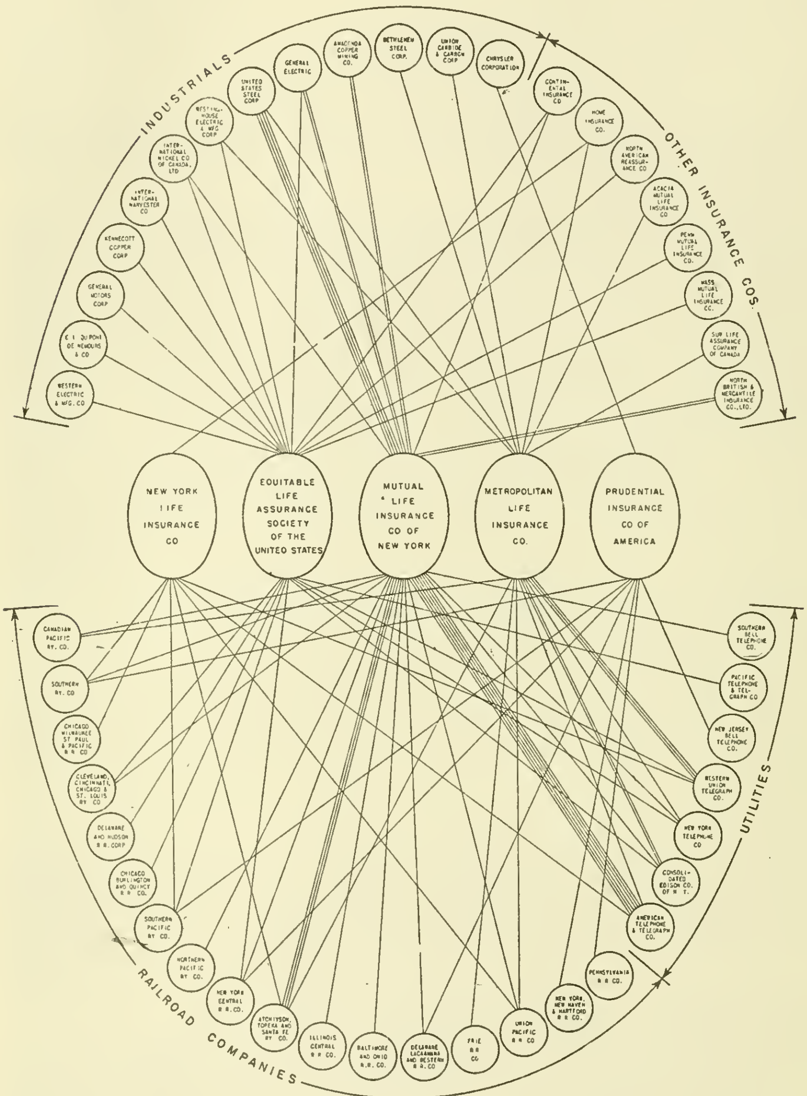
[2] Compiled from information submitted by directors of Metropolitan, Prudential, New York Life, Equitable and Mutual Life in response to a request of the Securities and Exchange Commission.

[3] These directors are respectively Mr. Newcomb Carlton, Mr. Joseph P. Knapp, Mr. Charles M. Schwab and Mr. Edward R. Stettinius of the Metropolitan; Mr. Horace D. Pillsbury of the Equitable; Mr. John A. Hartford and Mr. Roy E. Tomlinson of the Prudential; Mr. Lewis H. Brown, Mr. Robert C. Stanley, Mr. Daniel Willard, Mr. W. Gibson Carey, Jr., and Mr. Charles E. Adams of the Mutual Life; and Mr. Percy S. Straus, Mr. Charles A. Cannon, and Mr. James G. Harbord of the New York Life.

[4] For schedules of interlocking directorships of Metropolitan, New York Life, Mutual Life and Northwestern Mutual see pt. 4, exhibit Nos. 234, 262, 271, and 287, respectively.

Diagram A

THE FIVE LARGEST LIFE INSURANCE COMPANIES
INTERLOCKED BY DIRECTORSHIPS WITH IMPORTANT CORPORATIONS
(OTHER THAN BANKS)
1938



The strength of these interlocking connections may be emphasized by observing that they are not solely dependent upon the dual capacity of one or more directors. There are other tie-ins which operate to make the relationships more binding. Frequently the insurance companies have substantial bank deposits in the interlocking banks

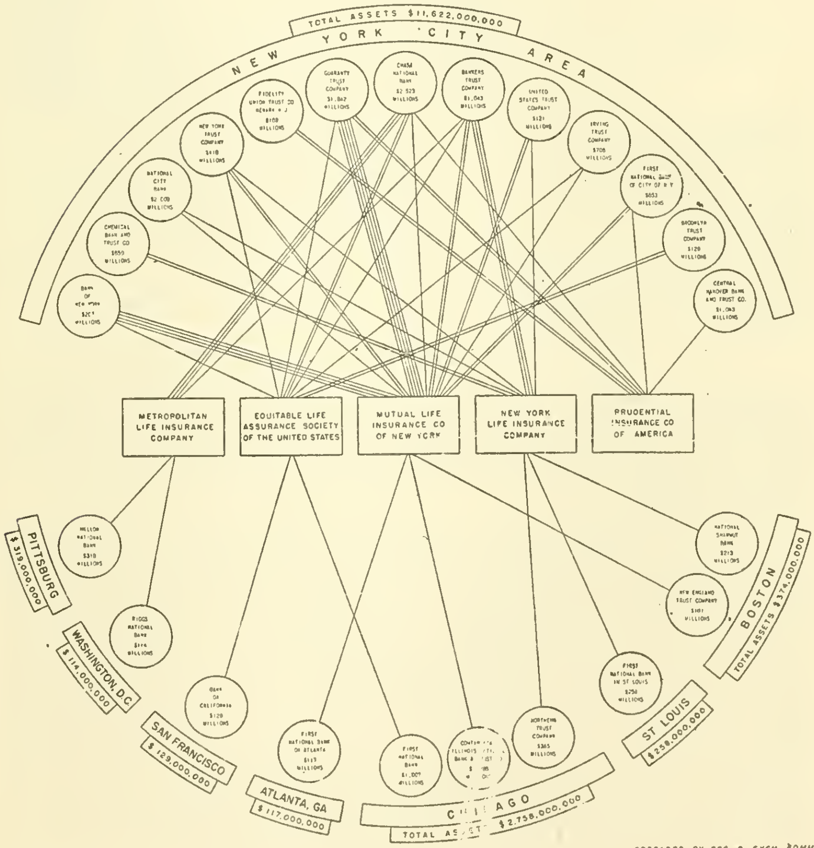
and substantial investments in, or outright business dealings with the interlocking corporations which bring about a closer contact.

The diagrams [5] which accompany the text were prepared to show the character and extent of interlocking between the 5 insurance companies and principal corporations. Diagram A presents all corporations with assets of $200,000,000 or more that interlocked with the 5 companies as of December 31, 1938. It will be observed that there are 13 industrials, 17 railroads, 7 utilities, and 8 insurance companies in this category or a total of 45 corporations, of which 20 interlock 2 or more times. Diagram B presents the principal interlocking connections of the same 5 insurance companies with banking institutions. Here it may be seen that these companies are affiliated through common directors with 23 large commercial banks having total assets of $15,691,000,000. The connection with New York

DIAGRAM B

58 DIRECTORSHIPS IN THE FIVE LARGEST LIFE INSURANCE COMPANIES INTERLOCK WITH 23 LARGE COMMERCIAL BANKS

1938



[5] Diagrams A, B, and C, which accompany the text, are all based upon information contained in pt. 13, exhibit No. 1345.

banks is particularly striking, 12 of the 13 banks shown having 2 or more common directors with the insurance companies.

Two aspects of this interlocking are particularly significant—the almost complete absence of interlocking between these life insurance companies [6] and the unusually pronounced connection between the five largest companies and principal New York banking houses. This latter fact requires special consideration.

As indicated by diagram C the 5 companies interlock with practically all major commercial and savings banks in the New York City area.[7] The most outstanding feature of this relationship is the close connection between these 5 principal insurance companies and the commercial banks. The 13 commercial banks shown on the diagram have a total of 48 interlocking directors on the boards of the 5 insurance companies, a number which comprises over a third of the total membership of the 5 boards. The representation of the 13 banks is indicated in the table below which lists these banks in order of size measured by the amount of their assets.[8]

Commercial banks	Number of directors interlocking with 5 largest insurance companies	Commercial banks	Number of directors interlocking with 5 largest insurance companies
Chase National Bank of the City of New York	7	New York Trust Co	4
National City Bank of New York	2	Bank of New York	5
Guaranty Trust Co. of New York	8	Fidelity Union Trust Co	2
Bankers Trust Co	7	Brooklyn Trust Co	2
Central Hanover Bank & Trust Co	1	United States Trust Co	3
Irving Trust Co	2	Total	48
Chemical Bank & Trust Co	2		
First National Bank of the City of New York	3		

These directorships are not divided evenly among the five life insurance companies in question. The Metropolitan, for example, has but four while well over 50 percent of the board of the Mutual Life is composed of representatives of large commercial banks in the New York area.[9]

The full significance of this interlocking may best be demonstrated by reference to some specific situations. Eight of the 13 commercial banks have either their president or the chairman of their board (sometimes both) on the boards of the "Big Five." For example, the largest insurance representation of the Chase National Bank is on the board of the Metropolitan. Mr. Winthrop W. Aldrich, chairman of the board of the Chase National Bank, is a director of the Metropolitan and Mr. Frederick H. Ecker, chairman of the Metropolitan board, is a director of the bank. The second largest representation

[6] Diagram A indicates that only four principal life insurance companies interlock with these five large companies, namely; Acacia Mutual, Massachusetts Mutual, Penn Mutual, and Sun Life Assurance Co. of Canada. In no case is there more than one interlocking directorship. (pt. 13, exhibit No. 1345).

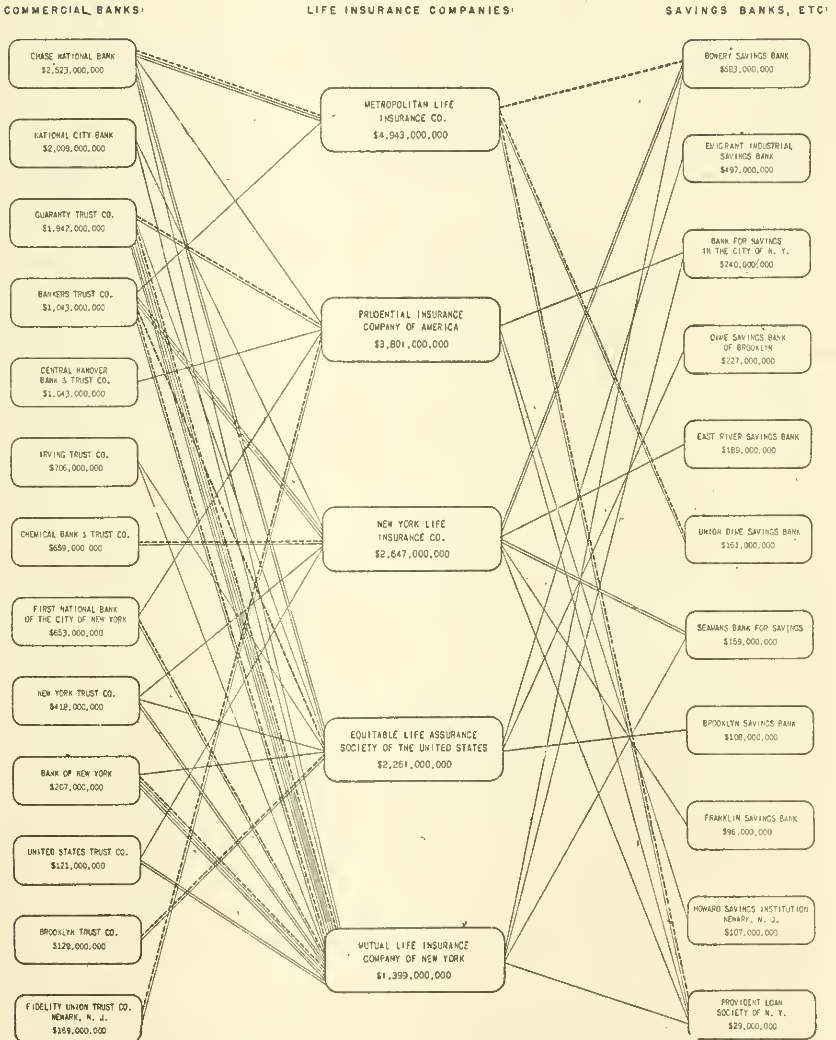
[7] Two principal commercial banks in New York City, Manufacturers Trust Co. and Bank of the Manhattan Co., do not interlock with any of these insurance companies.

[8] Pt. 13, exhibit No. 1345.

[9] The 48 interlocking banking directorships are distributed as follows (pt. 13, exhibit No. 1345): Metropolitan, 4; Prudential, 7; Equitable, 9; New York Life, 8; Mutual, 20.

DIAGRAM C

PRINCIPAL LINES OF RELATIONSHIP BETWEEN THE FIVE LARGEST LIFE INSURANCE COMPANIES AND OTHER FINANCIAL INSTITUTIONS IN THE NEW YORK CITY AREA 1938



EACH LINE REPRESENTS AN INTERLOCKING DIRECTORSHIP (DASHED LINE INDICATES EITHER A PRESIDENT OR A CHAIRMAN OF THE BOARD OF DIRECTORS SERVING AS A DIRECTOR OF AN INSURANCE COMPANY).

¹ FIGURES REPRESENT ASSETS AS OF END OF 1938.

OS-1333

PREPARED BY SECURITIES AND EXCHANGE COMMISSION

of the Chase National Bank is on the board of the Equitable Life Assurance Society, and it is not surprising to find Mr. Thomas I. Parkinson, president of the Equitable, on the board of the bank. In the case of the Guaranty Trust Co., its largest representation (five interlocking directors) is on the board of the Mutual Life, and here again the chief executive officers of the two institutions, Mr. William C. Potter, of the Guaranty Trust Co., and Mr. David F. Houston, of the Mutual Life, are each on the board of the other. The Guaranty Trust Co.'s second largest representation is on the board of the Prudential where one of the interlocking directors is Mr. W. Palen Conway, president and second executive officer of the Guaranty.[10] Furthermore it appears that the bank directors occupy particularly strategic positions on insurance company boards by reason of their frequent membership on the highly important finance committees, which have general charge of the investment of company funds.[11]

Indeed the relationship is so close that it may be said that a single group of directors has a substantial voice in determining the policies of the two most powerful financial enterprises in this country, insurance and banking.

In view of these dual directorships it is not surprising to find a close community of interest existing between the large New York banks and the neighboring insurance companies. With regard to bank accounts, for example, it appeared that, as of December 31, 1938, the 5 principal insurance companies had $428,000,000 on deposit in their various bank accounts. Of this amount $200,000,000, or almost half of the total cash, was deposited in New York City with the 13 principal interlocking banks. Furthermore, analyses of the principal home office accounts of the several insurance companies disclose that the allocation of these accounts has in many cases a direct relation to the banking representation on the board of the company concerned. For example, the Chase National Bank is the most powerful banking influence on the boards of both the Metropolitan and the Equitable and analyses of the bank deposits of these two companies disclose that each has placed its largest deposits with the Chase which holds $34,063,878 or 31 percent of its entire deposits, of the Metropolitan, and $40,433,858, or 36 percent of the entire deposits, of the Equitable. Similarly, the Mutual Life has placed its largest deposit, $10,575,932, or 17 percent of its entire deposits, with the Guaranty Trust Co. which, as has been indicated, occupies the dominant banking position on the Mutual Life board. The Prudential's largest deposit is also with the bank most influential on its board and the New York Life maintains many of its principal deposits with its interlocking banks. No instance was found where a major interlocking bank failed to get a substantial deposit.[12] Indeed there are strong indications that even

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[10] Pt. 13, exhibit No. 1345.

[11] The percentage of bank directors on the finance committees of the 5 companies at the end of 1938 was as follows: Metropolitan, 62.5 percent; Prudential, 71.4 percent; New York Life, 70 percent; Equitable, 20 percent; Mutual Life, 72.7 percent. Information compiled from company replies to Commission's investment questionnaire.

[12] 1938 Convention Form Annual Statements, Metropolitan, Prudential, New York Life, Equitable, and Mutual Life.

the relative size of deposits in interlocking banks is occasionally affected by the number of directors common to the bank and insurance company in question.

It is difficult to determine to what extent deposits are the direct result of solicitation by interlocking directors. Not only are most of the banks located in the same city as the insurance companies, thus making written communication infrequent, but the interlocking connections of these various banking houses with the insurance companies have existed over a long period of time and the maintenance of the accounts has become to some extent a matter of custom.

The files of the New York Life contained correspondence with one of its banking directors which is of interest in this connection. It appeared that Gen. James G. Harbord, a director of the Bankers Trust Co., joined the board of the New York Life in December 1931.[13] In June of the following year the New York Life deposited $1,000,000 in its account at the Bankers Trust Co.[14] Mr. Thomas A. Buckner, of the New York Life, characterized the making of the deposit as "purely a coincidence."[15] Although the exact circumstances under which the deposit was made were not explained, a letter from General Harbord, written at the time, to the then president of the New York Life is expressive. General Harbord's letter stated:[16]

> Dear Mr. Kingsley: As a director of the Bankers Trust Co., I want to thank you for the deposit of a round million which the New York Life has recently made. As a director of your own company, I want to express my appreciation.
>
> I regard the directorship in those two companies as quite the best thing that has come to me in business life, and it is very satisfactory to see this mutual relationship established between them.
>
> My cordial regards to you.
>
> Sincerely yours,[17]

Some instances of direct solicitation by banking directors were disclosed. An examination of the files of the Mutual Life revealed considerable information of this character. Of particular interest was correspondence between principal officers of the Mutual Life and Mr. John K. Ottley, president of the First National Bank of Atlanta, Ga., and a Mutual Life trustee. Mr. Ottley was elected a trustee of the Mutual Life on June 4, 1931.[18] Prior to his election the Mutual Life had established a small agency and home office account with the First National Bank.[19] The largest balance maintained by the Mutual Life in the First National Bank during the month of May 1931, immediately preceding Mr. Ottley's election as trustee, was $58,147.95.[20]

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[13] Pt. 4, R. 1433.

[14] Pt. 4, R. 1429, 1432.

[15] Pt. 4, R. 1433.

[16] Pt. 4, R. 1429.

[17] For testimony concerning New York Life's banking relationships, see pt. 4, R. 1428–1433; pt. 28, testimony of Alfred H. Meyers. February 26, 1940; and pt. 13, exhibit No. 1126.

[18] Pt. 4, R. 1454.

[19] Pt. 4, R. 1455; 1931 Convention Form Annual Statement, Schedule E.

[20] This was the highest balance maintained by the Mutual Life in the bank during the entire year of 1931 and was greater than the highest balance of the previous year (pt. 4, exhibit No. 277; 1930 and 1931 Convention Form Annual Statement).

The highest bank balances for the years subsequent to Mr. Ottley's appointment were shown to be as follows:

Year:	*Amount*
1932	$119,911.45
1933	551,558.30
1934	588,108.46
1935	865,286.39
1936	1,093,600.62
1937	1,138,681.06
1938	[1] 1,103,801.21

[1] Id.

These substantial increases in the Mutual Life's deposits with the First National Bank can be traced to Mr. Ottley's vigorous solicitation after his election as trustee. On September 7, 1933, Mr. Ottley wrote Mr. Turner, treasurer of the Mutual Life, a direct and revealing letter which read in part as follows: [21]

In my conversation with President Houston I stated to him that the present business of the Mutual Life with this bank is satisfactory and is duly appreciated. However, I advised him that my desire to have the relationship broadened and increased is based on three propositions. First, that as I make my living as president of the First National, my first interest is to build up its business. Second, that as a trustee of the Mutual Life—which is an honor I appreciate—I want the full interest of my bank—with its important sectional contacts—in the company's southeastern activities. This, I am sure you will agree, I can properly expect only as the size and value of the Mutual Life's business with us is at least on equal footing with other accounts with us of similar companies. Third, that I believe these purposes can be accomplished without costing our company anything.

* * * * * * *

You will understand that in going into this great detail I have tried to point out practical arrangements whereby my desire as president of this bank and as trustee of the Mutual Life could be accomplished with advantage to each and disadvantage to no one. Anything you can do for me in the matter will be greatly appreciated.

Nine days after writing this letter, Mr. Ottley's bank received a 90-day time deposit of $500,000 from the Mutual Life, and Mr. Ottley wrote Mr. David F. Houston, president of the Mutual Life, on September 16, 1933, stating: [22]

I am grateful for the special consideration shown and am very proud to have the closer tie-in between the bank and the insurance company in which I have very great interest.

In August of 1935, Mr. Ottley's correspondence indicates that he was again taking up the question of increasing the bank deposits, and 10 days after writing Mr. Turner, Mr. Ottley's bank received an additional deposit of $250,000.[23]

[21] Pt. 4, exhibit No. 272.
[22] Id.
[23] Pt. 4, R. 1456, exhibit No. 272.

Later, on May 5, 1936, Mr. Turner wrote Mr. Ottley, stating in part as follows: [24]

Referring to our conversation of last Wednesday, I have arranged to increase the company's balance with your bank to, say, $1,000,000, including the time deposit of $500,000, so that the relation between current and time funds may be equal.

and Mr. Ottley replied under date of May 10:

I wish to assure you of my appreciation of this compliment, and at the same time to tell you how good this news makes your trustee feel.

Solicitation of bank accounts by other Mutual Life trustees was also revealed. The evidence showed that in 1937, Mr. Stanley Field while a trustee of the Mutual Life, solicited the account of the Mutual Life for the Continental Illinois National Bank & Trust Co. of Chicago. As a result of this solicitation an increase was made in the Mutual's account with that bank, and Mr. Field acknowledged the increase stating: [25]

* * * I wish to express my personal appreciation of the action which you are taking to increase this deposit. * * *

It also appeared that a $2,000,000 deposit by the Mutual Life in the Chase Bank was made in 1934 at the solicitation of Mr. Cornelius Vanderbilt, then a director of the Chase and a trustee of the Mutual Life.[26] Similarly, an account was opened in the Bankers Trust Co. of New York, with which Mr. S. Sloan Colt, trustee of the Mutual Life, was connected. This account was opened after Mr. Colt came on the board of the Mutual Life and apparently authorized at a meeting of the finance committee at which Mr. Colt was present.[27] With respect to this deposit, Mr. Houston testified: [28]

Mr. GESELL. The thing that interests me, Mr. Houston, is that in 1928 the balance of your company with Bankers Trust Co. was a little in excess of $31,000; in 1929, a little in excess of $30,000; in 1930, a little in excess of $26,000; in 1931,

---

[24] Pt. 4, R. 1457. With respect to these deposits, Mr. Houston, president of the Mutual Life, testified (pt. 4, R. 1457, 1458):

"Mr. GESELL. Now would you have made these non-interest-bearing deposits with Mr. Ottley's bank if he had not made a specific solicitation of your company for those deposits?

"Mr. HOUSTON. In all probability. We were making them in different places. We had to put them somewhere.

"Mr. GESELL. Do I understand from your statement that you had funds to deposit and if directors sought those funds for those banks and you felt the banks were sound, you were willing to make the deposits with them?

"Mr. HOUSTON. We made them in banks where we did not have directors.

"Mr. GESELL. That does not answer my question.

"Mr. HOUSTON. I don't care whether it does or not. My disposition would be to do it, rather in spite of the fact the trustee is an officer of the bank.

"Mr. GESELL. I would like an answer to my question, whether you care to answer it, sir. My question was if a director or trustee of your company is connected with a bank and solicits the deposit of your company, and you feel that bank is sound, is it your practice to make the deposit?

"Mr. HOUSTON. I would not say it is our practice. We might make the deposit."

[25] Pt. 4, R. 1458, 1459, exhibit No. 275.

[26] Pt. 4, R. 1464.

[27] Pt. 4, R. 1459, 1460.

[28] Pt. 4, R. 1460, 1461.

a little in excess of $150,000; and then immediately after Mr. Colt becomes a trustee of your company, the balance jumps to over $1,500,000.

Mr. HOUSTON. Yes.

Mr. GESELL. Is there any connection between the fact that Mr. Colt becomes a trustee of your company and a member of your finance committee and this large deposit of $1,000,000 is made in this particular bank?

Mr. HOUSTON. Not necessarily. I am rather surprised that it isn't larger, in view of the strength of the Trust Co. and the service it renders.

* * * * * * *

What I meant to say was that it was not entirely improbable that if Mr. Colt had never become a member of the board, we might have a deposit, and a large deposit, in the bank, because I have confidence in his bank and it is one which I believe would take good care of the funds, and as I said before in answer to a similar question, I think it is some advantage to have an account in a bank, one of whose responsible officers is a trustee of your company.

Mr. O'CONNELL. Then you mean you were influenced by the fact?

Mr. HOUSTON. Other things being equal, I certainly would have no objection to it.

Mr. O'CONNELL. I gathered from your last answer that you do mean that you were influenced by his membership on your board and on the board of directors of the bank.

Mr. HOUSTON. We would not make a deposit in a bank simply because we happened to have a trustee who is connected with that bank.

Mr. O'CONNELL. I understand that, but I did understand you to say that you were influenced by the fact that he was a member of your board. You said it was to your advantage.

Mr. HOUSTON. Yes.

Mr. O'CONNELL. Which I understood you to say influenced you. Thank you.

Mr. Houston testified that he did not recall any instance where his company had refused to make a deposit when a director had solicited one in the manner reviewed above.[29]

Further discussion of the influence of interlocking directorships upon the conduct of officers and directors will be found in section VI.

[29] Pt. 4, R. 1463. Contrast testimony of Mr. Michael J. Cleary, president, Northwestern Mutual Life Insurance Co. This company maintains 6 principal bank accounts, 2 in banks with which the company interlocks and 4 where there is no common director connection. Not only do the accounts in the interlocking banks antedate the connection through directors, but the company has adopted a policy of maintaining substantially equal balances in all 6 banks. This is accomplished through daily transfers. It also appeared that another bank affiliated through 2 interlocking directors was not 1 of the 6 principal banks of deposit (pt. 4, R. 1498, 1499.)

SECTION V

Failure of Directors to Attend Board Meetings

Some directors fail to attend meetings of the life insurance company boards of which they are members. Preoccupied with other affairs, they falter in their attendance and in effect abdicate, placing their responsibilities entirely in the hands of those directors who may choose to attend.

The law does not, and indeed should not, recognize any distinction between "working directors" and "honorary directors." It is now established beyond contradiction that directors, to fulfill the minimum obligation of their position, must attend meetings of the board and participate in the deliberations which result in formulation of company policy.[1] Even this minimum requirement has been disregarded by many directors of the larger insurance companies. The records of the Metropolitan, for example, show that though the company has 24 directors, an average of only 15 have attended the regular monthly meetings during the last 10 years.[2] Three meetings were found to have been conducted with less than a quorum [3] and one-half or less of the full board was present at 25 out of the 125 meetings held since 1929.[4]

For certain directors, absence from directors' meetings was the rule and attendance the exception. Mr. Charles M. Schwab, chairman of the board of Bethlehem Steel Corporation, a director of Metropolitan, attended but three meetings from 1932 through 1938 and for a period of 3 consecutive years during this time failed to appear at a single meeting;[5] Mr. D'Alton Corry Coleman, vice president of the Canadian Pacific Railroad, who was elected a director in 1929, attended but nine meetings during the following 10 years and was never present at meetings held during the 2 years immediately following his appointment to the board;[6] and Mr. William H. Crocker, president of the First National Bank of San Francisco, failed to attend a single meeting during the 5 years prior to his death in September 1937.[7] Lastly it was disclosed that Mr. L. A. Taschereau, Prime Minister of the Province of Quebec, did not attend a single meeting during the 16

[1] Fletcher, Cyclopedia of Corporations, vol. 3, sec. 1049; *William* v. *Brady* (232 Fed. 740, District Court, N. J. (1916)); *Bowerman* v. *Hamner* (250 U. S. 504 (1919)); *Prudential Trust Co.* v. *Brown* (171 N. E. 42 (Mass. 1930)); *Dinsmore* v. *Jacobson* (242 Mich. 192, 218 N. W. 700 (1928)); *Martin* v. *Hardy* (251 Mich. 413, 232 N. W. 197 (1930)); *Kavanaugh* v. *Gould* (223 N. Y. 103, 119 N. E. 237 (1918)).

[2] Pt. 4, R. 1529, exhibit No. 235.

[3] Pt. 4, R. 1278.

[4] Pt. 4, R. 1529, exhibit No. 235.

[5] Pt. 4, R. 1270, see also infra p. 40.

[6] Pt. 4, R. 1277.

[7] Pt. 4, R. 1277. Mr. Crocker was not in physical condition to travel during this period. Ibid. (See also pt. 4, R. 1271.)

years he was a member of the Metropolitan board.[8] Correspondence introduced into the record of the hearings disclosed that he had accepted the position of director with the distinct understanding that he would not have to attend meetings.[9]

On at least two occasions Metropolitan directors indicated their inability to attend board meetings and requested to be relieved of their responsibilities. It is significant that in both instances they were persuaded to continue on the board and in effect permitted to remain absent from its deliberations. The directors involved were Mr. Charles M. Schwab, chairman of the board of Bethlehem Steel Corporation, and Mr. John W. Davis, a partner of the law firm of Davis, Polk, Wardwell, Gardiner, and Reed.

During 1932 and 1933 Mr. Schwab attended only 1 meeting of the Metropolitan Board out of the 26 which were held.[10] On February 9, 1934, he wrote Mr. Frederick H. Ecker, then president of the Metropolitan, as follows:[11]

> You probably have heard that I have been in pretty poor health the past 5 months, and I do not seem to be rapidly recovering. As a result of this, I am retiring from everything I can. You probably also have noticed that I have even retired from the Chase Bank, where I have been a director so many years. The only directorates I am now on are those of the Bethlehem Steel Co. and the Metropolitan Life Insurance Co.
>
> It seems to me that you should have someone who could give active attention to your company as a director, and this I am at present unable to do nor likely to be able to do for some little time. Under these circumstances I wonder if you would not like me to resign to make way for someone else.

---

[8] Pt. 4, R. 1279. Concerning the services rendered by Mr. Taschereau, Mr. Frederick H. Ecker testified (pt. 4, R. 1281):

"Mr. GESELL. Can you tell me, Mr. Ecker, what services Mr. Taschereau performed?

"Mr. ECKER. Specifically, no. I can tell you that he did stand very high in the community. His acting as a director of the company was an endorsement of the company, and in Canada I know that means a good deal among the French Canadians. They have high respect for men in public life, and there couldn't be anything about a company that wasn't entitled to their respect if Mr. Taschereau was a director.

"In addition to that, I can't give you specific cases, but I haven't the slightest doubt that our people in Canada consulted and talked with Mr. Taschereau about matters that had to do with the management of the company's affairs."

[9] Mr. Taschereau ceased to be Prime Minister in June 1936. In 1938 Mr. Frederick H. Ecker wrote Mr. Taschereau suggesting he be replaced in view of his inability to attend meetings (pt. 4, exhibit No. 241). To this letter Mr. Taschereau replied in part as follows (pt. 4, exhibit No. 242):

"Some years ago, while in New York, I was approached by the then president of the company, Mr. Haley Fiske, and was asked by him to join the board. Mr. Fiske told me that on account of his Canadian business and especially of the French Canadian clients of the Metropolitan Life he wished to add on the board the name of a well-known French Canadian. I was then the Prime Minister of the Province of Quebec.

"It was distinctly understood at the time that, as I was a very busy man, I could not attend the meetings of the board, and I accepted the honor offered to me under this distinct condition, which Mr. Fiske told me he fully understood. Needless to say that I was not invited for the services that I could render to a board composed of so distinguished men."

[10] Pt. 4, R. 1270.

[11] Pt. 4, R. 1270, exhibit No. 236.

To this frank letter, Mr. Ecker replied asking Mr. Schwab to remain on the Board:[12]

Dear Charlie, and may I have the privilege of also adding my dear, dear friend: * * * With respect to the particular subject of your letter, we are having no difficulty in getting a quorum for our meetings. Frankly, I would have more regret than you express at breaking off your relations with the Metropolitan. I much appreciate the way you write about it. My preference is the situation should not be disturbed. If, on our side, it changes at all, I will be frank and let you know.

Mr. Schwab still remained on the board at December 31, 1938. During the 5 years from 1934–38, he attended only 2 of the 60 board meetings held.[13]

The case of Mr. John W. Davis is similar. After attending but six meetings in the preceding 4 years, Mr. Davis wrote Mr. Ecker in June, 1930, as follows:[14]

I was greatly disappointed when just as I was leaving my office to attend the directors' meeting on the 24th matters came forward which made it impossible for me to get away. This has happened so often in the past and my attendance at meetings has been so infrequent that I am driven to the conclusion that I should get off the board and permit you to elect someone whose attendance can be more relied upon. I quite agree that no member of any board of directors should complain if he is called upon for a half day once a month. If he finds it, however, difficult or impossible to give even that much time, I think he should get out of the way.

Mr. Ecker replied:[15]

I wish you would give the matter further thought in the hope that your decision will be otherwise. I have understood that because of your many engagements it was not always convenient to attend the regular meetings, but have felt that in case of necessity you would be available.

Mr. Davis finally resigned in April 1931, having attended but one meeting in 1930 and one in 1931.[16]

There was ample evidence of the failure of many directors to attend board meetings of two other large companies, Mutual Life and Equi-

[12] Pt. 4, R. 1269, 1270, 1271, exhibit No. 237. Mr. Ecker explained his action as follows (pt. 4, R. 1285):

"Mr. ARNOLD. I understood that one of the considerations in your urging Mr. Schwab to stay was a sort of reward for past services.

"Mr. ECKER. Oh, no; not a reward for past services; no; a recognition of his valuable service in the past and our hope to continue him on the board. May I add this: Service as a director is like service in any other line. If you had a man a good while, he knows more about the business and with less time can render more valuable service than one who has never been a director and has to learn the business; and when we have a valuable old director on the board—just because he is ill, it seemed a decent thing to keep him there, for his sake, and a worth-while thing for the company."

Mr. Ecker testified that he did not take up the matter of Mr. Schwab's letter with the board "in a formal manner" but that he "consulted with other members about the situation." There was no meeting of the Metropolitan board between the date of Mr. Schwab's letter and Mr. Ecker's reply (pt. 4, R. 1271).

[13] Pt. 4, R. 1270.

[14] Pt. 4, exhibit No. 239.

[15] Pt. 4, exhibit No. 240.

[16] Pt. 4, R. 1276. Mr. Davis was also a director of the Mutual Life at the time. He has continued to be a member of the board of that company, but in the 12-year period from 1928–39 there have been only 6 years when he has attended one-half or more of the meetings held (pt. 28, exhibit No. 2340).

table. Examples of directors' nonattendance in these companies during the period since 1929 are indicated in the following schedule:[17]

Mutual Life

Name of director	Number of meetings eligible to attend during period	Meetings attended
Stanley Field	112	7
George P. Miller	50	0
John K. Ottley	114	31
Daniel Willard	139	35
Clarence M. Wooley	151	50

Equitable

Name of director	Number of meetings eligible to attend during period	Meetings attended
Ralph Budd	78	15
John J. Pelley	103	28
Horace D. Pillsbury	139	8
John H. Walbridge	139	43

A director who fails to attend directors' meetings fails to exercise the ordinary care and prudence which policyholders may expect of him in the fulfillment of his fiduciary responsibilities.[18] Members of an insurance board should share equal responsibility in the affairs of a company. The failure of some to attend meetings places an undue burden on those who are active and may frequently result in the management directors, i. e., the officer-directors of a company, acting in the capacities of managers as well as supervisors and thus eliminate the checks and balances which are desirable in the policyholders' interest.

[17] Pt. 28, exhibit No. 2340. Prudential and New York Life directors have been much more regular in attendance. Ibid. (See also pt. 4, R. 1426, 1427.)

No instance was found where any company informed its policyholders, in connection with elections to the board or otherwise, of the failure of certain directors regularly to attend meetings. Mr. Frederick H. Ecker testified on this subject stating (pt. 4, R. 1281):

"Mr. Gesell. May I ask you with respect to all these instances which we have reviewed whether any effort was made to acquaint the policyholders as the names were put up again and again for renomination and election of the degree to which these particular directors had attended the meetings of the board of directors, and participated through that means in the affairs of the company?

"Mr. Ecker. Would it be lacking in courtesy or out of place for me to say that I can only think of that as my saying to the policyholders in some formal communication that the men who had been nominated on the administration ticket were in any respect unfit to serve. I can't conceive of that as possible, and again it seems to me that is so obvious that it isn't a suitable question. Of course, I didn't. Our action with policyholders consisted in advising them of the men who had been nominated."

See also pt. 4, R. 1281–1283 and exhibit No. 243.

[18] Op. cit. supra, note 1, at p. 39.

Directors fail to function for many reasons; they live too far away,[19] they are too busy,[20] they are chosen as figureheads and not expected to render active service,[21] they are inadequately compensated,[22] they are not policyholders and hence have no interest at stake [23] or they fail completely to recognize the obligations they have assumed in accepting their positions. In addition the large size of the boards undoubtedly dilutes the sense of individual responsibility and tends to encourage a director to look to his fellow directors for the fulfillment of his duties.[24] Last, but not least, the entrenched status of the board makes its members impervious to policyholder pressure and tends to encourage complacency.

At the root of the problem is the apparent fact that the field for selection of directors has been narrowed to a small group of men who have assumed obligation for the conduct of many varied and technical enterprises although practically each member of the group has some primary and exacting business responsibility of his own.[25] In regard to this matter, Mr. Frederick H. Ecker testified as follows: [26]

Mr. DOUGLAS. We all know instances in corporation history of this country—I am not speaking now about Metropolitan—where directors have been chosen merely for window dressing. That has not been an unusual practice.

Mr. ECKER. Maybe those were the rubber stamps you referred to. We haven't any.

Mr. DOUGLAS. It is not necessarily to be classified with rubber-stamp directors or dummy directors, but a man whose name is a prominent name and who

[19] It must be recognized that sometimes directors are not resident in the city or State where the insurance company may have its principal offices. The laws of many States contain provisions which require a certain number of directors to be resident in the State of incorporation. For example, see sec. 48 (5f), New York law 1940; ch. 175, sec. 94 of the Annotated Laws of Massachusetts; and ch. 73, sec. 652 of the Smith Hurd Illinois Annotated Statutes. It is of interest to note that Prudential, which has had a very creditable record of attendance, has no directors whose residence or place of business is not in Newark, N. J., where the company's home office is located. Other of the larger companies have from 6 to 13 directors who do not reside in the same city as the company's home office or within easy commuting distance thereto.

[20] Mr. Frederick H. Ecker testified that some directors "are so much engrossed in other things they are unable to get there (i. e. to board meetings) because they are men of affairs and prominent in their business" (pt.4, R. 1288).

[21] See discussion of Mr. L. A. Taschereau, p. 41 supra.

[22] This becomes particularly obvious when it is recognized that compensation of directors is nominal if viewed in the light of the duties and responsibilities they should assume. Customarily directors receive a modest per diem when actually in attendance at meetings and traveling expenses when it is necessary for them to come from outside the city to attend. Average compensation of directors of the "Big Five" companies during 1938 was as follows (compiled from 1938 Convention Form Annual Statements):

Metropolitan	$1,306.50
Prudential	2,053.75
New York Life	2,100.00
Equitable	1,688.71
Mutual	954.29

[23] The laws of many principal insurance States, including New York, New Jersey, Connecticut, Massachusetts, and Illinois, contain no provisions requiring directors of mutual companies to be policyholders. Mr. Frederick H. Ecker testified that whether or not an individual owned a Metropolitan policy was not a factor taken into account in the selection of the directors of that company (pt. 4, R. 1283).

[24] There is considerable variation in the size of boards of directors of principal life-insurance companies. Twenty-seven mutual companies and 25 stock companies or a total of 52 companies each with assets of $35,000,000 or more were examined in this connection. It was found that 9 companies had from 6 to 10 directors, 23 companies from 11 to 15 directors, 11 companies from 16 to 20 directors, 4 companies from 21 to 25 directors, 1 company from 26 to 30 directors, and 3 companies with over 30 directors. The larger companies had the larger boards. Of the 6 companies whose assets were each in excess of $1,000,000,000, 3 had more than 30 directors, 2 had from 21 to 25 directors, and 1 company had from 11 to 15 directors. Compiled from Convention Form Annual Statements.

[25] Pt. 4, R. 1286, 1288.

[26] Pt. 4, R. 1286.

carries prestige and influence. I take it that has at times been a consideration in the selection of the administration ticket by the Metropolitan.

Mr. ECKER. Not deliberately, expecting they wouldn't render any other service than that performed by having their name in the window, no; but it just works out that way. It isn't possible to get men of the type I am speaking of—24 or 25 working directors—and it is becoming increasingly difficult to get any directors who could qualify as a director of a great insurance company.

* * * * * * *

Mr. ECKER. As a general thing, I should think the companies I have had opportunity to observe show about the same record as our own. Where there was a large board, there are a few that are very regular in their attendance; there are some that are irregular.

The CHAIRMAN. But it is becoming increasingly difficult, is it not, to get the attendance of directors?

Mr. ECKER. Yes; it is, and as I have said, increasingly difficult to get directors, to get men to serve as directors.

The CHAIRMAN. To what do you attribute that difficulty?

Mr. ECKER. The difficulty in attending simply means occupation and that they are so much engrossed in other things they are unable to get there because they are men of affairs and prominent in their business.[27]

The variety of responsibilities undertaken by directors of the five largest companies has already been illustrated. It will serve to emphasize the point, however, to mention that the directors of the Metropolitan are also directors of 14 bank and trust companies, 13 industrial companies, 3 other life insurance companies, 1 accident insurance company, 1 surety company, 9 fire insurance companies, 1 casualty insurance company, 2 mercantile companies, 2 oil companies, 4 publishing companies, 8 real estate ventures, 10 railroads, 1 steamship company, and 18 utilities.[28] It is not surprising that some directors, occupied with other interests which are both lucrative and more directly connected with their principal lines of business, are unable to give much attention to the work of the particular life insurance company on whose board they serve.

That the problem is not without solution was demonstrated through the testimony of Mr. Michael J. Cleary, president of the Northwestern Mutual, who stated that insofar as possible his company eliminated interlocking relationships and that in his opinion this policy did not impair the quality of the board.[29] Mr. Cleary testified: [30]

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[27] It is of interest to note in this connection that, with the single outstanding exception of Mr. Thomas A. Buckner, chairman of the board of the New York Life, the chief executives of the five largest companies have assumed heavy responsibilities which can contribute but remotely to the welfare of their individual companies and which, if taken seriously, will require much time and energy, thus detracting from their efficiency as executives. The directorships of these officials are as follows (information submitted in response to request of Commission):

Mr. F. H. Ecker, chairman of the board of the Metropolitan is a director of: The Chase National Bank of the City of New York, Cincinnati, Indianapolis and Western Railroad, Provident Loan Society of New York, Union Dime Savings Bank, Western Union, Consolidated Edison Co. of New York.

Mr. Franklin D'Olier, president of the Prudential, is director of: The Pennsylvania Railroad Co., National Biscuit Co., Morristown Trust Co.

Mr. Thomas I. Parkinson, president of the Equitable, is director of: Chase National Bank of the City of New York, Consolidated Coal Co., Western Electric Co., Boardman Co., Westinghouse Electric and Manufacturing Co., Emigrants Industrial Savings Bank, Continental Insurance Co.

Mr. David Houston, of the Mutual Life, is director of: Guarantee Trust Co., American Telephone & Telegraph, United States Steel Corporation, North British and Mercantile Insurance Co., Mercantile Insurance Co.

[28] Pt. 4, R. 1266, exhibit No. 234.

[29] Pt. 4, R. 1493, 1506.

[30] Pt. 4, R. 1493.

Mr. GESELL. Mr. Cleary, how many meetings of the board of directors of your company are there a year?

Mr. CLEARY. Four.

Mr. GESELL. Am I correct in saying that the Wisconsin law prescribed that these directors must attend a certain number of meetings each year?

Mr. CLEARY. That is true.

Mr. GESELL. What is the law about that?

Mr. CLEARY. Three consecutive absences automatically removes a man from the board and makes him ineligible to reelection for a fixed period of time.

Acting Chairman KING. Would sickness be an excuse?

Mr. CLEARY. No; there is no excuse.

Mr. GESELL. If a man is ill, if a man wants to travel, if a man is very busy, if a man doesn't want to come, if he lives too far away—none of those things is an excuse?

Mr. CLEARY. None at all.

Mr. GESELL. Am I correct in saying that the operation of that law has resulted from time to time in eliminating from your board of directors men who do not show sufficient interest to attend three meetings?

Mr. CLEARY. It has.

Mr. GESELL. Also men who have fallen into bad health or by reasons of age or otherwise are unable to attend?

Mr. CLEARY. That is true.

Mr. GESELL. So that through this statute you do have an active board of directors in constant attendance on the affairs of the company?

Mr. CLEARY. I would say that was true.

Mr. GESELL. Is it fair to say that most of your directors attend at least three meetings a year?

Mr. CLEARY. My recollection is that the tabulation showed an attendance record of approximately 80 percent.

In explaining the procedure followed in selecting directors for the company, Mr. Cleary brought further light to the subject:[31]

Mr. GESELL. I notice that another man was eliminated because he was too busy. Is that because he is unable to give enough attention to the affairs of the company, is that what you mean by "too busy"?

Mr. CLEARY. Well, we have always taken the position that the law requires attendance at meetings, that the trusteeship carries responsibility, and naturally we don't want to put men on who may be forced off by failure to function.[32]

The solution of this question of directors, nonattendance lies, in the last analysis, with the business community which must come to recognize that a life insurance company directorship is a position requiring active service and genuine attention to duty.

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[31] Pt. 4, R. 1496.

[32] It is of interest to note that since the hearings before the committee on the subject of directors' nonattendance, the Legislature of the State of New York has passed an act (ch. 88, sec. 62, Laws of 1940) which provides:

"The office of a trustee or director of any domestic mutual insurer shall immediately become vacant whenever he shall have failed to attend the regular meetings of the board of trustees or directors, or to perform any of his duties of trustee or director for six successive meetings unless excused by the board for such failure."

The wording of the statute leaves much to be desired. Apparently complete discretion is left with the board and it is not even clear whether the board must excuse in advance of nonattendance.

SECTION VI

Activities of Directors and Officers for Personal Gain

A director or officer is in a position to use the funds of his company in many ways to serve his personal interests. He may borrow money directly or in the name of a corporation he owns or controls; he may sell goods or services to the insurance company, possibly at a premium; he may cause the insurance company to purchase his own securities or to provide money for financing a speculative business venture he is promoting; he may place friends or business associates on the pay roll of the insurance company at exorbitant salaries; he may pad expense accounts or draw compensation in advance with no contemplation of repayment; he may direct the depositing of company funds to his advantage; he may cause preferential contracts to be executed in his favor or, if he acts in concert with at least some of his fellow directors, he may even change the form of the company from mutual to stock or stock to mutual whichever best serves his private purposes. Though the studies which the Commission was able to make in this connection did not cover the field thoroughly it may be said that many of these practices were not found to be prevalent in the largest mutual companies. Our necessarily incomplete study of some of these problems shows that many directors and officers of the largest mutual companies have conducted themselves with propriety and that relatively speaking officers and directors of the largest mutual companies have used their positions to initiate transactions for their personal profit less often than have the directors and officers of numerous smaller companies. No direct personal loans to officers or directors of the five major companies were disclosed.

As indicated above many life insurance companies lend money to their officers and directors or to business concerns in which their officers and directors are financially interested. It is true that a few States have enacted laws prohibiting such officials from borrowing from their companies but elsewhere the practice still prevails.[1] Thirty-one

[1] 16 States prohibit life insurance companies from making loans to their officers and directors or at least, have statutes which to some degree restrict disposal of company funds in a manner which will pecuniarily benefit the officers or directors. These States are: Massachusetts, Michigan, Texas, Pennsylvania, Missouri, California, Indiana, Iowa, Kentucky, Minnesota, New York, North Dakota, Tennessee, Virginia, Wisconsin, and the District of Columbia. The New York law effective December 31, 1938, reads as follows (sec. 36, New York insurance law, printed in pt. 4, exhibit No. 259):

"No director or officer of an insurance corporation doing business in this State shall receive any money or valuable thing for negotiating, procuring, recommending, or aiding in any purchase by or sale to such corporation of any property or any loan from such corporation, nor be pecuniarily interested either as principal, coprincipal, agent, or beneficiary in any such purchase, sale, or loan; nor shall the financial obligation of any such director or officer be guaranteed by such corporation in any capacity. And any such guarantee shall be void, provided that nothing herein contained shall prevent a life insurance corporation from making a loan upon a policy held therein by the borrower not in excess of the net value thereof.

"No insurance corporation doing business in this State shall make any loan to any of its officers, directors, or trustees, nor shall such officers, directors, or trustees accept any such loan. Any corporation or person violating any provisions of this section shall be guilty of a misdemeanor."

In the recodification of the New York insurance law, effective January 1, 1940, sec. 78, investment, officers, and directors, restrictions upon officers or directors were increased to prohibit an officer or director from receiving any direct or indirect interest in the prohibited transactions.

It appeared that the Mutual Life loaned $90,000 to Mr. Frank L. Polk prior to his becoming one of its trustees. This was a mortgage loan on Mr. Polk's house and was carried at 6-percent interest. After Mr.

companies, as of December 31, 1938, were found to have loans outstanding on their books in the amount of $693,526.[2] These direct personal loans to officers and directors were distributed as follows:

Type company	Total number of companies examined	Outstanding loans Dec. 31, 1938	
		Number of companies	Amount
Mutual	65	2	$6,969
Other	173	29	686,557
Total	238	31	693,526

In addition, there is evidence of other loans to "insiders," which would not be comprehended in the above table, including loans made to nominees which concealed the beneficial interest of the director or officer concerned, and a variety of different loans to corporations in which officials of the lending insurance company were heavily interested financially.[3] Several examples of companies engaged promiscuously in lending money directly or indirectly to their officers and directors were spread upon the record. One such example was that of the Monumental Life Insurance Co., of Baltimore, Md. This company was organized in 1858;[4] it has at the present time approximately $300,000,000 of insurance in force, and operates in 13 States.[5] For many years, schedule C of the convention form annual statements of this company, which it filed with all 13 State officials who had supervision over its affairs, disclosed collateral loans made from time to time to one Irene T. Reaney, whose name was shown on the schedule in each instance as the "actual borrower." The statements disclosed that 14 such loans were made from July 12, 1929, to December 9, 1937. These loans totaled $225,900, with as much as $45,000 being outstanding and owing at any one time.[6] In the course of the

Polk became a trustee of the Mutual Life he became a member of both its real-estate committee and of a special two man subcommittee, formed for the purpose of adjusting mortgage loans. On one occasion arrangements were made for Mr. Polk's loan to be continued open and on another, interest was reduced to 5 percent coincident with a $15,000 payment on principal. Mr. Polk did not vote when either of these matters came before the committees of which he was a member although on one occasion the adjustment was originally recommended by the special two man subcommittee of which Mr. Polk was one of the members (pt. 4, R. 1466, 1467).

[2] This information was compiled from item 11 of the general interrogatories in the convention form annual statement which reads as follows:

"Total amount loaned during the year to directors or other officers, $------; to stockholders not officers, $------. Total amount of loans outstanding at end of year to directors or other officers, $------; to stockholders not officers, $------ (exclusive of policy loans)."

It should be noted that schedule C of the statement requests information concerning collateral loans in such form as to disclose borrowings by officers and directors. If officers and directors borrow through mortgage loans or unsecured loans, however, the details of such transactions cannot be ascertained from the statement. In addition, loans to relatives of officers or directors or companies in which officers or directors are interested are not specially designated in any way and cannot be ascertained from the statement.

[3] See pp. 48 to 60, infra. In a slightly different category are loans by stock companies to their stockholders. These loans totaled $244,749 as of December 31, 1938, and were outstanding in two companies (item 11, general interrogatories, 1938 convention form annual statements). The record also contains evidence that certain officers of life insurance companies drew salaries in advance and submitted liberal expense accounts. For testimony on these subjects see pt. 13, R. 6753, 6755, 6758, 6759; exhibit No. 1134.

[4] Pt. 12, R. 5618.

[5] Id.

[6] Pt. 12, exhibit No. 1089.

hearings it was developed that Miss Irene T. Reaney was a stenographer employed at Monumental who received a salary of $50 a week. She testified that all except $2,400 of these loans shown in her name had actually been made to Mr. Paul M. Burnett, then president of the Monumental and later chairman of its board. It had been the practice for Mr. Burnett to put up the collateral and to receive the proceeds of the loan.[7] Examination of the convention form annual statements disclosed that Mr. Burnett had signed such statements on several occasions when those statements, both in schedule C and in the general interrogatories, contained false entries with respect to his borrowing.[8] Mr. Burnett testified that he had not arranged for his loans to be concealed because of the charter provisions of the company which made such loans unlawful or because such loans violated the laws of several States in which the company did business.[9] No adequate explanation of his conduct in this connection, however, was given. In addition to the Burnett loans it appeared that another director, Dr. F. H. Vinup, had borrowed money from the company on two occasions in 1935 and that the wife of another director was at one time obligated to the company in the amount of $20,000 resulting from collateral loans. The fact that at least one of these was a loan to an officer or director was not disclosed.[10]

Evidence was also presented demonstrating that certain officers of the company had used the funds of the company to further various business ventures in which they were interested as officers or stockholders. Mr. Milton E. Roberts, vice president and director of Monumental was asked to explain a series of transactions between Monumental and these various enterprises. Mr. Roberts had been active in working out the details of the transactions under scrutiny and was qualified to explain their over-all result. His testimony disclosed that even after the transactions had actually been carried out, he was unable to reach a judgment as to whether or not they had been in the best interests of the insurance company.

Briefly, the facts were as follows: Mr. Roberts was the "controlling operator" of a company known as Real Estate Trustees, Inc., a corporation incorporated in 1924.[11] It appeared that although the Monumental was authorized under law to make mortgage loans directly, at the suggestion of Mr. Roberts [12] it was agreed that Real Estate Trustees, Inc., would make mortgage loans and pledge the mortgages with the insurance company as security against collateral loans from the insurance company to Real Estate Trustees, Inc. In this manner Real Estate Trustees, Inc., was placed in a position to receive a commission from the broker in the case of each loan made as well as the benefit of an interest differential resulting from the fact it paid Monumental a lower interest rate than that which it received from its mortgages. The net result of these transactions was that Monumental lent money on mortgages indirectly through Real Estate Trustees, Inc., and in this manner benefited certain of its officers and directors who were interested in the operations of that company. It is not surprising that the Real Estate Trustees, Inc., prospered and paid dividends from the date of its organization in 1924 until 1930. Even

[7] Pt. 12, R. 5681-5683.
[8] Pt. 12, R. 5689, 5690.
[9] Pt. 12, R. 5686, 5691.
[10] Pt. 12, R. 5692, 5693.
[11] Pt. 12, R. 5703.
[12] Pt. 12, R. 5704.

after it ceased paying dividends, it continued to borrow from the Monumental on a collateral-loan basis.[13]

At the end of 1932, Real Estate Trustees, Inc., was obligated to the insurance company in the amount of $766,803.87.[14] At about this time the mortgage company changed its name to Land Mortgages, Inc., and the business was continued thereafter under that name. At the same time steps were taken toward liquidating the indebtedness between the two companies. This indebtedness remained at over one-half million dollars from 1933 through 1937, however, and liquidation proceeded very slowly.

It was not until 1939 that the indebtedness between the Monumental and Land Mortgages, Inc., which then stood at $446,990.05.[15] was settled. At that time a series of round-about transactions involving the Consolidation Co., a real estate development company the majority of whose stock was owned by Mr. Roberts,[16] were initiated. The transactions resulting in the liquidation of the $446,000 obligation were as follows:

1. Monumental purchased from Land Mortgage for $296,500 certain securities which had been hypothecated by the latter company with the Monumental as partial collateral against the indebtedness. Of this sum, $274,125 represented payment for 4,193 shares of Real Estate Trust Co. stock.[17] The Real Estate Trust Co. stock was purchased at $125 a share when the then market price was around $64 a share.[18] It was understood that Mr. Roberts, within 2 years from the date of the agreement, would repurchase these same shares from Monumental at the $125 a share price.[19] In effect, Monumental gave twice the value of the stock to Land Mortgages in return for Mr. Roberts' agreement to repurchase.[20] The purchase price was applied to the indebtedness.[21]

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[13] Pt. 12, R. 5703-5705, exhibit No. 9 . Mr. Roberts testified with respect to these transactions as follows (pt. 12, R. 5706):

"Mr. GESELL. They were substantial transactions then, were they not, as between land mortgages and real-estate trustee on the one hand, and the Monumental on the other?

"Mr. ROBERTS. And very profitable, during that time, to the insurance company.

"Mr. GESELL. Also of some profit to you gentlemen interested in the mortgage?

"Mr. ROBERTS. Quite naturally.

"Mr. GESELL. Then this was another case, was it not, Mr. Roberts, where certain of the officers and the directors of the insurance company were dealing with the insurance company?

"Mr. ROBERTS. Well, you can't deny a fact, Mr. Gesell, that is shown from the records, but the question of a motive is an entirely different thing.

"Mr. GESELL. I made no reference to a motive.

"Mr. ROBERTS. I am as human as anybody that ever lived and an opportunity to make money honestly and fairly—I don't believe I would have passed it up.

"Mr. GESELL. Even though it was an opportunity to make money off a company where you were a director?

"Mr. ROBERTS. If you depend on the integrity of the men involved that is the only thing you can possibly do business on."

[14] Pt. 12, exhibit No. 963.

[15] Pt. 12, R. 5711. Mr. Roberts testified (Id.):

"* * * you could do practically nothing in the way of liquidating such frozen assets—that it was deemed advisable to endeavor to get the indebtedness settled."

[16] Pt. 12, R. 5709.

[17] Real Estate Trust Co. is a bank organized November 1, 1926. Mr. Roberts and other officers of Monumental were interested in the bank from the date of its organization. A substantial amount of the original capital was subscribed by Real Estate Trustees, Inc. (pt. 12, R. 5706, 5707). The Monumental carried bank balances with Real Estate Trust Co. at all times subsequent to 1929, these balances reaching a high of $255,769.61 as of December 31, 1932 (pt. 12, exhibit No. 964).

[18] Pt. 12, R. 5711.

[19] Pt. 12, R. 5712.

[20] Id.

[21] Id.

2. In return for the payment of $50,490.05, the remaining indebtedness of $150,490.55 to Monumental was settled in full[22] and Monumental agreed to release all of the remaining security which Land Mortgages had pledged as collateral. In other words Monumental wrote off $100,000 of the indebtedness.

It appeared that Land Mortgages did not have cash sufficient to enable it to make the payment of $50,490.05. It, therefore, pledged the collateral which Monumental had released with Consolidation Co. in return for $50,000 which Consolidation advanced to Land Mortgages. Consolidation in turn pledged the same collateral with Monumental and received a loan of $50,000. In effect, therefore, Mcnumental released certain collateral against which it could have foreclosed and received value in order to enable Land Mortgages, through Consolidation Co., to repledge the same collateral with it and in this manner receive funds sufficient to pay off the remainder of the indebtedness. It was simply a circuitous transaction by which Monumental lent the money which was used to pay off the debt that was owing it, securing the new loan with the collateral of the old.[23]

The collateral which was released and subsequently repledged by Consolidation with Monumental was given a release value of $148,625, and Mr. Roberts testified that from the standpoint of Consolidation it was worth considerably more than $50,000.[24] Mr. Roberts was asked whether this transaction was in the best interest of the insurance company; his testimony in this respect, considering that he was interested in these transactions as director of the insurance company as well as director of the other companies involved, is illuminating.[25]

Mr. Gesell. Well now, that was a rather favorable transaction from the point of view of you gentlemen interested in the real-estate business, from these various real-estate companies, wasn't it?

Mr. Roberts. I would like you to put the same proposition to an outsider and see what answer you would get on it. You couldn't possibly have worked it out.

Chairman Ferguson. Mr. Roberts, as I said a few minutes ago, when Mr. Gesell asks you a question, please answer it "Yes" or "No," and then make your explanation of it.

Mr. Roberts. I would say "No," and the other answer is "Time will tell."

* * * * * * *

Mr. Gesell. Coming to the minutes, Mr. Roberts, that I was looking for, I believe you stated you didn't think it was to the advantage of the Consolidation Co., this transaction.

Mr. Roberts. I said time will only tell.

Mr. O'Connell. I understood you to say "No," in direct answer to the question, Mr. Roberts. Didn't you say the answer to the question directly was "No," and your comment on it was "Only time will tell."

Mr. Roberts. Yes, sir; I did.

Mr. O'Connell. Well, you did say it was not a favorable transaction from the point of view of Consolidation. Isn't that correct?

Mr. Roberts. That is a correct answer if you want to look at it in the abstract. There are other sides to it.

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[22] Id.

[23] Pt. 12, R. 5713–5715.

[24] Pt. 12, R. 5715.

[25] Pt. 12, R. 5716–5718.

Mr. Gesell. Then I would like to call this directly to your attention. The minutes of the meetings of the board of directors of Consolidation Co., Inc., held on May 23, 1938, at which you were shown to be present, contain the following statement with respect to this transaction.

"It was obviously to the advantage of this company to persuade remaining assets from Land Mortgages and repledge them with Monumental to secure the loan aforesaid."

That is rather in direct opposition to your testimony.

Mr. Roberts. That may be true and that would be in making the transaction and in order to straighten out and clear up the whole matter, was probably considered by the company that the prospect of the new money and the ability to develop it would be an advantageous transaction. That is probably true.

Mr. O'Connell. Which is true in your opinion? You have now said it was to the advantage and it was not to the advantage.

Mr. Roberts. I would answer to the individual, if I were not associated with the various interests I wouldn't have been interested. Now, my connection—well, it would have to have been with somebody who had a sincere interest in not only the Consolidation Co. coming in at the time it did, but with the interests of the Monumental Life Insurance Co. to endeavor, as far as possible, to insure it against any loss.

Mr. O'Connell. Rather a difficult position to be in when you are representing three or four interests at one transaction?

Mr. Roberts. It is strange to try to explain all your transactions and your motives.

Mr. O'Connell. Isn't it rather difficult to properly represent all the varied interests that are involved in such a transaction?

Mr. Roberts. Well, Mr. O'Connell, it is a difficult thing; you divorce your own selfish interests every time from every transaction.

Mr. O'Connell. Well, one way of doing it is not to be on both sides of the transaction.

Mr. Roberts. Well, service is a beautiful thing.

Mr. O'Connell. That is one way to determine what to do in the future, isn't it?

Mr. Roberts. Absolutely; I agree with you. I didn't want to refer to the method by which I acquired control of the land mortgages, but I called (sic "bailed" [26]) out everyone of those stockholders by giving them good stock.

Mr. O'Connell. Would you care to clarify the record as to whether you think, in answering "Yes" or "No," whether this transaction was to the advantage of the Consolidation Co. You have said both, actually.

Mr. Roberts. The only way I could clear it up is by saying I hope it will be.

Mr. O'Connell. So you now don't know?

Mr. Roberts. I am in a dilemma.

Mr. O'Connell. We have all the possible answers anyway: You think it was an advantage; you don't think it was an advantage; and you don't know.

Thus does the commingling of a director's personal affairs with that of the insurance company he represents prevent his independent exercise of business judgment in the interest of the policyholders.

Another company from which officers and directors borrowed large sums of money is the Shenandoah Life Insurance Co. of Roanoke, Va. This company was organized under the laws of Virginia in 1914.[27] At

[26] See Verbatim Record of the Proceedings of the Temporary National Economic Committee, vol. 5, p. 68.

[27] Pt. 13, R. 6464.

the present time it has approximately $60,000,000 of ordinary insurance and $120,000,000 of group insurance in force.[28] The company does business in 14 different States.[29]

During the period from 1929 to 1938 Shenandoah made 95 collateral loans to officers and directors, or members of their families. These loans totaled $714,740, and the records of the company indicate that there was as much as $330,000 outstanding in loans to officials of the company at one time.[30] It appeared that many of these loans were made to the four principal officials of the company who had been responsible for its organization in 1914 and who had been prominent in its affairs since that time as stockholders, directors, and officers. An examination of the records of the company also disclosed at least 15 mortgage loans made directly or indirectly to officers or directors. These loans were frequently in substantial amounts, running as high as $150,000 in the case of a loan on an apartment house owned by one of the officers.[31]

As in the case of Monumental, some collateral loans made by Shenandoah were not truly reflected in the official reports of the company, the beneficial interest of the borrowing officer being concealed by making the loan to a nominee. For example, several collateral loans totaling $15,871.21 were made to one M. F. Weaver. It was developed in the course of the hearings that Mr. R. H. Angell, then president of Shenandoah, put up the collateral and received the proceeds of these loans which in all cases were made for his personal benefit or that of his company, the Central Manufacturing Co.[32]

Included in the collateral loans to officers and directors were indirect loans made to various companies which they owned and controlled. Among these were several real-estate concerns operating in and around Roanoke, Va., and a lumber company in which Mr. R. H. Angell, former president of Shenandoah, was interested.[33]

In many instances the collateral against the loans was of doubtful value. This is partly demonstrated by the fact that $38,142 of such loans has been written off by the company and, as of December 31, 1938, may be found included as unsecured bills receivable in the nonadmitted assets of the company. In addition the collateral was for the most part made up of securities of local companies which had no established market price and in many instances were securities of companies in which the directors and officers were themselves interested.[34]

Some doubts may also be raised as to the value of the collateral because of the circumstances under which the loans were made. It

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[28] Pt. 13, R. 6464, 6465.

[29] Pt. 13, R. 6465.

[30] Pt. 13, R. 6473, exhibit No. 1121.

[31] Pt. 13, R. 6466–6472.

[32] Pt. 13, R. 6468, 6469. This type of "dummy" loan to an officer or director deserves special mention. Two other examples of loans of this character were disclosed by the testimony. In one instance a loan of $400,000 was made by Federal Reserve Life Insurance Co. to one F. E. Bushman with the understanding that Mr. Bushman would in turn loan a similar amount to Mr. Massey Wilson and Mr. E. W. Merritt, two officers of Federal Reserve. Pt. 13, R. 6647, 6648. Similarly, it appeared that the Illinois Bankers Life Assurance Co. loaned $250,000 to the Lincoln Securities Co. at the same time that the Lincoln Securities Co. loaned $200,000 to Mr. Hugh T. Martin, president of the Illinois Bankers. The circumstances surrounding these two loans will be considered later in more detail. See infra, pp. 117 and 82.

[33] Pt. 13, R. 6467–6469, 6471, 6472.

[34] Pt. 13, R. 6470, exhibit No. 1133.

appeared that the loans were approved by a so-called managing committee of the Shenandoah. This committee consisted of the principal officers of the company who were also, as has been indicated, the principal borrowers from the company. These officers therefore passed upon the adequacy of their own collateral and placed a valuation upon it. Under these circumstances it is highly doubtful that any objective judgment as to the advantage of the loan from the point of view of the company could have been obtained.[35]

The Insurance Department of the State of Virginia repeatedly criticized the loans, but the officers and directors of the company failed to take vigorous steps to liquidate them, their failure being due, in part, to financial embarrassment on the part of the persons involved.[36] The Virginia Department stated that:

> The practice of making such loans is open to criticism. There are too many examples of the hazard of this practice when carried to extremes for our examiners to fail to recommend that such loans now held to (sic) be substantially curtailed from time to time and that the granting of further loans of this type be materially restricted.

This statement was made in 1932.[37]

By 1935, however, 17 such loans totaling over a quarter of a million dollars and representing approximately 83 percent of the total collateral loan account of the company were still outstanding.[38] It appeared, moreover, that during the period from 1932 to 1935 additional collateral loans approximating $100,000 had been made for the benefit of officers and directors. These loans were made in spite of the fact that during the period the disbursements of the company exceeded its income and that the company was operating under restrictions in order to conserve its liquid position.[39]

In still another instance, that of the Lincoln National Life Insurance Co., of Fort Wayne, Ind., an interesting series of cross loans between officials of several life insurance companies was revealed. Mr. Arthur Hall, president of the Lincoln, desired to borrow money against stock of his insurance company. The Indiana law prohibited Mr. Hall from borrowing directly from the Lincoln National. Accordingly, he communicated with several neighboring insurance companies and arranged through a series of letters written in May of 1929 to borrow a total of $140,000 from three such companies, the Peoples Life Insurance Co., of Frankfort, Ind., the American Central Life Insurance Co., and Central States Life Insurance Co. Officers of each of these companies from which Mr. Hall borrowed also borrowed from Lincoln National. Thus it appeared that in November 1929 the Lincoln National loaned $50,000 to Mr. Thomas M. Ryan, chief counsel of the Peoples Life Insurance Co., on stock in Peoples, Mr. Hall having borrowed a similar amount from the Peoples the preceding month. In December, the Lincoln National loaned $50,000 to Mr. Harry R. Wilson, an officer of the American Central Life Insurance Co., Mr. Hall having borrowed a similar amount from the American Central the preceding

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[35] Pt. 13, R. 6470, 6471.
[36] Pt. 13, R. 6476, 6477.
[37] Pt. 13, R. 6476.
[38] Pt. 13, R. 6477.
[39] Pt. 13, exhibits Nos. 1121, 1123. These transactions will be considered further in a subsequent portion of this report. Infra pp. 70 to 74.

October. In January of 1931, Mr. James A. McAvoy, an officer of Central States, borrowed $32,000 from the Lincoln National, secured by Central States stock, and thereafter by three different loans made from April to August, Mr. Hall borrowed a total of $40,000 from Central States. It appeared that Mr. Hall was on the finance committee of the Lincoln National and the three borrowers from the Lincoln National were on the finance committees of their respective companies. In all but one case the loans were paid off but the Lincoln National suffered a loss of $40,000 on the McAvoy loan. Mr. Hall testified there was no reciprocity involved in these transactions and that at the time one loan was made no return loan was contemplated. It seems clear, however, that these transactions arose from a community of interest existing among the officers of the companies involved and were prompted by a realization that in no case could the borrowing official of any company have borrowed the money directly from his own concern. It is significant that these loans were made on terms more favorable than those which apparently could have then been obtained from banking institutions.[40]

An example of promiscuous borrowing may be found in the case of the officers and directors of Travelers Insurance Co. who borrowed heavily from two banks which their company owned or controlled.

Travelers is the seventh largest life insurance company in the United States and the largest company not operating on the mutual plan.[41] It is the parent company in the so-called Travelers group, which includes, in addition to the two banks, a land company, an indemnity company, a broadcasting company, and two fire-insurance companies.[42] The combined assets of the Travelers group total over $1,000,000,000.[43] All subsidiary companies in the group are owned entirely by Travelers, except for equities represented by directors' qualifying shares, with the exception of one bank in which, however, Travelers maintains a controlling interest. Principal officers of Travelers are officers of the subsidiary companies and the various companies are further connected by extensive interlocking directorships.[44]

The two banks controlled by the Travelers are the Connecticut River Banking Co., in which it has a 71-percent interest, and the Travelers Bank & Trust Co., which it owns 100 percent exclusive of directors' qualifying shares. The former is a commercial bank and the latter primarily a savings bank. Both banks have offices in the Travelers Insurance Building, at Hartford, Conn., and are closely allied with each other through common officers and directors. Travelers representatives constitute a majority on the board of each bank and both banks are depositories for Travelers funds.[45]

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[40] Pt. 28, testimony of Arthur M. Hall, February 16, 1940.

[41] Travelers has 200,000 shares of common stock, par value $100 a share, outstanding and approximately 7,000 stockholders. Officers, directors, and employees of the company own less than 10 percent of the stock outstanding. Specifically officers own 2,419 shares; home-office employees other than officers, 870 shares; branch-office employees, 928 shares; and directors other than officers, 3,084 shares; a total of 7,301 shares. Pt. 13, R. 6369–6371; 1938 convention form annual statements.

[42] Pt. 13, exhibit No. 1093.

[43] Pt. 13, R. 6367.

[44] Pt. 13, exhibits Nos. 1093, 1094.

[45] Pt. 13, R. 6372-6378, exhibits Nos. 1098, 1099, 1111.

Travelers acquired its interest in the Connecticut River Banking Co. in 1912.[46] An examination of the records of the bank disclosed that during the period 1912–39 it had loaned money at various times to officers, directors, and employees of Travelers Insurance Co. The majority of the loans were collateral loans, but some mortgage loans and even unsecured loans were disclosed. In most instances, officers and directors commenced borrowing in small amounts and increased the amounts of their loans as time went on. During this period, 53 officers and directors of companies in the Travelers group made a total of 506 loans from the bank. These loans amounted to $3,047,664.92 and included loans to Mr. L. Edmund Zacher, president of Travelers; Mr. Wilbur S. Sherwood, cashier; Mr. Arthur L. Shipman, a director; Mr. Louis F. Butler, then president and director; and Mr. Benedict D. Flynn, vice president and actuary. As of July 20, 1939, officers and directors and employees of Travelers were obligated to the bank in the amount of $493,758.04.[47]

A comparable situation was found to exist in the case of the Travelers Bank & Trust Co., which was organized by Travelers.[48] This bank also loaned money to officers, directors, and employees of Travelers Insurance Co. Immediately after the bank was organized four or five mortgage loans which Travelers had carried on its books for its employees were transferred to the bank. Subsequently, many loans to Travelers' officers appeared. An analysis of the accounts for the period from 1930 to 1939 disclosed that directors, officers, and employees of companies in the Travelers group borrowed $347,442.77 from the bank on loans other than mortgage loans. In addition, it was found that mortgage loans were also outstanding on the books of the bank to officers and employees of the insurance company.[49]

[46] Connecticut River Banking Co. was organized in 1825, and until 1912 the bank operated independently. In 1912 the bank had 5,000 shares of capital stock outstanding of a par value of $30 a share. Travelers Insurance Co. commenced purchases of the stock in May 1912, and by June 5 of the same year had succeeded in accumulating around 62 percent of the outstanding shares. Some 608 shares, representing working control, were purchased from one of the principal stockholders, and the remaining shares were picked up in small blocks through market purchases or otherwise. As of December 31, 1938, a statement of condition of the bank showed its total resources and total liabilities at $9,200,047.78. In the commercial department of the Connecticut River Banking Co., $4,298,256.19, or 56.5 percent, of the entire deposits were deposits held for companies in the Travelers group. Since it acquired control, Travelers Insurance Co. has received dividends from the bank totaling $866,230.80 (pt. 13, R. 6372–6374, 6407, exhibits Nos. 1095, 1097).

[47] Pt. 13, R. 6379, 6382, 6387–6391, 6405–6407, 6416.

[48] This bank was originally organized for the sole purpose of handling certain trust accounts which an officer of Travelers held as trustee for the benefit of stockholders of the insurance company. Subsequently the bank's activities were expanded by the creation of a savings department and the opening of its trust department to the public. The bank has resources and liabilities as of December 31, 1938, of $12,527,791.99 and has paid $391,000 to Travelers in the form of dividends since its organization (pt. 13, R. 6375, 6376, exhibits Nos. 1096, 1097).

[49] Pt. 13, R. 6417–6418, exhibit No. 1109. A recapitulation of borrowing by insurance officials from both banks during the 10-year period from 1929 to 1939 is presented in the following table (pt. 13, R. 6414–6416):

Name of borrower	Position with Travelers	Number banks from which money borrowed	Largest amount of loans outstanding	Date largest amount of loans outstanding
H. H. Armstrong	Vice president	1	$36,450.62	Feb. 6, 1932
William B. Bailey	Economist	1	15,000.00	Oct. 17, 1935
Gladden W. Baker	Treasurer	2	20,100.00	Oct. 5, 1931
Percy V. Baldwin	Assistant secretary	2	17,421.29	Jan. 1, 1929
Walter E. Batterson		2	48,526.20	Do.

Footnote 49 continued on page 56.

Footnote 49 continued from page 55.

Name of borrower	Position with Travelers	Number banks from which money borrowed	Largest amount of loans outstanding	Date largest amount of loans outstanding
Bartlett T. Bent	Assistant secretary	2	$15,357.00	Mar. 14, 1932
Allan E. Brosmith	Attorney	2	25,890.00	Feb. 14, 1930
William Brosmith	Director	1	5,000.00	Nov. 9, 1929
Edmund J. Buckley	Agent	1	10,531.20	Feb. 6, 1929
Louis F. Butler	President	2	52,000.00	May 6, 1929
Thomas J. Butler	Superintendent agencies	1	8,500.00	Nov. 13, 1929
Joseph T. Cabaniss	Medical director	2	11,000.00	Jan. 1, 1929
James H. Coburn	Vice president	2	18,000.00	Mar. 28, 1938
John J. Cusick	Traveling auditor	1	10,613.75	June 23, 1930
Charles Deckelman	Manager, claims	1	7,078.24	Mar. 4, 1929
H. H. Elsworth	Director	1	26,000.00	Nov. 26, 1929
Everett S. Fallow	Actuary, accounting division	2	8,473.00	July 15, 1929
Charles E. Ferree	Assistant agency secretary	2	11,122.03	Jan. 1, 1929
B. D. Flynn	Vice president	2	80,450.00	May 26, 1931
Howard A. Giddings	do	1	7,500.00	Jan. 1, 1929
Frank B. Goudy	Director (Neb. S.)	1	10,000.00	June 2, 1931
James C. Graves	Surgical director	1	32,400.00	Jan. 1, 1929
F. L. Grosvenor	Medical director		37,000.00	Oct. 4, 1932
H. Pierson Hammond	Actuary	2	35,000.00	Nov. 25, 1929
John J. Hart	Superintendent automobile division.	2	18,520.00	May 14, 1929
Frank P. Hayden	Assistant secretary	2	24,000.00	July 28, 1930
James E. Hoskins	Assistant actuary	2	14,300.00	Sept. 15, 1930
James L. Howard	Director and vice president	1	58,500.00	Oct. 1, 1930
Joseph R. Lacy	Assistant secretary	2	22,220.48	Jan. 1, 1929
Joseph D. Leahy	do	2	13,700.00	Apr. 30, 1929
Walter W. Mallory	Agency secretary	2	46,000.00	Sept. 30, 1931
Francis T. Maxwell	Director	1	110,000.00	Sept. 20, 1930
John McGinley	Vice president	1	25,000.00	Jan. 1, 1929
Bertrand A. Page	do	2	100,000.00	Nov. 30, 1929
Charles E. Perry	Medical department	2	11,020.58	June 25, 1930
Fred E. R. Piper	Assistant manager casualty claim.	2	8,500.00	Sept. 11, 1929
Jesse W. Randall	Vice president	2	29,276.00	Jan. 1, 1929
C. Donald Raney		2	15,541.06	Nov. 15, 1929
Walter R. Rearick	Superintendent	2	13,699.80	Oct. 31, 1929
Daniel A. Read	Secretary	2	23,315.00	Oct. 15, 1929
James E. Rhodes	Attorney	2	29,300.00	Apr. 29, 1930
Walter Roberts	Assistant cashier	2	70,500.00	Oct. 31, 1929
Lewis M. Robotham	Secretary	2	40,000.00	Mar. 19, 1929
Robert D. Safford	Vice president	2	8,500.00	Aug. 25, 1933
Wilbur S. Sherwood	Assistant cashier	2	65,000.00	Sept. 16, 1929
Arthur L. Shipman	Director	1	42,658.87	Dec. 16, 1930
Wellington R. Slocum	Cashier	2	17,500.00	Jan. 1, 1929
George M. Smith	Assistant surgical director	1	8,300.00	Do.
C. Luther Spencer, Jr	Director	1	19,000.00	Dec. 5, 1930
Howard R. Sullivan	Assistant manager casualty claim.	2	47,150.00	Nov. 21, 1930
R. J. Sullivan	Vice president	1	17,500.00	Jan. 1, 1929
C. W. VanBeynum	Manager publicity department.	2	13,069.84	Sept. 16, 1936
John L. Day	Director	1	10,000.00	Jan. 1, 1929
Roger W. Wight	Superintendent agencies	1	10,150.00	May 31, 1932
Robert H. Williams	Vice president		41,500.00	Jan. 8, 1932
L. E. Zacher	President	1	50,000.00	July 15, 1929

It was the practice for the banks to lend money to Travelers Insurance Co. employees, officers, and directors at a preferential interest rate. Top officers of the company, including Mr. Zacher, borrowed at a rate of interest lower by a full percent than the going rate (pt. 13, R. 6418–6421).

That these loans bulked large in the activities of the banks is easily demonstrated. At the Connecticut River Banking Co., the loans to officers, directors, and employees of Travelers group represented a substantial percentage of the bank's loans. The following schedule shows for the indicated dates the percentage of total bank loans attributable to officers, directors, and employees of the Travelers group: [50]

	Percent
Jan. 1, 1929	22. 3
Dec. 15, 1931	26. 61
Jan. 1, 1933	28. 85
Jan. 1, 1935	26. 21
Jan. 1, 1939	39. 43

Similarly at the Travelers Bank & Trust Co., loans to officers and directors of Travelers equaled 17.06 percent of the bank's mortgage loans and 36.17 percent of the bank's other loans, as of January 1, 1939.[51]

The number and amount of these loans or their importance in relation to the total bank loans does not indicate the full extent to which the personal affairs of the officers and directors became commingled with the affairs of the Travelers Insurance Co. and other companies in the Travelers group.[52]

Travelers Insurance Co. found it necessary, for example, to bail out the Travelers Bank & Trust Co. in which heavy loans to officers and directors of Travelers were outstanding, by purchasing securities from the bank at fictitious prices. Travelers Insurance Co. caused Ne-

[50] Pt. 13, R. 6392.

[51] Pt. 13, R. 6412, 6413.

[52] The record contains considerable evidence of the financial difficulties which may beset life insurance companies whose affairs become too involved with those of banking institutions. For example, Illinois Bankers Life Assurance Co. held shares of Monmouth Trust & Savings Bank and placed one of its officers on the board of the bank to guard its interest which represented an investment of $59,000 (223 shares out of 1,250 outstanding). The bank got into financial trouble and the Illinois Bankers put a disproportionate amount of its deposits in the bank to "keep it running." When the bank became more pressed the insurance company was obliged to take $41,045 of real estate and $87,000 of first mortgages from the bank and accept a deferred deposit of $50,000 thus reducing the bank's deposit liability by $178,845 (pt. 13, R. 6901–6903). In addition three cases of companies which failed as a result of banking affiliations since 1930 with substantial losses to policyholders were established—Home Life Insurance Co. of Little Rock, Ark., National Life Insurance Co. of the United States, Chicago, Ill.; and Continental Life Insurance Co., St. Louis, Mo. Pt. 28, testimony of Alfred M. Best, February 29, 1940. See also pt. 13, R. 6655–6657.

braska Securities Corporation,[53] at that time one of its subsidiaries, to purchase on December 24, 1931, certain securities having a then market price of $80,413.50 for a total of $221,720.58, or an amount $141,307.08 in excess of the true market price, in order to prevent the bank from failing through lack of adequate financial support.[54]

Further involvement resulted from the fact that as collateral against these loans the officials pledged substantial blocks of Travelers Insurance Company stock. The testimony disclosed that prior to the date Travelers became interested in the Connecticut River Banking Co., that bank held a negligible amount of Travelers Insurance Co. stock as collateral against its outstanding loans.[55] Commencing in 1912, however, the number of shares of stock so pledged increased until by December 15, 1931, 3,515 shares of Travelers Insurance Co. stock were held as collateral by the bank, of which 2,043 shares represented collateral pledged against loans to officers, directors or employees of the company.[56] At about this time the market price of Travelers Insurance Co.'s stock experienced one of its most precipitous declines. Commencing with a market price of $1,570 a share in April of 1930, the stock dropped to $950 a share by April of the next year and reached a low point of $175 a share by July 11, 1932.[57] The minutes of a meeting of the financial committee of the Connecticut River Banking Co. held on July 12, 1932, the day after this low point in the market was reached, record that as of June 25, 1932, the collateral securing the loans at the bank, which of course included many loans then outstanding to officers and directors of the insurance company was impaired to the extent of $367,000.[58] In an effort to prevent these loans from going under water and partially to protect the interests of its stockholders generally, Travelers Insurance Co. undertook to purchase distress stock in the open market by making various purchases through its several subsidiary companies during the period from 1930 to 1932.[59] The purchases were for the purpose of steadying

[53] The factors prompting the organization of Nebraska Securities Corporation as a subsidiary of Travelers were considered at some length in the hearings. It developed that in 1926 the company learned that one of its mortgage loan agents in Nebraska had falsified his accounts and over a period of years submitted to Travelers, and it had accepted, $1,251,500 of spurious mortgage paper. Travelers neither prosecuted the loan agent nor publicized the condition of its accounts with him. Instead, it made an agreement with the loan agent under which it obtained certain properties of dubious value owned by him and after crediting these to his account accepted his personal note in the amount of $685,429.07 which represented the balance of the obligation resulting from the issuance of the spurious paper. The note and properties were then sold to Nebraska Securities Corporation which Travelers had organized for the purpose and Travelers took back in payment therefor capital stock and notes of the Corporation. In subsequent years Nebraska Securities Corporation was used as a clearing house for transactions other than those originally contemplated and it became a repository for defaulted mortgages and certain foreclosed real estate which Travelers placed in the Corporation from time to time, receiving in return Nebraska Securities' notes. In its statement for the year 1932, the notes (classified as bonds in the annual statement) appeared in the balance sheet at their face value of $7,300,000 and the stock was carried at $459,900, a value of $20 a share instead of the par value of $100 a share. There was nothing to indicate that the underlying security of these investments consisted only of defaulted mortgages or farm properties of questionable values. The corporation was dissolved in 1936 and the account at that time showed that Travelers had lost $2,303,893 in principal and approximately $1,300,000 in uncollected interest. On the dissolution of the Corporation, its assets were acquired by Travelers. The ultimate loss to Travelers from these transactions, which were at no time fully revealed to its shareholders or policyholders, will not be known until these properties are sold to bona fide purchasers (pt. 13, R 6431-6463).

[54] Pt. 13, R. 6457-6459, exhibit No. 1118.

[55] Pt. 13, R. 6393.

[56] Pt. 13, R. 6392.

[57] Pt. 13, R. 6393.

[58] Pt. 13, R. 6394.

[59] Pt. 13, R. 6446-6449.

the market price.[60] The market for the stock was entirely an over-the counter market and at best a thin one.[61] On occasions these purchases were heavy, considering the general thinness of the market. For example, on October 2, 1931, during trading which saw the price of Travelers Insurance Co. stock drop from $540 to $473 a share, nine different purchases were made from various brokers through the Connecticut River Banking Co. for the account of subsidiaries of Travelers, for a total of 103 shares and an investment of $54,201.[62] It is of interest to note that during this period Travelers Insurance Co. took pains to conceal sales of stock by certain of its officers, in some instances purchasing stock from these officers directly to prevent it from appearing in the market.[63]

The purpose and effect of the trading was revealed through the following testimony of Mr. Zacher, who was primarily responsible for initiating the actual buying and selling orders. Mr. Zacher testified: [64]

Acting Chairman O'CONNELL. Would it be fair to say that you were purchasing stock during this distress period to help out the brokers and other persons who either held or ordinarily purchased the stock, and at the same time you hoped you would ultimately be able to liquidate the stock without taking the loss?

Mr. ZACHER. Or stockholders that had a pledge with the banks and the banks which had to liquidate part of those holdings.

Acting Chairman O'CONNELL. That is just exactly the point I am interested in. Wouldn't it be a fact that a number of your stockholders who had substantial blocks of stock would be in danger of losing their stock if it were pledged as collateral with the price of the stock not maintained?

Mr. ZACHER. Yes.

Acting Chairman O'CONNELL. Wasn't that one of the motives in buying the stock, to maintain the price?

Mr. ZACHER. Yes; it would have hurt the stockholders and indirectly the bank would have lost money and the insurance companies would have lost money, because they are all considerably interested in those bank stocks up there.

Mr. GESELL. And particularly your two banks, the Connecticut River Bank especially, would have lost a great deal of money since, as we saw at this period, there were over 2,000 shares of Travelers stock pledged as collateral against loans, many of these loans being made to officers and directors of your company.

Mr. ZACHER. Yes, but that didn't bother us so much because we knew the character of the borrowers, we knew what kind of job they had, we knew eventually without collateral they would make every effort to pay out.

Acting Chairman O'CONNELL. As a matter of fact, I think it was developed that many of the loans were under water and it didn't apparently bother you very much?

Mr. ZACHER. There was a short period, sir, where the market value went to nothing. There wasn't any market value in that particular time, but after the market steadied and we were able to get to these borrowers and call their attention to it, we finally got margins, or had the loans paid off, so there were only a few very loans that were what you might call under water so far as their collateral was concerned, and in each case we got insurance; so if they died before their loan was paid we would be protected.

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[60] Pt. 13, R. 6447.

[61] Mr. L. Edmund Zacher testified (pt. 13, R. 6462): "There isn't a great amount sold, from time to time, except when somebody dies and they have to settle up the estate."

[62] Pt. 13, R. 6454.

[63] Pt. 13, R. 6448.

[64] Pt. 13, R. 6460, 6461.

Acting Chairman O'CONNELL. At any event, it seems pretty clear, doesn't it, that one of the primary purposes of the purchase of this stock during the period was to maintain the market price of the stock so as not to have the depreciated price of the stock result in the sacrifice of the stock by officers or other persons who had substantial stock interests?

Mr. ZACHER. It wasn't so much the price as to keep the stuff moving, not to have it get stagnant.

Acting Chairman O'CONNELL. Why is it important to the company that it be kept moving?

Mr. ZACHER. So that it won't sink out of sight overnight.

Acting Chairman O'CONNELL. When you say "keep moving" you mean keep moving upwards?

Mr. ZACHER. No; keep moving back and forth to steady.

Mr. GESELL. In other words, when too much supply and too little demand existed you wanted to dry up some of the supply?

Mr. ZACHER. That's it.

Of the same effect as direct loans to officers and directors are loans made by insurance companies to corporations in which their directors or officers are interested as promoters. Some loans of this character have already been briefly mentioned. Many further examples may be found in the discussion of reinsurance arrangements and failures which follows in a subsequent section.

Not only do officers and directors borrow from their companies but the evidence also discloses that certain directors have used their connections to their advantage in securing business preferment in various types of transactions through the influence they are able to exercise as members of life insurance boards.

An example in point was provided through the testimony of Mr. Mitchell D. Follansbee, a director of the Metropolitan. Mr. Follansbee has been a director of the Metropolitan since 1915. During this time he has also been a partner of the Chicago law firm of Follansbee, Shorey & Schupp.[65] From 1915 to 1932, Mr. Follansbee's firm did no business for the Metropolitan.[66] Mr. Follansbee understood that it was the policy of the company to forbid any directors to represent the company as counsel.[67] In 1932, Mr. Samuel Fordyce, an attorney from St. Louis, was nominated and elected to the board of directors of the Metropolitan. Mr. Fordyce had represented the Metropolitan in legal matters prior to becoming a director and continued his legal representation of the company after he became a director.[68] When Mr. Follansbee learned of this fact he wrote Mr. Leroy A. Lincoln, then vice president and general counsel of the Metropolitan, on May 7, 1932, as follows:[69]

When I came on the board a great many years ago, when the company was first mutualized, I, or someone else elected at the same time, took the place of Mr. Butcher, and Mr. Butcher was told in those days that the policy of the company forbade any director to represent, as counsel, the company in any way. That policy was changed, as I understand, and the evidence of the change was that my

[65] Pt. 4, R. 1412–1416.

[66] Pt. 4, R. 1413.

[67] Pt. 4, R. 1413.

[68] Pt. 4, R. 1413 and 1414, exhibit No. 260. During the period from 1930 to 1938, the law firms of which Mr. Samuel Fordyce was partner received fees totaling $227,076. From 1930 to 1934 the amount of these fees rapidly mounted reaching a maximum of $48,666 in 1934 (Convention Form Annual Statements, Metropolitan 1930–38).

[69] Pt. 4, exhibit No. 260.

friend, Sam Fordyce, retained his legal representation for the company after he became a director.

The company is apt to have a lot of important real estate foreclosures in this vicinity, and I write to you as general counsel asking you to give our firm, which has always had both knowledge and facility in such matters, consideration.

As a result of this letter, Mr. Follansbee's firm was given opportunity to represent the Metropolitan, and in the next 6 or 7 years his firm represented that company in 1,382 foreclosures for total fees amounting to $336,920; in 6 loans matters for fees amounting to $2,025; in 7 sales matters for fees amounting to $1,250, and in 7 miscellaneous cases for additional fees amounting to $18,885 making a grand total of $359,080 in business received since the writing of the letter in May of 1932.[70] This substantial increase of business required Mr. Follansbee's firm to hire 6 additional employees and to increase its office space.[71]

Another example of the use by a director of his position for personal advantage may be found in certain transactions between the New York Life and the Employers Liability Assurance Corporation, of New York City. Mr. Charles D. Hilles is a director of New York Life and New York City resident manager and director of Employers. The Employers Liability Assurance Corporation writes various forms of casualty insurance including workmen's compensation insurance, general liability insurance, elevator insurance, steam boiler insurance, and fidelity insurance. Mr. Hilles testified that New York Life was interested in 4,922 buildings and that his firm had all of these properties covered by one form of insurance or another.[72] It developed that Mr. Hilles became a director of the insurance company in the spring of 1922.[73] A business connection with the Employers had already been established and thereafter the business grew rapidly. During the last 12 years the average annual premium paid to Employers by New York Life Insurance Co. amounted to $99,891.40[74] and the records showed that the yearly premiums had increased from $62,490.77 in 1927 to $182,658.43 in 1938, an increase of almost 200 percent. Mr. Hilles is in constant communication with officials of New York Life on business matters affecting the miscellaneous insurance account. He stated that he never solicited business from the New York Life but through one of his letters written in May of 1933, to Mr. Alfred L. Aiken, then vice president of the New York Life, his active solicitation of at least one line of business was disclosed. After indicating he had

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[70] Of this amount, about $25,000 was paid by owners of equities and the remainder was paid by the Metropolitan. (Pt. 4, R. 1414.) The fees Metropolitan paid to Mr. Follansbee's firm increased, while the relative amount of fees received by the firm of Hoyne, O'Connor, and Rubicam, which had previously represented the Metropolitan in the Chicago area decreased.

[71] Pt. 4, R. 1416. The convention form annual statements of the 5 largest companies indicate that fees are often paid law firms, 1 or more of whose partners interlock with the insurance companies. The following interlocking law firms received fees in 1938: In the case of the Mutual Life, Bruce and Bullitt in the amount of $8,105.59; in the case of the Prudential, Wainwright, Elder, and McDougall in the amount of $8,066.04 and Lindabury, Depue, and Faulke, $23,469.85; in the case of the New York Life, Root, Clark, Buckner, and Ballantine, $15,000 (see also pt. 4, R. 1440); in the case of the Metropolitan, Follansbee, Shorey, and Schupp, $14,772 and Fordyce, White, and Mayne, Williams, and Hartman, $29,479; in the case of the Equitable, Milbank, Tweed, and Hope, $6,555.64; and Pillsbury, Madison, and Sutro, $8,285.94. These fees totaled $113,734. For further testimony on the subject of directors acting as attorneys for the insurance companies on whose boards they serve, see pt. 4, R. 1413, 1414, 1440, 1441, and 1496.

[72] Pt. 4, R. 1473.

[73] Pt. 4, R. 1472.

[74] Pt. 4, R. 1473.

not been able to reach Mr. Aiken by telephone Mr. Hilles' letter stated:[75]

Now, however, another matter arises due largely to the connection of the McCall family with the National Surety Co., the surety and fidelity items of the miscellaneous lines of insurance of the New York Life were turned over to the National. I assume that the business of that company will be liquidated. In that case I hope it will be agreeable to you to have your fidelity and surety placed with us.

As to our financial position, I may say that we were the one company in a total of 103 in business in the country which made a gain in 1932 in volume in underwriting profit and in assets.

Mr. Hilles was also interested in the Employers Fire Insurance Co. A letter written to Mr. Hilles by the president of that company disclosed that he was expected to bring his influence to bear in directing New York Life's fire insurance business to the fire company. The letter stated:[76]

In the past you have on a number of occasions attempted to prevail upon the New York Life Insurance Co. to use the facilities of our fire company. They have, I believe, taken the position they cannot influence their property managers, who in many instances are insurance agents, to place with any one particular company the fire insurance on buildings in which they are interested as mortgagee.

While I quite appreciate their position, I have recently learned from Mr. Bertrand J. Perry, president of the Massachusetts Mutual Life Insurance Co., of Springfield, Mass., that they and many other life companies have decided to use but one fire company to give them the necessary coverage.

*   *   *   *   *   *   *

Possibly, the New York Life Insurance Co. has considered a similar plan. At any rate, I am wondering if you would be so good as to find out what they do and, more particularly, whether or not you could in some fashion or other influence them to use the Employers' Fire Insurance Co. as the company to handle their fire insurance on those properties they own. Such an arrangement, obviously, would help the fire company a great deal.

Yours for profitable premiums.

Two memoranda from the files of the New York Life disclosed that the officers of that company had adopted a policy of throwing business toward the Employers' Liability Assurance Corporation. One memorandum stated:[77]

Up to August 31 of this year (1933) the coverage referred to was placed with the National Surety Co. (later the National Surety Corporation). However, we were directed, after a conference of some of our executives, to place the coverage with the Employers' Liability Assurance Corporation from August 31, 1933.

Another stated:[78]

We find that the Buckeye Union Casualty Co. and the Shelby Mutual Co. are rather small concerns, and that the Employers' Liability and General Accident Cos. are the larger companies with whom we ordinarily would be willing to do business.

Our recommendation is that the Employers' Liability Assurance Corporation be used for two reasons. First of all, the fact that our own blanket liability policy is carried in that company, and second, it is the writer's understanding that the

[75] Pt. 4, R. 1473, exhibit No. 279.

[76] Pt. 4, exhibit No. 282.

[77] Pt. 4, exhibit No. 284.

[78] Pt. 4, exhibit No. 285.

General Accident Insurance Co. takes a very independent attitude in the handling of their business in New York. We have had very little insurance with them ourselves and cannot say just how they would react to any business we might be connected with.

The writer knows that several of our officers would prefer that the Employers' Liability Assurance Corporation be used for this coverage if possible.

Thus it appeared that New York Life's business with Employers' Liability Assurance Corporation prospered after Mr. Hilles came on the board of the former company both by reason of Mr. Hilles' solicitations and the disposition of his fellow officers to point business in his direction. Mr. Hilles has a 10-percent interest in the profits of his agency. The premiums from the New York Life Insurance Co. contributed to the profits of the agency and in this manner he received benefits from the New York Life business.[79]

Two additional examples of business dealings, not necessarily involving direct personal gain, between large insurance companies and business concerns with which one of their directors was connected, are as follows:[80]

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[79] Pt. 4, R. 1476, 1477. These transactions demonstrated the advantages which may accrue to a life-insurance director interested in other miscellaneous lines of insurance. For further testimony on this general subject, see testimony of Mr. Hendon Chubb, a director of the Prudential, pt. 4, R. 1480, 1488; testimony concerning the activities of Mr. Ridley Watts, a director of New York Life, pt. 4, R. 1479–1490; and testimony of Mr. Michael Cleary, president, Northwestern Mutual Life Insurance Co. regarding attitude of his company toward permitting directors interested in miscellaneous lines of insurance to sell the same to that company, pt. 4, R. 1496, 1497.

[80] An interesting excerpt from the testimony demonstrates the manner in which a company may utilize its interlocking directorships to build up its business and establish advantageous contacts. Mr. Wilfred Kurth, chairman of the board of the Home Insurance Co. of New York, the largest fire-insurance company in the United States, testified that the directors of his company were representative citizens who "must be of value to the company, either as producers of business or in the financial set-up."

He explained that the Home Insurance Co. maintained a service department whose duty it was to develop profitable business contacts through the interests of the various directors on the board. (Pt. 4, R. 1442, 1443.) Mr. Kurth testified (pt. 4, R. 1444, 1445):

"Mr. GESELL. How much do you pay your directors a year?

"Mr. KURTH. Pay them $4,000 a year. That started a little over 2 years ago.

"Mr. GESELL. That is a flat salary?

"Mr. KURTH. Flat salary.

"Mr. GESELL. Is it the purpose of the service department to see that they earn it by getting you this business?

"Mr. KURTH. Yes; we see to that, too. As a matter of fact, about the time I became president we began to realize that we had not developed through our directors possibilities in the way of getting business and we started about then and these calls became so great upon the directors that I finally suggested that we put them on a salary basis rather than a fee basis.

"Mr. GESELL. So that the inconvenience that was caused by getting new business would be compensated for?

"Mr. KURTH. They earned it.

"Mr. GESELL. Well now what prompted you to institute this plan of paying your directors for getting business?

"Mr. KURTH. Just as I say, we were calling upon them so frequently and they were really doing a lot of work and I don't think any ordinary fee pays a director that does his utmost in the interest of his company.

"Mr. GESELL. Did you find that without calling upon these connections you were excluded from business because of other connections between other companies?

"Mr. KURTH. Not so much that; it is surprising how—perhaps I should not say it; perhaps our competitors have not realized the advantage of using their directors, but it has been a very prolific source of income with us."

* * * * * * *

"Mr. GESELL. So that it is of real consequence to your company to get other board men who by reason of their varied connections and directorships in other companies can bring business to your company or take it away from someone else?

"Mr. KURTH. Very pointedly."

As examples of how the system works, Mr. Kurth stated that his company obtained business on real estate owned by the Bowery Savings Bank through the efforts of Mr. Lewis L. Clark, a director of the Home Insurance Co. and director of the bank. Several other examples were enumerated. Pt. 4, R. 1442–1445.

Mr. Alfred E. Smith, a director of the New York Life, is chairman of the board of the Meenan Oil Co. On two occasions he addressed letters to officials of the New York Life soliciting business on behalf of his oil company and it appeared that the Meenan Oil Co. in 1937 received orders for 1,275,000 gallons or more than half the oil supplied to properties of the insurance company. It appeared from the record that preferential treatment was given Mr. Smith's company until the matter came to the attention of Mr. George S. Van Schaick, vice president of the New York Life who issued contrary instructions to the company's superintendent of real estate.[81]

Mr. Carroll B. Merriam became a director of the Metropolitan in 1934. He was also a stockholder in and an officer of the Central Trust Co. of Topeka, Kans., which in turn controlled the Central Trust Mortgage Co.[82] These two concerns acted as mortgage correspondents for the Metropolitan during the time Mr. Merriam was on its board. The Metropolitan's connection with the Central Trust Co. had been established prior to Mr. Merriam's undertaking his directorship. Although the connection with the Central Mortgage Co. was developed after the directorship was established, negotiations looking toward such an arrangement had been under way before that time. In the period from 1934 to 1938 these firms received fees as correspondents or managers of Metropolitan farm properties totaling $132,852.[83]

[81] Pt. 4, R. 1436, 1437, exhibit Nos. 263, 264, 265, 266, and 304.

[82] Pt. 28, exhibit No. 2340 and Moody's Manual of Investments 1934, 1935.

[83] Pt. 28, testimony of Glen E. Rogers, February 19, 1940. 1934–38 Convention Form Annual Statements, Metropolitan, schedules G and J.

SECTION VII

Change of Plan of Company Operation to Benefit Personal Interests of Officers and Directors

Officers of some insurance companies have utilized their positions to their own advantage in still another way; namely, by changing the form of their companies from stock to mutual or from mutual to stock whichever their personal interests dictate. Three instances of this procedure were developed in the course of the testimony and will be discussed herein.

A. MONUMENTAL LIFE INSURANCE COMPANY

The recent history of the Monumental Life Insurance Co. of Baltimore, Md., provides an example of the manner in which the directors of a mutual company may take control from the policyholders by changing its form to that of a stock company.[1] From the date of its organization until February 6, 1928, Monumental operated as a mutual company.[2] At that time it was changed to the stock plan under the following circumstances. Prior to the conversion, the officers of the company who had been elected by the policyholders and who were presumably representing their interests learned that "cliques" were being formed among certain branch managers of the company to secure sufficient votes to control the forthcoming elections. The officers who had been with the company during its earlier stages were apparently fearful they would be ousted from their positions. Mr. Paul M. Burnett, chairman of the board of the Monumental, testified: [3]

Mr. GESELL. Well, your concern was then more the fear that these managers would oust you and your fellow officers from office than it was any overt act that had taken place?

Mr. BURNETT. That is not a fair construction. We had been in control of the company and built the company for many years.

Mr. GESELL. But the policyholders hadn't been—were in control?

Mr. BURNETT. We were in control; we were the ones managing the business and there was always that condition that we had to face.

Mr. GESELL. Now I wish you would be specific about the condition. Had the managers put men on the board of directors that you didn't want there?

Mr. BURNETT. No; the managers had not.

Mr. GESELL. It was merely the fact they were threatening to do so, was it not?

Mr. BURNETT. They were forming little cliques and doing various things that were exceedingly annoying to us in the management of our business.

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[1] This company is primarily an industrial company, having $60,780,553 ordinary and $211,533,033 industrial insurance in force as of December 31, 1938. The company was incorporated in 1858 as a mutual company under the laws of Maryland and began business in 1860. It was orginally known as Maryland Mutual Life and Fire Insurance Co. of Baltimore, In 1870 its name was changed to Mutual Life Insurance Co. of Baltimore. In July 1935, 7 years after it had ceased to be a mutual company, the company took its present name. Best's Life Insurance Reports 1939, p. 681 et seq.

[2] Pt. 12, R. 5619.

[3] Pt. 12, R. 5624, 5625.

Mr. GESELL. And among those things was the soliciting of proxies from policyholders with a view to putting people on the board of directors?

Mr. BURNETT. I didn't say that because they did not do that. I said it was the fear of that. It was the threat of that.

Mr. GESELL. Is it a fact that you were afraid they might do it?

Mr. BURNETT. They were in a position to do it.

Mr. GESELL. And had they done anything which indicated to you that they might do it?

Mr. BURNETT. Yes, we had known of several meetings that they had had to discuss it.

Mr. GESELL. That is what I am getting at. There were plans afoot, then, by these managers to solicit proxies from the policyholders and oust some of you fellows from the management of this company, weren't there?

Mr. BURNETT. No; I wouldn't say that. I don't know just how far they would have gone. I can only say that there were these cliques formed and they had some meetings for the purpose of discussing questions of that kind. Just how far they went I don't know; I wasn't invited to the meeting.

Mr. GESELL. And you and your fellow officers were fearful lest these plans might mature and result in displacing some of you from your controlling positions in the affairs of the company?

Mr. BURNETT. Well, I don't think that is just a fair presumption.

Mr. GESELL. I am not trying to presume anything.

Mr. BURNETT. You are answering the question. You are answering the question.

Mr. GESELL. Will you state it in your way, then?

Mr. BURNETT. Well, I would say this, that in any corporation of that kind a change of management would be disastrous.

Accordingly, the officers decided to take advantage of a statute, then a part of the Maryland Code, pursuant to which a company might change from a mutual to a stock plan of operation, and a formal resolution of the board of directors to effect this change was voted on October 6, 1927.[4] It is not entirely clear who was responsible for suggesting the conversion plan. With respect to this question Mr. Paul M. Burnett, then president of the company and now its board chairman, testified:[5]

Mr. GESELL. Well now, I want to understand that very clearly. You say you think the suggestion came from the insurance department. Did the insurance department suggest this or didn't they?

Mr. BURNETT. The insurance department did positively suggest it.

Mr. GESELL. Did they originate the idea?

Mr. BURNETT. They did.

Mr. GESELL. Do I understand that the insurance department came to you without any——

Mr. BURNETT. No; I didn't say that.

Mr. GESELL. Without any previous awareness on your part and made this suggestion?

Mr. BURNETT. I didn't say that. No, in our discussion of matters pertaining to the company with the insurance department it was suggested that we avail ourselves of the statute which had been passed several years before.

Mr. GESELL. Who initiated these discussions?

Mr. BURNETT. I think it came probably through some examination of our affairs.

[4] Pt. 12, R. 5627, exhibit No. 954.

[5] Pt. 12, R. 5623, 5624.

Mr. GESELL. Then it was some examiner of the company who suggested that you change from a mutual to a stock company?

Mr. BURNETT. No; I would say that my best recollection is that it was the actuary.

Mr. GESELL. What is his name?

Mr. BURNETT. Siegk—Arthur Siegk.

Mr. GESELL. Your impression is that he made the suggestion?

Mr. BURNETT. I think that he got back of it.

Mr. GESELL. That isn't my question.

Mr. BURNETT. Well, I say—I mean to say, I think he was enthusiastic for it; I think he was very anxious.

Mr. GESELL. I don't want to know who went out and beat the drum after it was originated. I want to know who originated the idea, Mr. Burnett.

Mr. BURNETT. I think the idea was originated by a suggestion made by him.

Mr. GESELL. To whom did he make that suggestion?

Mr. BURNETT. I wouldn't remember.

Mr. GESELL. What is your basis for saying that he suggested it?

Mr. BURNETT. Because I discussed it with him. I discussed the matter with him.

Mr. GESELL. Then he came to you to talk about it?

Mr. BURNETT. He came to me, or I went to him, I don't remember which.

Mr. GESELL. That is what I want to know. Did you go to him or did he come to you?

Mr. BURNETT. I don't know. I can't tell you at this late date.

Mr. GESELL. I will give you plenty of time to think about it.

Mr. BURNETT. I don't need the time, sir. I only say that I can't recall.[6]

Shortly thereafter a meeting of the company managers was held and the announcement made that the company intended to convert.[7] A cryptic notice sufficient only to meet statutory requirements was placed in two Baltimore newspapers, notifying the policyholders of a meeting to be held on January 5 of the following year to vote on the conversion plan.[8] No published notice was given outside of the city of Baltimore although 30 percent of the company's business was

[6] It is clear that the Maryland Insurance Department approved the plan (pt. 12, R. 5626, 5627, exhibit No. 960). Three representatives of the Maryland Insurance Department acquired stock in Monumental following the consummation of the conversion plan. These representatives were Mr. John P. Albert, an examiner for the Department who was in charge of the periodic official examinations of Monumental; Mr. Denton S. Lowe, an employee; and Mr. Arthur M. Siegk, actuary for the Department. Mr. Albert obtained 20 shares of Monumental stock on May 10, 1928. These shares were transferred to Mr. Albert from a certificate which had been issued in the name of Mr. Roberts and the purchase price of $2,000 was raised through a collateral loan, secured by the 20 shares, which was arranged for Mr. Albert at the Real Estate Trust Co.

Three months later Mr. Albert reduced his holdings to 10 shares and thereby reduced his indebtedness to $1,000. Coincident with this transaction Real Estate Trust Co. loaned $1,000 to Mr. Lowe against collateral of 10 shares of Monumental stock issued to Mr. Lowe at the same time. Mr. Siegk acquired 158 shares on February 20, 1938. The purchase price of these shares, or $17,380 was obtained through arrangements made at Weilepp Bruton Co., a Baltimore brokerage house. Mr. Siegk paid $5,000 down and borrowed $12,380 from this firm, pledging his shares as security. On the same day Weilepp Bruton borrowed $12,380 from Real Estate Trust Co., pledging 158 shares of Monumental stock and 5 shares of Mercantile Trust Co. stock as collateral. Thus the Real Estate Trust Co. financed directly or indirectly the stock purchases of all three of the Maryland Insurance Department's representatives. The Real Estate Trust Co. was closely affiliated with the Monumental, five of its directors, including Mr. Roberts, being directors of both the Trust Co. and Monumental. Cash dividends on the stock held in the name of the three Maryland Insurance Department representatives or members of their families have totaled over $40,000. In addition there have been substantial stock dividends declared by Monumental from time to time which materially increased the holdings of these three individuals (pt. 12, R. 5663-5670, exhibit No. 969).

[7] Pt. 12, R. 5627.

[8] Pt. 12, R. 5628, 5629.

outside Baltimore, and only 2 of the company's 27 branch offices were located in that city. No special notice of any kind was distributed among the policyholders.[9] Proxies for the meeting were solicited from the policyholders by the agents of the company who each received $10 for obtaining signatures to proxies in favor of the conversion.[10] The company at that time had approximately 1,000 agents and the expense of $10,000 incurred was paid from the general funds of the company.[11] The form of proxy used, in addition to containing authority to vote for the conversion itself, contained a provision whereby policyholders were asked to waive the rights guaranteed them under the Maryland statute to subscribe to stock of the new company. With respect to these waivers, which most of the policyholders signed, Mr. Paul M. Burnett, president of Monumental at the time of conversion, testified as follows:[12]

Mr. GESELL. You were anxious to get those waivers, weren't you?

Mr. BURNETT. Naturally we wanted them. That is the reason it is on there.

Mr. GESELL. Why did you want them?

Mr. BURNETT. We wanted to control the company.

Mr. GESELL. That is a very frank statement, you wanted to control the company.

Mr. BURNETT. Naturally.

Mr. GESELL. This was the policyholders' company that was involved, wasn't it?

Mr. BURNETT. We were proceeding under that statute.[13]

Testimony obtained from agents of the company at the time of the conversion indicated serious irregularities in the obtaining of these proxies. One agent admitted that it was impossible to obtain bona fide signatures to the proxies and that he signed the names of policyholders to the proxies in many instances.[14] He stated that he believed this was the general practice among the men at the time.[15] Another agent testified that when he was instructed to solicit proxies he was told that the proxies were simply for the purpose of changing the name of the company and that he had been so advised by his manager.[16] There were 489,073 policies outstanding at the time of the conversion and consents or proxies were obtained from holders of 376,982 policies.[17]

Following the policyholders' meeting giving necessary approval of the conversion plan, the officers and directors of the company undertook to allocate the shares of stock to be issued as soon as formalities in connection with the plan were completed. The minutes of the meeting of the board of directors stated:[18]

Be it further resolved, that the Board is of the opinion that the balance of the stock shall be allocated to the policyholders of the Mutual Life Insurance Co.

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[9] Pt. 12, R. 5629.

[10] Pt. 12, R. 5629–5631, exhibit No. 956.

[11] Pt. 12, R. 5630, 5631.

[12] Pt. 12, R. 5632.

[13] This form of proxy was approved by the State insurance commission in the State of Maryland. Notice to insurance commissioners of other States in which the company operated was not given until the plan had been almost entirely carried into execution. This notice was not in detail (pt. 12, R. 5632, 5633).

[14] Pt. 12, R. 5652.

[15] Id.

[16] Pt. 12, R. 6162.

[17] Pt. 12, R. 5635. The proxies were counted by employees of the company (pt. 12, R. 5636). A responsible official of the company in responding to a subpena duces tecum calling for the production of the proxies stated that he had made a search for the same and that in his best belief they had been destroyed in 1932 with the permission of a representative of the Maryland Insurance Department (pt. 12, R. 5660, 5661).

[18] Pt. 12, R. 5643.

holding an executive position therewith either as an official or departmental manager of the company or other capacities in order that the present management, control, and operation of the company may continue in the same hands and under the same management which has successfully conducted the company for years past * * *.

Shares were allocated on the following basis:[19]

	Shares		Shares
Subscribing policyholders	315	Assistant secretaries	300
Employees	350	Vice president	500
Managers of offices	1,425	President	760
Heads of departments	1,100		
Secretary	250	Total	5,000

As a result of these allotments, only three policyholders who were not employed by the company or connected in some way with its management received any shares of stock.[20]

The full extent to which the chief officers of the company consolidated their position in the management of the new company is not disclosed by the above allotments. It developed that many of the employees and managers were unable to take up their subscriptions and as a result 1,550 shares allotted to employees and managers from the total of 5,000 shares were released almost immediately from subscriptions and were purchased in the main by principal officers and directors of the company, principally Mr. Paul M. Burnett, who took 295 shares, and Mr. Adelbert W. Mears, a director, who took 500 shares.[21] It also appeared that many officers and employees who subscribed to the stock were subsequently unable to pay for it and as a consequence there was a possibility that these shares might fall into the hands of someone outside the influence of the management. Five

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[19] Pt. 12, exhibit No. 959. Mr. Burnett, who received the principal allotment, testified (pt. 12, R. 5644): "I can only say to you that I do not recall having any discussions about the allocation of the stock prior to this meeting (i. e., the meeting at which the allotments were made), nor did I participate in the discussions that took place on that subject at the meeting."

Mr. Roberts, another official of the company, testified, however (pt. 12, R. 5649):

"Mr. ROBERTS. Well, sir; I would be of the opinion that we knew really what we were going to do.

"Mr. GESELL. Ahead of time.

"Mr. ROBERTS. Ahead of time."

See generally pt. 12, R. 5638–5650.

[20] Pt. 12, R. 5699. Of these 3 policyholders, 2 received 5 shares each (pt. 12, exhibit No. 959); the other, a policyholder named Mr. Summerfield B. Pearson, eventually received 100 shares. Mr. Pearson was the only policyholder who objected to carrying out the conversion plan. Mr. Roberts, an officer of the insurance company, explained the issuance of 95 shares in excess of the allotment to Mr. Pearson as follows (pt. 12, R. 5678):

"Mr. GESELL. Instead of getting 5 shares he got 100 shares. What is the story behind that?

"Mr. ROBERTS. Well, Mr. Gesell, of course you want the story just as you know it to be. He was a broker. He also was a policyholder. He was employed by rather a large brokerage firm in Baltimore, and if my recollection serves me correctly he scouted around and got either proxies or assignments or something from other policyholders, in legal terms what we call a strike, and he came in and demanded more than he would be entitled to or would have been entitled to. Now, we had no dissenting voices of any moment except this Mr. Pearson. We weren't looking to engage in any acrimonious discussions with anybody, and the stock that he got was rather in a settlement to get rid of his objections.

"Mr. GESELL. In other words, by upping his allotment from 5 to 100 you were able to silence his objections?

"Mr. ROBERTS. That is practically the situation.

"The VICE CHAIRMAN. You considered him a nuisance?

"Mr. ROBERTS. He was, because I dealt with him.

"Mr. GESELL. Now, there is a regular provision in the statute for handling people like that. Why didn't you follow the statute procedure?

"Mr. ROBERTS. I am not a crusader or a moralist, either one, and I choose the line of least resistance.

"Mr. GESELL. That explains it. I have no further questions."

[21] Pt. 12, R. 5675–5677, exhibit No. 962.

officers and directors of the Monumental interlocked with a bank known as the Real Estate Trust Co.,[22] and a close connection existed between the insurance company and the bank. In order to assist employee subscribers who had been allotted shares to purchase the same, it was arranged that the bank would loan money to these subscribers to enable them to take up their commitments.[23] No such loan facilities were, of course, offered to the policyholders not connected with the management. Direct and indirect loans by the bank to assist these subscribers totaled $143,000.[24]

Following the conversion of the company from a mutual to a stock form, and the issuance of stock pursuant thereto, the same officers and directors who had previously managed the company remained in control and occupied the same official positions they had formerly occupied. It is significant that since the date of conversion, the company has been extremely profitable.[25] Starting with an original paid-in capital of $500,000 and a paid-in surplus of about $50,000, the company now has a surplus of approximately $2,100,000 and has declared stock dividends totaling $1,500,000 and cash dividends totaling $1,830,000.[26] An analysis of the dividend records of the company indicates that almost $600,000 in cash dividends has been paid to Mr. Paul M. Burnett, Mr. Milton Roberts, Mr. Howard W. Emmons, and Mr. Adelbert W. Mears, the four principal officers of the company who conceived and carried out the conversion plan. These four individuals remain in charge of the company's affairs at the present time and are its principal stockholders.[27]

B. SHENANDOAH LIFE INSURANCE CO.

A slightly different situation arose in the case of the Shenandoah Life Insurance Co., of Roanoke, Va.,[28] In this instance it was to the advantage of the principal officers to convert the company from a stock to a mutual form. This change was accomplished speedily under the following circumstances.

Immediately prior to 1930 the management control of the Shenandoah rested in the hands of five officers,[29] most of whom had been interested in the company since its organization in 1914. By 1930, the company had 50,000 shares of capital stock outstanding of which amount 40 percent, or 20,000 shares, was held by Associated Life Cos., Inc., a Rogers Caldwell enterprise.[30] The five officers owned only a few scattered shares themselves and occupied their positions in the management under an understanding with Associated Life Cos., Inc.[31] In 1930 Caldwell's far-flung financial interests collapsed and the 20,000 shares passed to Lehman Bros. & Co., the New York

[22] Pt. 12, R. 5670.

[23] Pt. 12, R. 5670–5674.

[24] Pt. 12, R. 5672.

[25] Pt. 12, exhibit No. 966.

[26] Pt. 12, R, 5723. The surplus of the company immediately prior to the conversion date (Feb. 6, 1928) was $641,000 (pt. 12, R. 5621).

[27] Pt. 12, exhibit No. 969.

[28] See reference to collateral loans to officers, supra p. 53.

[29] Mr. R. H. Angell, Mr. W. O. Andrews, Mr. John Peter Saul, Jr., Mr. J. H. Dunkley, and Mr. E. Lee Trinkle (pt. 13, R. 6466, 6477).

[30] Pt. 13, R. 6477, 6478. For a more complete discussion of the insurance promotional activities of Mr. Rogers Caldwell, see pp. 120 to 131, infra.

[31] Pt. 13, R. 6478. No officer or director of Shenandoah had any interest in Associated Life Cos., Inc. Id.

investment banking firm which obtained the shares through foreclosure of a loan to Associated Life Cos., Inc.,[32] which it had made some time previously. The five officers of Shenandoah undertook to purchase the shares from Lehman Bros. & Co. in order "to keep the control of the company in the Shenandoah Valley" and to make sure of the continuance of their positions as officers in the company.[33] Mr. John P. Saul, Jr., executive vice president of Shenandoah, testified: [34] "We didn't want that block of stock to get into the hands of some interest which might not be friendly." An agreement was reached in February 1931 fixing the purchase price at $800,000, or $40 per share, payable $200,000 down and $125,000 a year thereafter until completion of payments in February 1936.[35] The down payment was made and each officer executed his joint and several note for the remaining $600,000 obligation.[36] Immediately thereafter the officers created Shenandoah Holding Corporation "for the sole and express purpose" of acquiring the 20,000 shares.[37] It was recognized, however, that each officer remained personally liable for $600,000, owing to Lehman Bros. & Co. under the purchase agreement.[38] After meeting the $125,000 payment due in February 1932, Shenandoah Holding Corporation sold its interest in the Lehman Bros. purchase contract to Insurance Equities, Inc., a concern operated by insurance company promotors.[39] Insurance Equities, Inc., assumed the obligation to Lehman Bros. & Co. and, in addition, gave Shenandoah Holding Corporation its note for $365,000.[40]

The next installment on the purchase price ($125,000) fell due February 25, 1933. This was also the date that the first interest and principal payments on the Insurance Equities, Inc. note to the Shenandoah Holding Co. fell due.[41] During the preceding January, it became evident to the insurance-company officials that Insurance Equities, Inc. was in "precarious financial condition" and that a default on its $365,000 obligation to the holding company could be expected.[42] In anticipation of this default the five officers undertook to meet the payment on the Lehman Bros. & Co. contract which was to fall due. At this time the Shenandoah Holding Corporation was without funds and the officers, therefore arranged for the Shenandoah Life Insurance Co. to lend $116,000 to the Shenandoah Holding Corporation. This loan enabled the officers to meet their commitments to Lehman Bros. & Co. and thus preserve their equity in the block of 20,000 shares. The $116,000 loan was secured solely by the worthless note of Insurance Equities, Inc. to Shenandoah Holding Corporation, upon which a default was certain, and was made at a time when the life

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[32] Pt. 13, R. 6479.

[33] Id.

[34] Id.

[35] Pt. 13, R. 6479, 6480.

[36] Pt. 13, R. 6480.

[37] Id. In addition to the holdings of the five officers a small interest in Shenandoah Holding Corporation was taken by Mr. W. W. Boxley, of Roanoke City. About 1 year after it was founded other stockholders of Shenandoah Life Insurance Co. were given the opportunity to exchange two and one-half shares of Shenandoah for 1 share of the holding company. Not long after the holding company was organized Mr. Angell took over Mr. Andrews' one-fifth interest, giving the former a two-fifths interest (pt. 13, R. 6481).

[38] Pt. 13, R. 6480.

[39] Pt. 13, R. 6482.

[40] Id.

[41] Pt. 13, R. 6483, 6484.

[42] Pt. 13, R. 6484.

insurance company's disbursements exceeded its income and the company was operating under restrictions designed to conserve its liquid position.[43]

The next payment on the Lehman Bros. & Co. contract fell due in February of 1934, and Shenandoah Holding Corporation was not in a position to meet this payment as it fell due. The possibility of a default under the contract was therefore imminent and this would have meant that each of the five officers would have become personally obligated to Lehman Bros. & Co. in the amount of $350,000. Mr. Saul testified in this connection as follows:[44]

Mr. GESELL. The next payment came due in February of 1934; did it not?

Mr. SAUL. Yes, sir.

Mr. GESELL. Was the Shenandoah Holding Corporation in a position to meet that payment?

Mr. SAUL. No, sir.

Mr. GESELL. If the payment had not been made you and your five fellow officers would have been obligated, would you not, personally?

Mr. SAUL. Yes, sir.

Mr. GESELL. In what amount?

Mr. SAUL. In the unpaid balance of $350,000.

Mr. GESELL. Each of you would have had that as a personal obligation?

Mr. SAUL. Yes, sir.

The officers decided to change the company from a stock to a mutual plan in order to relieve themselves of this substantial financial obligation. The plan of conversion was so devised that the officers were at the same time able to maintain their dominant positions in the company's management.

In order to change the form of the company, it was necessary that the Virginia Legislature first enact a statute authorizing the same. No such statute was in existence in January of 1934. An officer of the Shenandoah Life Insurance Co. conferred with the Insurance Department of the State of Virginia and a statute to meet the situation was prepared and subsequently enacted.[45] With respect to this statute, Mr. John Peter Saul, Jr., an officer of the company, testified:[46]

Mr. GESELL. Was this an act which was passed primarily to meet the situation of your company?

Mr. SAUL. It was a very helpful act to our company and we received from the legislature the entire cooperation in the passage of it.

Mr. GESELL. So that it was passed for the benefit of your company primarily?

Mr. SAUL. I think it was passed with that view in mind, though it was not a special act for our benefit in any sense.

Mr. GESELL. Who initiated the passage of any such act as this? Was it your company?

Mr. SAUL. As I stated, I didn't hear of the consideration by the insurance department of such a statute in Virginia until it was called to my attention by the superintendent of insurance, and it immediately seemed to be a statute that would be helpful to us, and immediately we began to do all we could to have it enacted as promptly as possible.

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[43] Pt. 13, R. 6483, 6486. The Shenandoah Holding Corporation note was endorsed by four of the officers. Objection was taken to this loan by the Insurance Department of the State of New Jersey and the company withdrew from New Jersey at the end of 1933 (pt. 13, exhibit No. 1123).

[44] Pt. 13, R. 6487.

[45] Sec. 4251A and 4251B of the Virginia Code of 1936.

[46] Pt. 13, R. 6487, 6488.

Mr. GESELL. You mean that the insurance commissioner was considering, in a more or less general way, the possible advisability of having some such section that would enable stock companies to mutualize?

Mr. SAUL. Yes, sir.

Mr. GESELL. And when you heard he had that idea in mind you told him how desirable it would be from the point of view of your company?

Mr. SAUL. Yes, sir.

Mr. GESELL. And thereafter you did what you could to encourage the immediate passage of the act?

Mr. SAUL. That is right. He knew that also before I told him and he was very helpful and cooperative in the matter.

The statute was enacted sometime during the first week of March 1934.[47] Since the payment to Lehman Bros. & Co. fell due on February 25, 1934, it was necessary to obtain an extension in order that the conversion plan could be carried out. Accordingly an extension to May 15, 1934, was obtained.[48]

Thereafter events moved rapidly. On March 8, 1934, the directors approved the plan to change the form of the company. A stockholders' meeting was held and necessary approval of the stockholders obtained. Notices were immediately sent to policyholders of a meeting to be held April 30, 1934, at which the consent of the policyholders was obtained. Thus all formal steps were taken to complete the mutualization of the company by May 15, 1934, the date the payment to Lehman Bros. & Co. became due.[49]

The mutualization plan was so drawn as to require its completion prior to the payment becoming due. It provided that the outstanding shares of stock would be purchased at a price of $20 a share,[50] payable $15 in cash and $5 at some future time, subject to the authorization of the board of directors of the company. In addition, dividends were to be received by the stockholders for a period of 15 years subsequent to the retirement of the stock. It was specifically provided that the first shares to be purchased would be 20,000 shares from Shenandoah Holding Corporation. In the notices which were sent to the policyholders and stockholders, the principal provisions of the plan were set forth but no notice was given of the fact that the consummation of the plan would relieve the five officers of the company of their joint and several obligation of $350,000.[51]

There were other disclosures which should have been made to the policyholders at this time by the Insurance Department of the State of Virginia which, it has been shown, assisted in the enactment of the mutualization law, approved the plan and actually voted shares of stock in favor thereof.[52] Although the insurance department had stated that it viewed certain aspects of the management of the company with "utmost disfavor" it made no special effort to bring to the attention of policyholders and stockholders the information it possessed. In a letter written by three representatives of the Virginia

[47] Pt. 13, R. 6487.

[48] Pt. 13, R. 6489.

[49] Pt. 13, R. 6489, exhibit No. 1125.

[50] The market price of Shenandoah stock at the time of the agreement was $6 a share and the plan of mutualization provided for the purchase at $20 a share (pt. 13, R. 6490, 6491).

[51] Pt. 13, exhibit No. 1125.

[52] Lehman Bros. & Co. gave its proxy covering the 20,000 shares to the chief examiner of the State Insurance Department of the State of Virginia (pt. 13, R. 6491, 6492).

State Corporation Commission, under date of April 14, 1934, to Ex-Governor E. Lee Trinkle, then president of the Shenandoah Life Insurance Co., the following indications of mismanagement of that company were set forth: That a loan had been made to a director without any appraisal of the collateral and without previous approval of the company's managing committee; that the office system of the company was loose and conducive to irregularities; that substantial transactions had been recorded in the company's expense account in order to keep them from appearing in the annual statements of the company where they would come to the attention of proper authorities; that salaries were being drawn by the principal officers in advance; that unsecured advances were being made to officers; that the company was being charged for traveling expenses incurred on behalf of the Shenandoah Holding Corporation and that these charges were improper; that excessive salaries were being paid and that the managing committee was not directing the affairs of the company in the manner required under law.[53]

Thus without adequate disclosure to policyholders, the plan was carried to its conclusion. The Virginia statute did not require that any specified percentage of policyholders approve the change; only the majority approval of those voting was required. Not only were the policyholders' voting rights in this connection not fully explained to them by the management, but no opportunity to vote by proxy against the plan was provided. Only 777 policyholders were represented at the meeting and only seven negative votes were recorded.[54]

The same officers who were originally managing the company and whose management was so severely criticized by the Insurance Department continued to hold their offices, and there is no evidence that any immediate changes were initiated which inured to the benefit of the policyholders. The net effect of the transactions is concisely summarized in the following testimony:

> Representative CASEY. This mutualization bailed you and your associates out of some $300,000 obligation?
>
> Mr. SAUL. That's right.[55]

C. ILLINOIS BANKERS LIFE ASSURANCE COMPANY

The manner in which the management of a mutual assessment company seized control of its assets in the process of changing it to a stock company operating on a legal-reserve basis is exemplified in the case of the Illinois Bankers Life Assurance Co. of Monmouth, Ill.[56] Activities of the management in this instance give further illustration of the ease with which officers of an insurance company can utilize their positions for private gain.

Illinois Bankers was organized in 1897 as an assessment company with its main offices in Monmouth, Ill. The company, which was then

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[53] Pt. 13, exhibit No. 1134. As indicative of the position of the State corporation commission, the following language from the letter can be quoted (Id.): "We can scarcely find words to sufficiently condemn a practice whereby anyone, whether he be officer or otherwise, can go promiscuously into the files of the company and take down the collateral securing any loan, much less one to himself or member of his family, and keep this collateral in his possession for any purpose whatsoever. Such a practice is verging dangerously close to a violation of the criminal laws and again we must condemn your office system which would make it possible for any such thing to happen under any circumstances."

[54] Pt. 13, R. 6489, 6493.

[55] Pt. 1[illegible] R. 6493.

[56] Pt[illegible] [illegible]1-6950.

known as Illinois Bankers Life Association, was owned and theoretically controlled by its member policyholders. By 1929 it was operating in three States and had more than $108,000,000 of insurance in force.[57] Mr. William H. Woods was president; Mr. J. H. Ebersole was vice president and medical director; Mr. A. T. Sawyer was treasurer; Mr. R. M. Work was secretary; and Mr. Hugh T. Martin was general counsel.[58] These five officers also constituted the board of trustees of the association. None of them had any investment or proprietary right in the association except as a policyholder.[59]

Sometime prior to 1924 the management had concluded that the company's rates were inadequate and consideration was given to the advisability of reinsuring in another company or placing the company's insurance on a legal-reserve basis.[60] Many proposals were submitted by persons interested in acquiring an interest in the company and apparently the company's officers were willing to entertain offers from which they could personally profit. Mr. Woods, president of the company, testified: [61]

Mr. GESELL. And was some inducement offered by these brokers to the officers of the association for entering into the particular reinsurance agreement or proposal presented?

Mr. WOODS. I think there was.

Mr. GESELL. Can you recall any specific instance of that, Mr. Woods?

Mr. WOODS. No, sir, I don't, except one.

Mr. GESELL. Which one was that?

Mr. WOODS. There was no contract at all suggested on that, only that there was a fellow there from New York that offered a proposition of $750,000 for the directors if we would turn the company over to them. That is the only definite proposition, but there was no detail.

Mr. GESELL. What was that man's name, do you recall?

Mr. WOODS. No, sir; I do not.

Mr. GESELL. Did the officers and directors of the company agree to enter into that arrangement?

Mr. WOODS. Nobody knew it but me, so far as I know.

Mr. GESELL. That proposal was made to you.

Mr. WOODS. I gave no consideration to it whatever.

Mr. GESELL. You turned them down?

Mr. WOODS. Yes, sir.

Mr. GESELL. Had the officers of the company decided as a matter of policy that they would not seek a contract which would give them any personal advantage?

Mr. WOODS. No, sir.

Mr. GESELL. Were they seeking a contract which would in fact give them some such advantage?

Mr. WOODS. Well, I wouldn't say they were seeking those contracts. You didn't need to. Those propositions came voluntarily, very largely.

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[57] Pt. 13, R. 6772. Best's Life Insurance Reports 1930. For detailed information on the company's admitted assets, business written, and insurance in force during the period 1925–38, see pt. 13, exhibit No. 1348–13.

[58] Pt. 13, R. 6773, exhibit Nos. 1348–27, 1348–28. Exhibit No. 1348–11 is a schedule indicating directors of Illinois Bankers Life Association from 1925 to 1929.

[59] Pt. 13, R. 6778. Mr. William H. Woods first gained a foothold in the management in 1903 by purchasing a trusteeship from a previous incumbent for $2,000. See letter to the Temporary National Economic Committee, dated February 17, 1940 (pt. 13, R. 6778).

[60] Pt. 13, R. 6775, 6776.

[61] Pt. 13, R. 6777, 6778.

Mr. GESELL. Were they willing to enter into such an agreement?

Mr. WOODS. On a legal reserve basis; yes.

Mr. GESELL. That if you could get some type of contract which you felt was equitable to the policyholders which would reinsure the business in a legal reserve company, you and your fellow trustees were willing to have as part of that agreement a provision which would give you some personal advantage?

Mr. WOODS. Yes, sir.

Mr. GESELL. On what basis was that justified, Mr. Woods? You gentlemen were trustees, were you not?

Mr. WOODS. Yes.

Mr. GESELL. It was a semi mutual, in fact, a mutual company?

Mr. WOODS. It didn't affect the policy contract in the least. It was not detrimental to the policyholder as far as that is concerned.

Mr. GESELL. They would have had adequate reserves and adequate protection?

Mr. WOODS. As much so as without it.

Mr. GESELL. On the other hand, you gentlemen had no financial stake in the company, did you?

Mr. WOODS. No.

In 1924 a plan was evolved to change the form of the company to a legal reserve basis by organizing a new legal reserve stock company in which the business of the mutually owned assessment company would be reinsured. Mr. Martin, who was apparently the originator of this idea, was given an option to purchase all stock of the new company which was subscribed to by the five officers mentioned above. The reinsurance plan was tentatively approved by the insurance department of the State of Illinois but before it could be put into effect there was a political shift in the department and the new head of the department, by giving notice that he disapproved the plan, caused it to be temporarily abandoned.[62]

By 1929, however, a new insurance commissioner was again in office in Illinois and the 1924 plan was revived.[63] As a first step a new corporation, the Illinois Bankers Life Assurance Co., was formed for the purpose of reinsuring the business of the assessment association. The officers were hesitant and fearful that the change might upset the even tenor of their ways and jeopardize their security. Mr. Martin, however, determined to gain control of the company and he proposed to secure acceptance of the reinsurance plan by paying large sums of money to his hesitant associates. Accordingly, in September 1929, he paid Mr. Woods, the president of the association, $100,000

[62] Pt. 13, R. 6790, 6791. It also appeared that the officers were involved in litigation at the time and that their positions were threatened by opposition from certain of the company's agents who were soliciting proxies to remove them from office. In this connection, Mr. Woods testified (pt. 13, R. 6810):

"Mr. GESELL. * * * Did the officers of the company, the trustees of the association, learn that the agents had been gathering proxies to oust them from office?

"Mr. WOODS. Yes, sir.

"Mr. GESELL. When did you learn that?

"Mr. WOODS. I can't give you the date.

"Mr. GESELL. Approximately.

"Mr. WOODS. The first I knew of it was we got a few of these proxies from one of the agents in Texas. That was supposed to go to the general agent at Dallas. Instead of that, he sent it to the home office.

"Mr. GESELL. That was about in 1924, was it not?

"Mr. WOODS. Well, I tell you, I don't like to say definitely on the date, but it was about that time, I think; yes.

"Mr. GESELL. What did the management of the company do?

"Mr. WOODS. Well, we got busy.

"Mr. GESELL. Tell us just what you did when you got busy.

"Mr. WOODS. We got out and tried to get proxies."

[63] Pt. 13, R. 6780, exhibit Nos. 1348-14, 1348-19.

in cash and gave him six notes in the amount of $10,000 each;[64] he paid Dr. Ebersole $25,000 in cash and three notes of $25,000 each; and he bought certain property from Mr. Work for a price of $75,000, which was about $35,000 in excess of the value of the property. Mr. Martin agreed to purchase for Mr. Sawyer a substantial block of stock in the new company.[65]

There can be no doubt that the consideration for these payments was the consent of the trustees to execute the reinsurance contract and permit the business of the assessment company to pass to the new stock company. Mr. Martin testified:[66]

Mr. GESELL. You wanted control of the company, didn't you, Mr. Martin?

Mr. MARTIN. Yes, sir.

Mr. GESELL. And so far as you were concerned, that was the motivating factor in your payment of these sums?

Mr. MARTIN. Yes.

He denied, however, that any of the trustees receiving these payments had indicated they would not sign the reinsurance agreement if the payments were not made. Though admitting the trustees were either "rather fearful about the difficulties and the hazards of the change," or that they wanted to be "secure" in their old age,[67] Mr. Martin insisted that they had not made any specific agreement.[68] The situation was more clearly revealed by the testimony of Mr. Woods who stated:[69]

Mr. GESELL. You received this $100,000 in September, the previous September? Am I not correct in saying, Mr. Woods, that that $100,000 was the consideration you received for signing this reinsurance contract?

Mr. WOODS. No, sir.

Mr. GESELL. Isn't there a direct relationship between the $100,000 and your signature on these documents?

Mr. WOODS. Well, I conclude that would be true to an extent, but in signing that contract it was paying me for what I had done in the 28 years that I had been there—25 or 24 years, or whatever it was.

Mr. GESELL. You wouldn't have signed the contract if you didn't have the $100,000, would you?

Mr. WOODS. Very likely not.

Mr. GESELL. In other words, you felt that your service with the company deserved some compensation?

Mr. WOODS. Absolutely.

Mr. GESELL. And you weren't going to agree to any reinsurance contract of any kind with one person or another until you had the money that you thought those services were worth?

Mr. WOODS. Well, it wasn't necessary to consider it.

Mr. GESELL. In other words, you were in a position to control it, weren't you?

Mr. WOODS. I was.

Mr. GESELL. You could have stopped the reinsurance agreement, couldn't you?

Mr. WOODS. No; I couldn't myself.

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[64] Pt. 13, R. 6782, 6788. In addition to this substantial sum Mr. Woods received a salary increase of $6,000 per annum (pt. 13, R. 6784).

[65] Pt. 13, R. 6789, 6790, 6807.

[66] Pt. 13, R. 6790.

[67] Pt. 13, R. 6788.

[68] Pt. 13, R. 6789.

[69] Pt. 13, R. 6785, 6786.

Mr. GESELL. As president of the company for all these years, and with your intimate contact with the agents, couldn't you have gone out and stopped this contract?

Mr. WOODS. No, sir; I could not, without the consent of the other directors.

Mr. GESELL. You had some of them with you?

Mr. WOODS. It was practically unanimous as far as the directors were concerned.

A month after receipt of the payments, the plan was carried into effect, all trustees assenting. No disclosure of the payments was made to anyone including the policyholders of the assessment company for whom the trustees were presumably acting.[70]

The Illinois Bankers Life Assurance Co. was incorporated in Illinois with a capital stock of $100,000 and a paid-in surplus of $50,000; 1,000 shares of stock were issued, 200 in the name of each of the 5 officers: Messrs. Wood, Ebersole, Work, Sawyer, and Martin. Of these 5 the first 3 had no real interest in the stock and endorsed it over in blank; they appeared as stockholders, however, in order to give the public and the agents of the association confidence in the new company. Mr. Wood remained as figurehead president for the same reason. The real parties in interest in the new company were Mr. Martin, Mr. Sawyer, and Mr. John P. Nichol, a Chicago insurance man.[71] Though Mr. Woods remained as president, Mr. Martin was thereafter the dominating personality in the management and in control of its policies.[72]

The contract of reinsurance between the new stock company and the old assessment company was executed on November 19, 1929, by Mr. Woods who signed for both companies. This contract of reinsurance, provided in effect that the business of the mutually owned association, amounting to over $100,000,000 of insurance and over $7,000,000 of assets should be turned over, without consideration therefor, to the privately owned stock company.[73]

Though this contract was approved by the Illinois Insurance Department, insurance departments of other States protested vigorously, at first refusing to license the new company. The commissioner of Indiana wrote:[74]

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[70] The Illinois laws (Smith Hurd Illinois Annot. Stats., ch. 73, sec. 791) provides: "No director, officer, or member of any such company or companies, except as fully expressed in the articles of incorporation or contract of reinsurance, shall receive any fee, commission, other compensation or valuable consideration whatever, directly or indirectly, for in any manner aiding, promoting, or assisting in such consolidation or reinsurance." This law was originally enacted in 1919 (Jones Illinois Stat. Annot. 66.037).

[71] Pt. 13, R. 6792, 6793. The 1,000 shares were actually owned by Mr. Martin and Mr. Sawyer who held 800 and 200 shares, respectively. These shares were pledged with the Boulevard Bridge Bank of Chicago as partial collateral for a $150,000 loan made jointly by Mr. Martin, Mr. Sawyer, and Mr. Nichol (see p. 80, infra) (pt. 13, R. 6794). For names of directors of Illinois Bankers Life Assurance Co. from 1929 to 1938 see pt. 13, exhibit No. 1348-12.

[72] Pt. 13, exhibit No. 1348-12. Mr. Woods testified (pt. 13, R. 6782):

"Mr. WOODS. So far as authority was concerned, Mr. Martin was the main officer.

"Mr. GESELL. You took instructions from Mr. Martin?

"Mr. WOODS. Yes, sir.

"Mr. GESELL. On all phases of the business?

"Mr. WOODS. Very largely.

"Mr. GESELL. Who determined matters of policy?

"Mr. WOODS. Well, I think he did. Of course, it was considered, if there was any change there, by the directors.

"Mr. GESELL. You mean he would make the recommendations to the board which the board would adopt on consideration?

"Mr. WOODS. Yes; I think that is about the working of it" (Id.).

[73] Pt. 13, exhibit No. 1348-14.

[74] Pt. 13, exhibit No. 1348-36.

It further appears to me that a group of men have organized a stock company and are going to take over a mutual company with all of its benefits and standing without paying 1 cent therefor * * * I will not be disposed to permit the new company to operate in this State.

The commissioner of insurance of Michigan wrote:[75]

* * * the reinsurance of the Illinois Bankers Life Association was a most vicious one in the opinion of this department.

The actuary of the bureau of insurance of Nebraska wrote:[76]

This Department, believing that the proposed contract of reinsurance of the business of the Illinois Bankers Life Association is not for the best interests of the policyholders but detrimental thereto, and decidedly to the interest and profit of the officers thereof, who own and control the company proposing to assume under reinsurance contract, the business of the Illinois Bankers Life Association hereby protests against the carrying out of that reinsurance contract.

Officials of several other State insurance departments made similar protests. Nevertheless, the approval of the Illinois department was not withdrawn, and licenses were subsequently granted in most of the States which had protested in spite of the fact that the original terms of the reinsurance agreement were not altered.[77] Mr. William R. Baker, himself a former insurance commissioner of Kansas,[78] who was employed by the company to aid it in securing its State licenses, was questioned regarding this vacillating attitude of the commissioners. His testimony indicated clearly the inability of the State insurance commissioners to protect the policyholders of their respective States. An excerpt from this testimony follows:[79]

Mr. BAKER. * * * we will take Oklahoma as an example * * * Mr. Reid [Oklahoma Commissioner] was sometimes rather vehement in his statements——

Mr. GESELL (interposing). What did he say to you on this occasion?

Mr. BAKER. He told me that in his opinion the contract was extremely unfair, and that—I am not endeavoring to quote.

Mr. GESELL. As best you recall, of course.

Mr. BAKER. Yes; he felt that the officers of the stock company and the board of directors of the stock company and the officers, the stockholders, had taken an unfair advantage of the assessment association, that they had not received value for that assessment business.

Mr. GESELL. Well, now, Mr. Reid subsequently licensed this company in Oklahoma, did he not?

Mr. BAKER. Yes, sir.

Mr. GESELL. That was after your talk with him?

Mr. BAKER. Subsequent to my conversation with him.

Mr. GESELL. Well, now, what suggestion or talks did you have with him that led to his taking that position?

Mr. BAKER. The argument, contention, that I made to Mr. Reid, and which I made to the other commissioners of insurance, was that in my opinion their obligation was to the residents of their respective States, who were members of the assessment association, and that it would be better from the standpoint of those people for their home department to be in a position to exercise supervision,

[75] Pt. 13, exhibit No. 1348–39.

[76] Pt. 13, exhibit No. 1348–41.

[77] Pt. 13, R. 6881. Insurance Commissioners of Indiana, Michigan, Nebraska, California, Oklahoma, Missouri, and Washington all expressed disapproval of the reinsurance contract (pt. 13, R. 6880).

[78] See discussion of Federal Reserve Life Insurance Co., p. 108, infra.

[79] Pt. 13, R. 6885

jurisdiction, or control to some extent over the operations of this company by permitting it to come into the State rather than by excluding it and therefore lose its jurisdictional power, examination.

Mr. GESELL. You mean by that that if he refused the new company license, then all he'd have, as far as the company was concerned, would be a bunch of policyholders in his State who had taken out policies with the assessment association, and no company which he could control or regulate.

Mr. BAKER. That was my——

Mr. GESELL (interposing). It was one of these between-the-devil-and-the-deep-blue-sea situations, then, wasn't it?

Mr. BAKER. Yes, sir; one end of the stick was as hot as the other, possibly.

Mr. GESELL. And even though the commissioner thought the thing was unfair or inequitable or the officers had taken unfair advantage of the assessment policyholders, in order to keep some control over the company, to protect those policyholders who had already come in previously into the association, he was obliged to license it.

Mr. BAKER. To do that, to have that power, he would be obliged to license; yes.

Mr. GESELL. And in that way obliged to let the new company come in and conduct its business there, to sell new policies, continually?

Mr. BAKER. Yes, sir.

By 1938 the company was operating in about 16 States including all but 2 of the States which originally raised objections to the contract.[80] There is no evidence that the State commissioners had knowledge of the surreptitious payments to the hesitant trustees or of the many other management irregularities which arose before the arrangements to put the assessment policyholders on a legal reserve basis were completed.

Before discussing the manner in which assessment policyholders were switched from assessment policies to legal reserve policies it will be necessary to mention briefly the method by which Mr. Martin raised funds sufficient to purchase a controlling interest in the stock of the new company and to make such generous payments to the trustees. In order to finance the new company, Messrs. Martin, Sawyer and Nichol pledged the thousand shares of its stock (both the shares issued to them and those endorsed in blank) to the Boulevard Bridge Bank of Chicago for a joint personal loan of $150,000. The loan was further secured by a $50,000 certificate of deposit of the new company. This certificate, which represented the paid-in surplus of the company, was endorsed and shown by the books and records of the bank to have been pledged as collateral against the loan. It remained so pledged from October 1929 to June 1935, although on occasion it was sent from Chicago to Monmouth to satisfy questions of insurance department examiners working on the books of the insurance company.[81] Mr. Martin denied that this certificate of deposit was pledged as collateral and state that it was merely left with the bank for "safekeeping." It would appear however that since the certificate was endorsed and since Messrs. Martin, Sawyer,

[80] California and Michigan (pt. 13, R. 6775, 6881).

[81] Pt. 13, R. 6794–6798, 6799–6801. All arrangements for obtaining the certificate of deposit from the Boulevard Bridge Bank of Chicago were made between Mr. Martin and Mr. Sawyer. Neither of these individuals could explain why it was necessary to send the certificate to Monmouth from Chicago to satisfy the examiners (pt. 13, R. 6800–6803). In this connection it is of interest to note that the company regularly answered "No" to item 15 of the general interrogatories of the 1938 Convention Form Annual Statement which asks, "Were any of the stocks, bonds, or other assets of the company loaned during the year covered by this statement?" (pt. 13, R. 6801).

and Nichol agreed not to withdraw the deposit until the loan was paid, the officers of the insurance company used its funds to help secure a personal obligation.[82]

If the transactions by which Mr. Martin raised funds to pay off his fellow trustees are unraveled, an even more direct use of company funds is revealed. In order to obtain these funds Mr. Martin arranged to borrow $600,000 face value preferred securities of a real estate company known as Holmhaven on the Gulf from Mr. Herbert G. Shimp of Chicago. Mr. Shimp was a friend of Mr. Martin and engaged in the business of rewriting policies, i. e., switching policyholders from one form of contract to another.[83] He loaned the securities because he hoped thereby to obtain the contract to rewrite the policies of the assessment association following the execution of the reinsurance contract. The testimony on this point [84] is unequivocal and doubly significant in that Mr. Shimp subsequently did obtain the

[82] Pt. 13, R. 6794–6804. Mr. Sawyer, who took the stand immediately after Mr. Martin, testified with respect to the endorsement of the certificate (pt. 13, R. 6802, 6803):

"Mr. Gesell. Why was the certificate endorsed, Mr. Sawyer?

"Mr. Sawyer. That I can't tell you. I don't remember. I don't remember when it was endorsed or why or anything about it.

"Mr. Gesell. Well, now, you have been treasurer of this company. Why would you endorse a certificate? To make it negotiable?

"Mr. Sawyer. Yes.

"Mr. Gesell. In other words, to make it good collateral in the hands of the bank, wouldn't you?

"Mr. Sawyer. I don't think that was the purpose.

"Mr. Gesell. That would be the effect of it if the bank wanted it as collateral? They'd want it endorsed?

"Mr. Sawyer. That I couldn't say.

"Mr. Gesell. Supposing you were in the bank and you had a certificate of deposit. You also have a loan out. You wanted to have some recourse against the certificate of deposit. You'd want to have it endorsed, wouldn't you?

"Mr. Sawyer. That I couldn't say. The bank never asked me to endorse the certificate and I don't know anything about the endorsement, when it was or——

"Mr. Gesell. If the bank didn't ask you to endorse this, then somebody signed your name to it improperly, because it says, 'Bearing the following endorsements: That of the Illinois Bankers Life Assurance Co. by yourself as treasurer.' Who asked you to, if the bank didn't?

"Mr. Sawyer. I can't recall. It was endorsed with my name.

"Mr. Gesell. This was a personal obligation of you and Mr. Martin and Mr. Nichol at the bank?

"Mr. Sawyer. I had no knowledge of that at all. The notice that I signed had no reference to this certificate in any way, shape, or form.

"Mr. Gesell. You knew you were borrowing money in your individual capacity, didn't you?

"Mr. Sawyer. Yes, sir.

"Mr. Gesell. Then, what was the certificate of deposit doing up there under any possible circumstances?

"Mr. Sawyer. As I said, my recollection of it is exactly as Mr. Martin's testimony. It was held there not to be cashed at the bank.

"Mr. Gesell. Do you know it was trickling back to the company every now and then when the examiners came in?

"Mr. Sawyer. I know it has been in our possession.

"Mr. Gesell. Why did you have to have it back?

"Mr. Sawyer. Well, I can't recall. I think the examiners questioned where it was and they seemed satisfied with it. That is my recollection.

"Mr. Gesell. They seemed satisfied with it when they saw you had it in your own hands?

"Mr. Sawyer. Well, I can't recall.

"Mr. Gesell. Did you have any discussions with the examiners about it?

"Mr. Sawyer. That I cannot recall.

"Mr. Gesell. The only thing you can really recall about this is that you can recall that what Mr. Martin said was true?

"Mr. Sawyer. That is practically it; yes."

[83] See p. 105, infra, for a discussion of rewriting.

[84] Pt. 13, R. 6845.

Illinois Bankers' rewrite contract under which he received gross commissions of $1,527,452.[85]

Mr. GESELL. Did you anticipate this loan would help you get the rewriting business on that contract? Was that the purpose for which it was made?

Mr. SHIMP. Well, I was hopeful it would be helpful in obtaining the contract.

Mr. GESELL. Well, was that one of the motivating considerations that led you to make this loan?

Mr. SHIMP. That and the friendship of Mr. Martin.

Mr. GESELL. Did Mr. Martin tell you at the time the loan was made that if you made it to him, he would be in a position to give you this rewrite contract?

Mr. SHIMP. No, sir.

Mr. GESELL. Well, what was there in your conversation with him that led you to think that you would have some benefit with respect to this contract if you made the loan?

Mr. SHIMP. Well, it had been discussed with Mr. Martin and some of his associates at various times.

Mr. Martin then pledged the $600,000 Holmhaven on the Gulf with Mr. James W. Stevens, an officer of a bank known as the Lincoln Securities Co., from whom Mr. Martin had borrowed $200,000 with which to pay off his fellow directors who had indicated their uncertainty about the reinsurance contract.[86] In order to repay the Stevens' loan, Mr. Martin arranged for Illinois Bankers Life Assurance Co. to lend $250,000 to the Lincoln Securities Co. The loan was made on January 15, 1930, and on the same day the Lincoln Securities lent Mr. Martin $200,000, which he used to pay off his obligation to Mr. Stevens.[87]

This loan was shown by the minutes of the insurance company to have been recommended by Mr. Woods and approved at a meeting of the board of directors. Mr. Woods denied that he had ever attended such a meeting and stated that the loan was never approved by the board of directors.[88] Regardless of the manner in which the loan was authorized, it is clear that Mr. Martin did not make an adequate disclosure of his beneficial interest therein. He testified: [89]

Mr. GESELL. What disclosure did you make to your fellow trustees with respect to this transaction?

Mr. MARTIN. To the fellow directors? I don't think I made any disclosure at the time.

M. GESELL. As to your interest, your personal interest in this transaction?

Mr. MARTIN. No.

[85] Pt. 13, R. 6844, 6845, exhibit No. 1348-70. See also pp. 83 to 87, infra. Holmhaven on the Gulf went went into receivership in 1933 and Mr. Shimp wrote off the loan as a loss, never having received repayment, in part or in whole, from Mr. Martin (pt. 13, R. 6846).

[86] Pt. 13, R. 6818. Mr. Martin was counsel for Illinois Life Insurance Co. (pt. 13, R. 6823). This company failed in July 1933 with an estimated initial loss to policyholders of $15,276,000. Pt. 28, exhibit No. 2336.

[87] Pt. 13, R. 6814, 6815, 6818, exhibit No. 1348-20.

[88] Pt. 13, R. 6813-6816, exhibit No. 1348-18. In spite of Mr. Woods' denial Mr. Sawyer insisted that the minutes reflected his best recollection of what happened. Mr. Woods testified (pt. 13, R. 6817):

"Mr. WOODS. They called me to Chicago about this particular loan. They didn't tell me exactly what the collateral was going to be.

"Mr. GESELL. Who called you to Chicago?

"Mr. WOODS. Mr. Martin. Mr. Ramer was there. He told me about this loan, about the Lincoln Securities. That is the first time I had ever heard of it. I asked him—I told him I would like to see a statement of this Lincoln Securities, and he said, 'Well, the Lincoln Securities doesn't make any statement.' That is exactly the situation as far as that loan is concerned, and I don't think it would be very hard to guess why I wasn't very much in favor of the loan."

[89] Pt. 13, R. 6820.

The insurance company lost heavily on the Lincoln Securities loan. In order to raise the necessary cash to make it, it was forced to sell certain Liberty bonds. The collateral received in turn from Lincoln Securities was of an inferior character and included mortgage obligations of two of Mr. Martin's sisters-in-law amounting to $100,000, as well as mortgage obligations of Mr. Martin himself. The Lincoln Securities Co. subsequently defaulted on the obligation and the insurance company got nothing but collateral of doubtful value since it included mortgages which still remain in the company's portfolio and which are seriously delinquent as to principal and interest; other collateral became worthless. In addition to the loss on the note, the insurance company was obliged to pay $46,267 in settlement of a lawsuit ensuing out of this transaction.[90]

Thus was Mr. Martin able to utilize the funds of the company to meet his immediate financial requirements and to set the stage for the final step in the plan to gain control of the company, namely, the rewriting of the policies.

As has been stated, the Illinois Bankers Life Association operated on the assessment plan. Under this plan no legal reserve was accumulated, and premium rates could be raised from year to year if it were found necessary to do so to meet claims. The policies reinsured by the newly formed stock company were taken over as assessment policies, and in order to get them onto a legal-reserve basis upon which the new company was to do business, the management decided that they should be rewritten.

Mr. Herbert G. Shimp, of Chicago, had formerly been in the business of rewriting insurance policies and he was anxious to get back into it. He was a friend of Mr. Martin's and as has been indicated, had helped him finance the pay-off of the Illinois Bankers' officers.[91] Mr. Martin gave the rewrite contract to Mr. Shimp's newly formed corporation, the American Conservation Co. This contract provided that the American Conservation Co. would receive a commission equal to 70 percent of the first premiums paid by the association policyholders after thay had transferred to a legal-reserve policy with the new company, and 80 percent of the first premium and certain renewal commissions on any new business written in connection with the transfers. Under this contract the Illinois Bankers Life Assurance Co. paid American Conservation Co. $1,523,479.54 from 1930 to 1935 for the transfer of the policies of about 40,000 members of the association.[92]

The plan for transferring policies was inequitable both in its form and execution.[93] To understand the proposal offered the assessment policyholders it is necessary to describe a typical transfer. Assume the case of a person who, in 1913, at the age of 35, had then taken out an ordinary whole-life policy in the assessment company. In 1930 the annual premium on his policy would have been $16.48 per $1,000. Under the transfer arrangement he was offered his choice of four types of policies: Ordinary life with endowment at age 85, dated currently; 20-payment endowment at age 85, dated currently; whole

[90] Pt. 13, R. 6816, 6820–6824.

[91] See pp. 81 to 82, supra.

[92] Pt. 13, R. 6827, 6828, exhibit Nos. 1348–21, 1348–23, 1348–70.

[93] It is significant that 2 senior officers, Mr. W. H. Woods, president, and Dr. J. H. Ebersole, vice president and medical director, as well as 2 junior officers, Mr. Stephen E. Hinshaw and Mr. A. W. Barnes, did not convert their assessment policies to a legal-reserve basis (pt. 13, exhibit No. 2262). No assessment has been made against policies not transferred (pt. 13, R. 6841).

life 50-percent return premium, dated back to 1913; or a 20-payment life, 70-percent return-premium policy, dated back to 1918. Over 70 percent of the policyholders selected the 20-payment life policy which, although the most costly to the transferring policyholder, was also the most profitable to the transfer agents, whose compensation depended on the size of the premium required by the rewritten policy. Under this plan the policyholder who took out his assessment policy in 1913, when he was 35, would be given in exchange a legal reserve policy dated as of 1918, or at age 40. The annual premium on the new policy at that age was $47.49 which the policyholder would pay from the time he made the exchange, which was usually in 1930, until 1938, a total of eight annual premiums.[94]

After the transfer in 1930, then, the contract stood as if it were a 20-payment life policy which had been in force for 12 years. Such a policy on a legal-reserve basis would have accumulated a reserve of $350.55. To provide this reserve in the instant case, the policyholder signed a loan note for the $350.55 plus an extra charge of 1 annual premium, $47.49, to cover transfer expenses. (This amount under the plan could be paid in cash.) This loan constituted a lien on the reserves and was deductible from the value of the policy.[95]

The assets already accumulated by the association for the benefit of the policyholder were credited one-third to the payment of premiums on the new policy, and two-thirds to a "survivorship fund" which was to be held by the company for a period of about 8 years and then divided among the surviving, persistent policyholders.[96]

The transfer arrangement was unfair to transferring policyholders. Interest on the "survivorship fund" was allowed at the rate of 3½ percent compounded while interest on the lien on the reserves was charged at the rate of 6 percent thus making a differential adverse to the policyholders.[97] Furthermore the beneficiaries of an insured who died prior to the disposition of the fund were deprived of two-thirds of the reserves which their insured had accumulated under the association. Similarly, a policyholder who surrendered his policy after transferring but before the termination of the fund was forced to forfeit his interest in the fund.

This "survivorship fund" had one further disadvantage in that it provided an easy opportunity for misrepresentation. Evidence of misstatements by agents of Mr. Shimp's American Conservation Co. was spread upon the record in the form of letters written at various times to the Illinois Bankers Life Assurance Co. by policyholders whose policies had been rewritten.[98] One of the most general complaints was that the transfer agents had promised policyholders that their interest in the "survivorship fund" would be sufficient to pay off their loan in full plus interest by the time the 20-payment life policies ma-

[94] Pt. 13, R. 6830, 6836, 6837.

[95] Pt. 13, R. 6831–6833. The loan arrangement has frequently been used by other companies in changing from an assessment to a legal-reserve basis, and it seems to be particularly susceptible of misunderstanding and misrepresentation. See, e. g., *James* v. *Franklin Life Ins. Co.*, 180 Ill. App. 632 (1913); *Noth* v. *Fidelity Mutual Life Ins. Co.*, 211 Ill. App. 94 (1918); *Mayer* v. *Illinois Life Ins. Co.*, 211 Ill. App. 285 (1918); *Rose* v. *Missouri State Life Ins. Co.*, 148 S. W. 181 (1912); *Dewerthern* v. *Reserve Loan Life Ins. Co.*, 234 S. W. 1048 (1921); *Payne* v. *Minnesota Mutual Life Ins. Co.*, 191 S. W. 695 (1916); *Boulware* v. *Missouri State Life Ins. Co.*, 159 S. W. 761 (1913); *Kapralian* v. *Central Life Ins. Co.*, 267 N. W. 598 (1936). All of these cases involve the setting off of a reserve loan of the type here used against the cash-surrender value of the policy.

[96] Pt. 13, R. 6832, 6833, exhibit No. 1343–25.

[97] Pt. 13, R. 6832, 6833.

[98] Pt. 13, exhibit Nos. 1348–51 to 1343–56.

tured. In fact this proved not to be the case and as a result policy-holders found the amount of their anticipated protection substantially reduced in an amount equal to the still unpaid and outstanding loan.[99] For example, one policyholder complained to the company.[100]

My wife and I were told by your agent, Mr. Ralph M. Waterbury, that the note which I signed was merely issued so that I could not draw out the cash value until 7¾ years, and that the premiums would clear the note if paid in full to August 12, 1938.

Another said:[101]

In 1930 your high-pressure salesman so explained the plan of reinsurance so that I thought that after the 22d of this month the policy which I hold would be worth $1,000 to my beneficiary at my death. In other words, that the survivorship fund and deferred dividend would be enough to liquidate the loan, and am very much surprised at the status at the present time.

Numerous other policyholders made similar complaints.[102]

Even more reprehensible was the addition of the extra year's premium to the amount of the loan note.[103] That this extra premium was a most substantial levy is demonstrated by the fact that it enabled the payment of commissions to American Conservation Co. totaling $1,523,479 from 1930 to 1935. The true purpose of this charge was disclosed as the result of an examination of the books and records of the American Conservation Co. There appeared on the records of American Conservation Co. an account designated No. 282, "Special account earned commissions" which Mr. Shimp periodically credited with amounts totaling $430,000, or 25 percent of the commissions he received under the Illinois Bankers transfer contract. This was done pursuant to a contract dated January 2, 1930, between Mr. Shimp and Mr. John P. Nichol which recited the latter's willingness to use his efforts to get rewriting business, including the Illinois Bankers business, for Mr. Shimp.[104]

The $430,000 was drawn out of the account in a manner which concealed the name of the person receiving payments. Only after unravelling a series of intricate transactions was it determined that the money passed in devious ways from Mr. Nichol to Mr. Hugh T. Martin, who was the ultimate party in interest. Mr. Martin testified:[105]

Mr. GESELL. Can you tell us how much money you ultimately received, either directly or indirectly, from the American Conservation Co. by reason of these kick-backs on the agreement which the American Conservation Co. had with the Illinois Bankers Life Assurance Co.?

Mr. MARTIN. I wasn't quite clear about the total.

Mr. GESELL. Can you tell us how much was gotten on the contract?

Mr. MARTIN. There was something in excess of $400,000.

Mr. GESELL. Mr. Leary's figure was $430,000.

Mr. MARTIN. Yes.

Mr. GESELL. Did you get all of that money?

Mr. MARTIN. You mean did I get it personally?

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[99] Pt. 13, R. 6913–6915.

[100] Pt. 13, exhibit No. 1348–52.

[101] Pt. 13, exhibit No. 1348–51.

[102] Pt. 13, R. 6913, 6915.

[103] See p. 84, *supra*.

[104] Pt. 13, R. 6849, 6851, 6855, exhibit No. 1348–31.

[105] Pt. 13, R. 6856. Of this sum, $50,000 was used to help finance a $100,000 increase in the capital stock of Illinois Bankers Life Assurance Co. (pt. 13, R. 6869–6871).

Mr. GESELL. Or did it go to accounts in which you had an interest?

Mr. MARTIN. It went to accounts in which I had an interest.

Mr. GESELL. Or came to you personally.

Mr. MARTIN. That may have been. Several checks came to me personally but mostly all paid on accounts in which I was interested and loans there on the bank.

Mr. GESELL. So that the entire $430,000 came to your benefit?

Mr. MARTIN. Yes.

One or two examples will serve to illustrate the manner in which the funds were drawn off.

On September 12, 1930, a check in the amount of $15,000 was drawn by the American Conservation Co., payable to the order of the Boulevard Bridge Bank. This check was used to purchase a cashier's check of the Boulevard Bridge in the amount of $15,000, issued on the same date, and payable to the order of John P. Nichol. The check bears the endorsement, "Pay to the order of Halsey, Stuart & Company, John P. Nichol," and the records of Halsey, Stuart & Co. indicate this check was credited to the account of Hugh T. Martin, and used by Mr. Martin in part to purchase on October 14, 1934, $29,000 State and Washington Building bonds.

On September 30, the American Conservation Co. issued its check in the amount of $25,000, payable to the order of the Boulevard Bridge Bank in Chicago. This check was used to purchase two cashier's checks from the Boulevard Bridge Bank. These cashier's checks were made payable to the order of John P. Nichol, dated September 30, 1930, and were in the amounts of $15,000 and $10,000, respectively. The $15,000 check bears the endorsement "Pay to the order of Lincoln Securities Company. John P. Nichol." The $10,000 cashier's check bears the same endorsement. The cash-book records of the Lincoln Securities Co. indicate that on September 30, 1930, $25,000 was credited to the accounts of the Hugh T. Martin Loan Account at Lincoln Securities Co.[106]

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[106] Pt. 13, R. 6852, 6853. Neither the nature nor effect of these transactions was explained to the board of directors of Illinois Bankers Life Assurance Co. (pt. 13, R. 6859). Since some of the funds were used to pay off the loans made to finance the original stock issue, Mr. Sawyer, who was obligated on loan, was directly benefited by the arrangement. He learned of these transactions sometime after they had been consummated. His testimony in this respect is revealing (pt. 13, R. 6866):

"Mr. GESELL. Mr. Sawyer, you have been sworn, have you not?

"Mr. SAWYER. Yes, sir.

"Mr. GESELL. When did you first learn that Mr. Nichol and Mr. Martin and yourself were receiving benefits from this rewrite contract which Assurance Co. had with the American Conservation Co.?

"Mr. SAWYER. I can't definitely say. I think it was the latter part of '31 or the early part of '32.

"Mr. GESELL. The latter part of '31 or the early part of '32?

"Mr. SAWYER. That is my recollection.

"Mr. GESELL. How did you find out about it, Mr. Sawyer?

"Mr. SAWYER. I was informed by Mr. Martin.

"Mr. GESELL. What did he say to you?

"Mr. SAWYER. He told me of the contract and that I would participate in it to the extent of paying off indebtedness incurred in the reorganization of the company.

"Mr. GESELL. You mean in the purchase of your stock?

"Mr. SAWYER. Yes.

"Mr. GESELL. What did you do about it then?

"Mr. SAWYER. Well, I thought it was incom_

Thus, in summary, it appears that a group of policyholders owned a life insurance company with assets of approximately $8,000,000. Mr. Hugh T. Martin, an officer of that company, decided to take control away from the policyholders and to place himself in the dominant position. Some of his fellow officers hesitated to join him in this venture. He bought their cooperation for about $300,000. A new company was organized to take over the assets and after an inequitable reinsurance plan was consummated, Mr. Martin used the funds of the company to satisfy obligations incurred in the payments to his fellow officers and even to finance in part the stock which he owned in the company. Finally, a rewriting contract was engineered through which policyholders, partially by misrepresentation, were persuaded to transfer their policies on a basis which was inequitable and at a price which was padded to the amount of approximately $10 a policyholder in order that a fund of $430,000 might be diverted for Mr. Martin's personal benefit. This sum was sufficient to satisfy all obligations incurred in acquiring the company and Mr. Martin thus was placed in the position of controlling approximately $8,000,000 without having invested a cent. This position he has continued to occupy. He is both president and principal stockholder of the company today.[107]

"Mr. GESELL. I am sure it was.

"Mr. SAWYER. And I so reported it on my income-tax return.

"Mr. GESELL. You reported it as income on your income-tax return?

"Mr. SAWYER. Yes.

"Mr. GESELL. Did you feel that fulfilled your obligation to the policyholder and everybody else concerned?

"Mr. SAWYER. I did.

"Mr. GESELL. You had no concern as to the propriety of the contract or the arrangement?

"Mr. SAWYER. No, I did not.

"Mr. GESELL. You registered no protest before the board?

"Mr. SAWYER. No."

[107] A similar case involving breach of trust by the managements of life insurance companies was that of the reinsurance of the Western States Life Insurance Co. by the California State Life and the merger of the two companies, described in *American Trust Company* v. *California Western States Life Insurance Company*, 98 Pacific (2d) 497. In order to secure control of Western States the president of California State began negotiations with four large stockholders of Western States. A valuation of $7,000,000, or $70 a share, was placed on the business and assets of Western States. Since, however, the California State did not have enough cash to buy the stock outright, it was arranged that the general stockholders of Western States should be offered $40 cash plus one-half share of California State worth $20, or the equivalent of $60, for each share of Western States. The cash required was to come from new issues of California States stock and from the cash and liquid assets of California itself and of Western after its acquisition.

The offer of $60 a share was considered acceptable for the general stockholders of Western States, but it was not acceptable to the four large stockholders with whom the transactions were had. Accordingly, it was agreed that these stockholders would sell their stock under the offered arrangements, but that California State would agree to repurchase the California State stock of these four at $30 per half share, $10 more than market. California State thus undertook a liability of about $1,400,000 under the repurchase agreement. This repurchase agreement was not revealed to other stockholders of Western States or to the State insurance commissioner who approved the reinsurance and merger.

In setting aside the repurchase agreement, the court said, inter alia: "There is finally, a much graver fraud committee in this case than that hereinbefore discussed, namely, the fraud on the policyholders of the companies. A life insurance company is something more than an ordinary business corporation and its policyholders are not ordinary creditors. The directors of such a corporation cannot say that they owe fiduciary duties only to the corporate entity as such. The statutes of this State and the States generally contain the most positive assertion of duties owed to policyholders, and declare in unmistakable terms the public policy of this State to protect them from any such abuses by those entrusted with the management of their companies."

SECTION VIII

Responsibilities of Life Insurance Company Directors

It is to be regretted that it is not now universally recognized as axiomatic that life insurance company directors are fiduciaries (even if not technically trustees) and as such must not confuse their personal or business affairs with those of the company to whose policyholders and stockholders they are obligated to maintain the highest fiduciary relationship. There is need of a more clearly defined attitude toward life insurance directors who, as a result of their own efforts or otherwise, are placed in a dual capacity and who thus exercise a divided responsibility.[1] Whenever a director's personal affairs are confused with those of his company or whenever he is called upon to satisfy conflicting obligations, he can no longer act with complete independence. This is true regardless of the form of the transactions involved or the degree to which the director may directly benefit therefrom.

A few situations which arise in the day-to-day conduct of the insurance business will serve to illustrate the potentiality of abuse that inheres in this conflict of interests. An insurance company, for example, owns securities of a corporation which are in default and the president of that corporation is on the board of the insurance company. The question arises as to what the insurance company shall do to protect or dispose of its investment. Consideration is also being given to the attitude which the company should take in a forthcoming reorganization. It is obvious that the president of the corporation whose de-

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[1] The general law with respect to the responsibilities of corporate directors has been well established through numerous cases. Fletcher, Cyclopedia of Corporation, vol. 3, states at Section 838 as follows:

"Directors and other officers, while not trustees in the technical sense in which that term is used, occupy a fiduciary relation to the corporation and to the stockholders as a body."

Fletcher considers the conflicting theories of whether a director is an agent or a trustee, citing cases supporting either proposition, and concludes as follows:

"But whether or not directors and other corporate officers are strictly trustees, there can be no doubt that their character is that of a fiduciary so far as the corporation and the stockholders as a body are concerned. In other words, it is unquestionably true that, as agents entrusted with the management of the corporation, for the benefit of the stockholders collectively, they occupy a fiduciary relation, and in this sense the relation is one of trust."

Twin-Lick Oil Co. v. *Marbury*, 91 U. S. 587, 23 L. Ed. 328 (1876); *Spiegel* v. *Beacon Participations*, 8 N. E. (2d) 895 (Mass. 1937); *Bosworth* v. *Allen*, 168 N. Y. 157, 61 N. E. 163 (1901); *Kavanaugh* v. *Kavanaugh Knitting Co.*, 226 N. Y. 185, 123 N. E. 148 (1919); *Pink* v. *Title Guarantee & Trust Co.*, 274 N. Y. 167, 8 N. E. (2d) 321 (1937); 14a C. J., Corporations, sec. 1866; 19 C. J. S., Corporations, sec. 761; Berle and Means, The Modern Corporation and Private Property, N. Y. 1933, p. 221; Spellman, Corporate Directors, N. Y. 1931, sec. 6, and cases cited.

For leading cases on transactions initiated by directors for personal profit and transactions between interlocking corporations, see: *Geddes* v. *Anaconda Mining Co.*, 254 U. S. 590, 41 S. Ct. 209, 65 L. Ed. 425 (1920); *Irving Bank-Columbia Trust Co.* v. *Stoddard*, 292 Fed. 815, C. C. A., 1st Circuit, 1923; *Munson* v. *Syracuse G. & C. R. Co.*, 103 N. Y. 58, 8 N. E. 355 (1886); *Pollitz* v. *Wabash R. R. Co.*, 207 N. Y. 113, 100 N. E. 721 (1912); *Globe Woolen Co.* v. *Utica Gas & Electric Co.*, 224 N. Y. 483, 121 N. E. 378 (1918); 19 C. J S., Corporations, sec. 781; Fletcher, Cyclopedia of Corporation (Perm. Ed.), vol. 3, Sec. 931 and cases there cited; Spellman, Corporate Directors, N. Y. 1931, sec. 182, and cases cited.

These cases establish generally the proposition that directors must not use the corporate assets for their own benefit and that whenever transactions between interlocking concerns are challenged the courts will carefully scrutinize the dealings to make certain that the consideration and motivating representations were fair and complete.

faulted securities are involved cannot participate dispassionately in the deliberations of his fellow directors and give necessary impartial advice.[2] Or, again, the case might arise of a life-insurance company which has deposited a substantial portion of its funds in a large bank. The chief executive officer of the bank and several of its directors serve on the board of the insurance company which is considering the advisability of changing its banking relationships either with a view to giving a broader distribution to its funds or perhaps even to withdrawing its entire deposits from the interlocking bank whose financial soundness may be under question. These banking officials have an obligation to their bank. It is certain they could not properly disclose confidential banking information to the board of the insurance company especially if it might be injurious to the bank, and it is equally certain that as members of the insurance board they could not deliberate without bias.[3] A similarly undesirable situation is potential where a director is engaged in providing professional services to the insurance company on whose board he serves. A lawyer, for instance, who obtains substantial fees from the insurance company and who has to a large extent built up his office on the expectation that those fees shall continue is not only unable to judge the merits of the disbursements to himself but also his very presence in the directors' room may make it difficult for his fellow directors to question his fees or the basis upon which he is proceeding.[4]

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[2] The larger legal reserve companies all own securities of interlocking concerns which are in default. As of December 31, 1938, Metropolitan owned $15,791,000 bonds of this character, Prudential $2,824,000 and New York Life $13,567,000 (par values). Replies to Commission's Investment Questionnaire for Metropolitan, Prudential, and New York Life.

No instance of the removal of a director when defaulted securities of a corporation in which he was interested appeared in the portfolio was found in the case of the 5 largest companies. It is of interest to note, however, that the Northwestern Mutual, in a wholly comparable situation, eliminated Mr. Fred W. Sargent, president of the Chicago and North Western Railroad Co., from the board after securities of the railroad held by the insurance company went into default (pt. 4, R. 1495).

[3] Mr. David I. Houston, president of the Mutual Life, testified (pt. 4, R. 1469, 1470):

"Representative REECE. What is the responsibility of the directors of the company?

"Mr. HOUSTON. They have complete control of it.

"Representative REECE. The interests of the directors, then, should first be to conserve and advance the interests of the company—

"Mr. HOUSTON (interposing). Of the policyholders.

"Representative REECE. In the case of an insurance company, of the policyholders.

"Mr. HOUSTON. Yes.

"Representative REECE. Then the interests of the directors of a bank, of course, or the responsibility of the director of a bank is to advance the interests of the bank, or the responsibility of a director of an industrial concern is to advance the interests of that concern. In case a man is a director of both the bank and of an insurance company, if the two companies have interrelationship, there might be no conflict in his responsibility, but on the other hand, it is possible that there might be a conflict and put him in a position where he would have to decide which institution should have its interests first advanced. Or do you think there is a possibility of that situation arising?

"Mr. HOUSTON. There might be, in which case I think the trustee would resign from one or the other. I certainly should, if I were aware of a conflict of consequence.

"Representative REECE. I think so, and I would assume that a director would not do so.

"Mr. HOUSTON. I do not know any member of our Board where any real conflicts of interest developed or persisted, who would not tender his resignation from one or the other.

"Mr. ARNOLD. Which would he resign from? He is put in a very uncomfortable position, isn't he?

"Mr. HOUSTON. Certainly.

"Mr. ARNOLD. And in general you would say directors shouldn't represent conflicting interests, wouldn't you?

"Mr. HOUSTON. If real conflicts of interest exist.

"Mr. ARNOLD. Or they shouldn't put themselves in situations which might in the future lead to conflicts of interest.

"Mr. HOUSTON. That might be the case. We have not been troubled by any conflict to date."

[4] See testimony of Mr. Mitchell D. Follansbee, contra (pt. 4, R. 1415).

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The outright lending of money to directors for their personal use presents this problem in even bolder relief. Such loans cannot be acted upon by the directors objectively and handled dispassionately in the manner of ordinary business transactions.[5] More often than not they are forerunner to other types of malpractice. That they are injurious to the policyholders' best interests cannot be questioned. The case of the Travelers will serve to illustrate the difficulties inherent in such a situation. In this instance, as has been indicated, about 50 officials of the company borrowed substantial sums of money from banks which the Travelers owned and controlled and it appeared that in order to protect some of these loans the insurance company was obliged to purchase and sell shares of its own stock to bolster the market price and thus prevent collateral values behind the loans from being further weakened.[6] During the course of the transactions those officials, who were also officers, directors, or members of the finance committees of the banks were called upon to act in dual capacities and in effect were obliged to pass upon the soundness of their own loans and the advisability of the transactions which were entered into for the purpose of protecting such loans. These officials in some cases borrowed money on collateral which was appraised by their fellow officers, and they then participated in meetings of the finance committees and of the board of directors at which the advisability and business soundness of the loans were passed upon and discussed. No more forceful example could be found of the difficult position in which directors and officers of insurance companies place themselves when they commingle their personal financial affairs with those of the company for whose policyholders and stockholders they serve as trustees. It is difficult to believe that the directors in this case were able to reach that degree of objectivity in decision which is required of the true trustee.[7]

Differing only in degree from these outright loans to officers and directors is the great variety of transactions through which a director may obtain a preferred business position. In this connection it is interesting to note that there is no uniform standard of conduct required or adopted by insurance officials in meeting this type of problem. Some officials stated that in their judgment it was proper for an insurance company to deal with its directors provided these dealings were not to the disadvantage of the insurance company;[8] another seemed to be saying that transactions with directors' banks, even though resulting from the direct solicitation of the director himself, were proper if the bank was sound and if the interlocking director removed himself from his embarrassing position when an active conflict occurred;[9] another director took the position that it would not be proper for him to solicit business himself from the insurance company but that others interested in the same outside venture as himself

[5] Mr. H. Harold Loweree, secretary of Monumental whose concealed loans to an officer have already been considered (p. 47, supra), testified (pt. 12, R. 5702):

"The VICE CHAIRMAN. In this instance I say the collateral was adequate—no question about this—but what I am pointing out is the danger of this practice of establishing a precedent to allow the practice of directors and managers of a company to come and obtain loans, even though they have collateral, because the value of that collateral is passed upon by these selfsame men who come looking for loans.

"Mr. LOWEREE. I can't help but recognize the general principle that you say, and I agree with you."

[6] See pp. 58 to 60, *supra*.

[7] For similar examples, see pt. 13, R. 6470–6473, 6859–6862.

[8] Pt. 4, R. 1434, 1446–1451.

[9] Pt. 4, R. 1454–1471.

should be free to do as they pleased in this connection.[10] Still other officials who had used insurance funds to further their personal business careers, and who in so doing had in some instances subjected their companies to great risk and even loss and who had not disclosed their full personal interest in such transactions, were unwilling to admit the impropriety of their actions.[11] Finally still other officials stated that any business dealings between life-insurance companies and their directors were abhorrent and should be scrupulously avoided.[12]

Except in these latter instances the various attitudes toward insurance directors, as outlined above, appeared to be more a justification of their past activities than a carefully considered definition of the policy proper from the viewpoint of the public interest or as a matter of business ethics.

Transactions between directors and their companies are frequently explained or justified on the ground that only men of the broadest business experience should be selected for directorships and that such men inevitably have wide business interests, at least some of which are certain to overlap with those of the insurance company. One official stated if the elimination of interlocking transactions were carried to its logical extreme, the company could not even buy a desk from Macy's department store since Mr. Percy Straus, president of the store, is on the board of the insurance company.[13] That comment was of course nonsensical; a matter of degree is clearly involved. The evidence, however, demonstrated conclusively that many directors have a direct personal interest in the outcome of their company's transactions, and that they are even active in initiating and forwarding transactions from which they intend to gain personal benefit. Furthermore the evidence disclosed situations conducive to conflict arising from interlocking directorships. One such example may be found in the heavy investment of company funds in securities of corporations which interlock with it.[14] Such investments are frequent. An analysis showed that as of December 31, 1938, only five of the 26 largest companies had no investments in securities of corporations with which they interlock, and that the remaining 21 companies owned $721,726,100 of bonds and 1,726,623 shares of stock in interlocking corporations. Two companies had investments in as many as 24

[10] Pt. 4, R. 1482–1485.

[11] Pt. 12, R. 5693–5696; pt. 13, R. 6807–6827.

[12] Pt. 4, R. 1494–1500; pt. 12, R. 5931. Mr. Charles F. Williams, president of the Western & Southern, testified as follows (pt. 12, R. 5931):

"Mr. Gesell. Have you or any of the other principal officers or controlling stockholders had business relations with the company through outside affiliations of any sort?

"Mr. Williams. Never.

"Mr. Gesell. You have confined your business activities to the operation of the insurance company?

"Mr. Williams. That is right.

"Mr. Gesell. Is it your feeling that officers and directors should not deal with their own company, even when it is a stock company?

"Mr. Williams. I don't see how they can do it. No, of course not.

"Mr. Gesell. You think it is undesirable for that situation to exist?

"Mr. Williams. Yes, yes; it is even worse than undesirable."

[13] Pt. 4, R. 1438. In this connection Mr. Thomas A. Buckner testified (pt. 4, R. 1435):

"If we are stopped from having any ordinary transactions that are necessary transactions for our company, if we are to be estopped from doing business with any institution where a director of our company was connected—well, we would just have to get a lot of directors that lived out where they never neard of investments or securities or anything of that kind. We couldn't get a board of directors that could give us proper advice and counsel and help."

[14] At least two States, Indiana and Iowa, specifically prohibit domestic life insurance companies from investing in securities of a corporation in which an officer of the insurance company is an officer or director.

interlocking corporations.[15] In many instances, securities were in default and the consequent position of the interlocking director was subject to even more than ordinary conflict. Though it is sometimes customary for interlocking directors to avoid participation in the deals affecting the insurance company holdings of a particular security in which they may have an interest [16] this does not eliminate opportunity for gross abuse. Indeed as a practical matter it would seem that activities of an entire board might well be affected by the fact that a substantial number of the important transactions coming up may in some way involve the beneficial interest of one or more members of the board.

An indication of the extremities to which such a situation may go will be found in the acquisition of railroad securities by the Mutual Life during the period from 1910 to 1930. In this period, the Mutual acquired $300,759,420 of railroad bonds of which $146,596,121 or 48.7 percent, were securities of roads one or more of whose officers or directors were then directors of the Mutual Life. In 1 year, as many as 74.3 percent of the railroad securities acquired by the Mutual were of roads connected with it in this fashion. Frequently the directors who interlocked were found to be members of the Mutual Life's finance committee and thus in close touch with the company's investment policy and required to exercise an especially high degree of independent judgment in formulating recommendations to the main board.[17]

The record also contains evidence of several companies which made investments for the purpose of financing speculative activities in which their officers or directors were interested. Frequently these investments weakened the reserves of the insurance company and in several notable instances actually brought about the failure of the company with a resulting large loss to its policyholders. These examples are sufficient warning in themselves of potential dangers which may arise from the accumulation of investments in interlocking concerns.[18]

The experience of the Northwestern Mutual indicates that dubious interlocking connections may be virtually eliminated and directors kept removed from any possibility of conflict provided the management has determined to avoid such situations as a matter of policy and approaches the problem realistically. The record of this company has been so striking in this connection that it deserves some special comment.[19] Mr. Michael J. Cleary, president of the Northwestern Mutual Life Insurance Co., testified on this point as follows:[20]

Mr. Hinrichs. Mr. Cleary, you made it very clear that you tried to avoid any kind of interlocking relationship between your trustees and the business activities of the company. In the process of eliminating people who might have an interlocking interest, has it ever been necessary for you to turn down a man that you regarded as superbly qualified and accept somebody whose qualifications seemed to you to be inferior to those that you could have had if it were not for that interlocking relationship?

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[15] Pt. 28, exhibit No. 2265.
[16] Pt. 28, testimony of Thomas A. Buckner, February 12, 1940.
[17] Pt. 28, Supplementary data.
[18] See section entitled "Company Retirements—Reinsurance and Failures," pp. 101 to 141, infra.
[19] Pt. 4, R. 1493–1500.
[20] Pt. 4, R. 1506.

Mr. CLEARY. I wouldn't say that. My experience is that there is no superman. You can always find a duplicate.[21]

Under the Wisconsin law to which the Northwestern is subject, a majority of the company's directors must be residents of that State. The remaining directors of the company have been selected with a view to representing various geographical areas in which the company operates and have been chosen from various occupations in order to "represent a fair cross-section of the policyholders." In order to select a director to represent the New England area, for example, it appeared that the company prepared a list of 2,000 policyholders resident in that section. These persons were then subjected to investigation through communication with company representatives in the territory and through personal investigations by an officer of the company in an effort to determine their qualifications for a directorship.[22]

In selecting directors, the company has eliminated many individuals whose business activities or connections might conceivably place them in embarrassing or conflicting positions. One individual was not chosen simply on the ground that the Northwestern Mutual had a large investment in the company of which he was the chief executive officer. Another, who was active in the real estate field, was eliminated on the ground that his extensive activities in the Chicago area where the Northwestern Mutual had substantial holdings might bring him into conflict with the company's interests. Still another was removed from consideration because he was "too busy" and probably would not be able to attend meetings regularly, while another, an attorney, was eliminated because the company wanted to be free in its decision as to who would represent it legally. It also appeared that as a matter of general policy the Northwestern Mutual discouraged the inclusion of members of banking or investment banking institutions on its board since it sought to be perfectly free from "any embarrassment in buying and selling securities" and in the placing of its deposits.[23]

Mr. Cleary testified on this matter in part as follows:[24]

Mr. GESELL. Coming to the question of selection from another point of view, do you look to see whether or not the man is in any way subject to becoming in a conflicting position if he comes on the board of your company?

Mr. CLEARY. We have frequently given thought to that phase of it, and on several occasions eliminated men from consideration because of that factor.

Mr. GESELL. Since conflicting interest is subject to a difficult definition, will you tell us just the type of men and the type of situations that have arisen where you have felt that you had to eliminate a man because of this conflicting relationship?

Mr. CLEARY. Well, I might use the case of Mr. Way, of the Milwaukee Electric Co. Mr. Way is president. At the time his name was considered the company

[21] The Armstrong Report (vol. X, p. 392) stated:

"It is not believed that the companies will be deprived of suitable advice and direction by the prohibition of dealings with officers and directors, or with firms of which they may be members. The business of the company should be transacted under the direct supervision of the trustees and no opportunity should be afforded for a conflict between their personal interest and their official duty. It is entirely indefensible to permit one to act as the trustee of an insurance corporation in a transaction in which he may benefit, apart from his interest in the corporation, by the exercise of his discretion."

[22] Pt. 4, R. 1493, 1494.

[23] Pt. 4, R. 1494–1500.

[24] Pt. 4, R. 1494–1495.

owned between eight and nine million dollars of securities of that company. We had considered the question as to whether the holding might not be too large, what our attitude would be in the event of refunding. It was felt that it would be embarrassing to Mr. Way, and possibly to the company. We dropped his name.

Mr. GESELL. That was a case simply where your company had a large investment in his company, was it not?

Mr. CLEARY. Yes.

Mr. GESELL. Well now, what about any other instances that you have?

Mr. CLEARY. Oh, I don't know that I recall specific detail, Mr. Gesell, on another case.

Mr. GESELL. Do you remember the case of Mr. Fred W. Sargent of your company?

Mr. CLEARY. Yes.

Mr. GESELL. He became a trustee, did he not?

Mr. CLEARY. Yes.

Mr. GESELL. He was president of the Chicago & North Western Railroad Co.?

Mr. CLEARY. Yes.

Mr. GESELL. Your company had an investment in that railroad prior to his coming on the board?

Mr. CLEARY. Yes.

Mr. GESELL. His railroad got into difficulties?

Mr. CLEARY. Yes.

Mr. GESELL. The securities went into default?

Mr. CLEARY. Yes.

Mr. GESELL. Your company still held them, and as the result, the situation was felt to be such as to warrant Mr. Sargent's leaving the board of directors of your company.

Mr. CLEARY. That is true.

Mr. GESELL. What about banking and investment-banking connections, Mr. Cleary; do you seek bankers and investment bankers as your trustees?

Mr. CLEARY. No. Five or six years ago we had a vacancy in New York and my recollection is that we announced to the agents and others with whom we considered a selection that we preferred to select outside of the banking and the investment-house group.

Mr. GESELL. Why was that, Mr. Cleary?

Mr. CLEARY. Well, we want to be perfectly free, naturally, without any embarrassment in buying and selling securities. We also want to be perfectly free in dealing with our deposits in the New York area. Probably supercautious, but——

Mr. GESELL (interposing). You mean that there was the prospect that at some time if you had a banker on your board that you would want to deposit money in his bank, and then his presence on your board would be embarrassing, or you might want to buy securities through some investment banking house and the presence of that man on your board would be embarrassing?

Mr. CLEARY. That is a possibility, and I imagine one of the viewpoints that entered into our conclusion.

The nature of the life-insurance business is such that the highest possible standards of trusteeship are required from its directors. Mere compliance with the formalities of office are not enough. A director's responsibilities are continuing and exacting. It must be recognized that directors' meetings are frequently stilted or casual and prevent directors from having a sufficiently close contact with management problems. The mechanics of the board meetings may become all sufficient in themselves and vital matters of company policy may be

put into action after only pro forma consideration. Furthermore, there is a danger that as individual companies grow larger and their directors tend to become more immune from policyholder pressure, they may act in disregard of the policyholders' interests. The all-too-frequent use of their positions by some directors to promote their selfish purposes, especially when coupled with the power of these same directors to perpetuate themselves in office regardless of their efficiency or their concern for the welfare of the policyholders, gives rise to situations where laxness in administration may flourish and breach of trust may pass unheeded. If these tendencies become too marked, there can be no check on the honesty or prudence of the executive officers and deterioration of management is certain to eventuate.

As watchdogs for the policyholders, the directors must be ever alert to the policyholders' best interests and sufficiently attuned to problems of management that they may direct rather than merely nod in approbation and counsel rather than review. A director must be independent and free to exercise his judgment without fear or favor. His duties must be clearly defined, his responsibilities keenly felt. It is not enough that directors shall come forward in times of emergency to guide company policies with a firm hand. A director must be willing and able to devote large portions of his time and energies, not mere lip service, to his trust. In a business such as life insurance where management decisions vitally affect the daily welfare of vast sections of this country's population, the directors must have a sufficient understanding of their company's problems not only to prevent the great power of management from being abused or directed into improper channels but to make certain that it is exercised at all times in the positive interests of the policyholders.

Flagrant cases of conflict and breach of trust exist. Until these are eliminated by a wider acceptance of the attitude taken toward these problems by the more progressive States and the more enlightened company managements, the funds of many policyholders will remain in jeopardy.

SECTION IX

Salaries and Profits

Life insurance companies, as a whole, pay high salaries to home-office executives. An examination of the salary structures of the 6 largest mutual companies discloses that 2,465 executives in these companies received $5,000 or more in salary, compensation and emoluments (commissions excluded) during 1938. In the case of the Metropolitan 1,052 executives receive $5,000 or more per annum. Of these 183 receive $10,000 or more and 23 receive $25,000 or more. A somewhat comparable situation exists in the other 5 largest mutual companies.[1]

No attempt is made here to criticize or to defend the salary practices of the mutual companies. Attention should be directed, however, to the cooperative and nonprofit making character of a truly mutual company, to the fact that similar enterprises flourish without benefit of high-salary incentives, and to the fact that the policyholders have no direct voice in management affairs, and must depend solely upon the discretion of a board of directors whose responsibility to policyholders is, as has been demonstrated, frequently tenuous and unsubstantial. On the other hand, the heavy responsibilities of the officials, and the urgent necessity for attracting men of the highest ability must be recognized.

The 1938 salaries of the principal active executives of the 25 largest mutual companies are listed below: [2]

Salary of principal executives of 25 largest mutual insurance companies (1938)

Company	Name and title of principal executive	Salary
Metropolitan Life Insurance Co	L. A. Lincoln, president	$125,000
The Prudential Insurance Co. of America	F. A. D'Olier, president	[1] 100,000
New York Life Insurance Co	T. A. Buckner, chairman of the board	100,000
Equitable Life Assurance Society of the United States.	T. I. Parkinson, president	75,000
Mutual Life Insurance Co. of New York	D. F. Houston, president	125,000
Northwestern Mutual Life Insurance Co	M. J. Cleary, president	50,000
John Hancock Mutual Life Insurance Co	Guy W. Cox, president	60,000
Penn Mutual Life Insurance Co	William H. Kingsley, president	60,000
Mutual Benefit Life Insurance Co	John R. Hardin, president	60,000
Massachusetts Mutual Life Insurance Co	Bertrand J. Perry, president	50,000
New England Mutual Life Insurance Co	George Willard Smith, president	60,000
Provident Mutual Life Insurance Co. of Philadelphia.	M. Albert Linton, president	40,000
Connecticut Mutual Life Insurance Co	James Lee Loomis, president	41,000
Phoenix Mutual Life Insurance Co	Arthur M. Collens, president	30,000
Pacific Mutual Life Insurance Co	A. N. Kemp, president	32,400
Bankers Life Co	Gerard S. Nollen, president	[1] 36,000
National Life Insurance Co	Fred A. Howland, chairman of board	25,000
State Mutual Life Assurance Co	Chandler Bullock, president	36,000

[1] 1939 salary, first full year as principal executive officer.

[1] Pt. 13, exhibit No. 1346.

[2] From 1938 Convention Form Annual Statements, schedule G.

Salary of principal executives of 25 largest mutual insurance companies (1938)— Continued

Company	Name and title of principal executive	Salary
The Guardian Life Insurance Co. of America	Carl Heye, president	$27,000
Fidelity Mutual Life Insurance Co	Walter LeMar Talbot, president	36,000
The Home Life Insurance Co	Ethelbert Ide Low, chairman of the board	35,000
Acacia Mutual Life Insurance Co	William Montgomery, president	75,200
Berkshire Life Insurance Co	Fred H. Rhodes, president	24,000
State Life Insurance Co	Robert E. Sweeney, president	21,000
American United Life Insurance Co	George A. Bangs, managing director	18,000
Total salaries		1,341,600
Average salary		53,664

In the case of the stock companies, salaries and other emoluments paid to principal executives are somewhat smaller in amount than in the case of mutual companies. The following table lists salaries paid principal officers of the 25 largest stock companies during 1938.[3]

Salary of principal executives of 25 largest stock companies (1938)

Company	Name and title of principal executive	Salary
The Travelers Insurance Co	L. Edmund Zacher, president	(1)
Aetna Life Insurance Co	M. B. Brainard, president	[2] $52,083
Union Central Life Insurance Co. of Cincinnati	W. Howard Cox, president	50,000
The Connecticut General Life Insurance Co	Frazar B. Wilde, president	24,000
Equitable Life Insurance Co	H. S. Nollen, president	33,000
Western & Southern Life Insurance Co	C. F. Williams, president	60,000
The Lincoln National Life Insurance Co	A. F. Hall, president	50,000
General American Life Insurance Co	Walter W. Head, president	35,000
Reliance Life Insurance Co. of Pittsburgh	H. T. Burnett, vice president [3]	21,368
Kansas City Life Insurance Co	D. T. Torrens, president	24,000
Life Insurance Co. of Virginia	Bradford H. Walker, president	65,000
Jefferson Standard Life Insurance Co	Julian Price, president	40,000
The American National Insurance Co	W. L. Moody, Jr., president	20,000
Northwestern National Life Insurance Co	O. J. Arnold, president	36,000
Southwestern Life Insurance Co	C. F. O'Donnell, president	30,211
National Life and Accident Co	C. A. Craig, chairman of the board	25,000
Occidental Life Insurance Co	Dwight L. Clarke, executive vice president	17,500
California-Western States Life Insurance Co	O. J. Lacy, president	18,000
Great Southern Life Insurance Co	E. P. Greenwood, president	60,000
Columbian National Life Insurance Co		(4)
Ohio National Life Insurance Co	T. W. Appleby, president	50,000
Bankers Life Insurance Co	H. S. Wilson, president	19,500
Franklin Life Insurance Co	H. M. Merriam, president	18,000
Pan-American Life Insurance Co	Crawford H. Ellis, president	16,702
Monumental Life Insurance Co	Paul M. Burnett, chairman of the board	25,000
Total salaries, 23 companies		790,364
Average salary		34,364

[1] Full salary not revealed by convention form annual statement. Life department salary amounts $32,603.

[2] Includes salaries from subsidiary companies.

[3] The president, Arthur E. Braun, receives no salary. He is reported as president of Farmers Deposit National Bank. Farmers Deposit Trust Co., an affiliate of the bank, owns 59.65 percent of the outstanding stock.

[4] Not supplied.

[3] From 1938 Convention Form Annual Statements, schedule G, and correspondence with the companies.

It must be recognized in this connection that the financial benefits inuring to principal officers of stock companies are not limited to salaries since in most cases these officers hold a substantial interest in the stock of their companies and may receive liberal cash or stock dividends from time to time. Information compiled from answers to a special questionnaire of the Commission is summarized below to indicate the percent of each company's outstanding shares held by officers and directors of the company.[4]

Company	Percent of company's outstanding shares held by officers and directors of company [1]	Company	Percent of company's outstanding shares held by officers and directors of company [1]
The Travelers Insurance Co	2.7	Jefferson Standard Life Insurance Co	32.4
Aetna Life Insurance Co	6.8	American National Insurance Co	71.2
Union Central Life Insurance Co. of Cincinnati	12.6	Northwestern National Life Insurance Co	54.0
The Connecticut General Life Insurance Co	10.6	Southwestern Life Insurance Co	12.2
Equitable Life Insurance Co	20.8	National Life and Accident Co	37.3
Western and Southern Life Insurance Co	56.3	Occidental Life Insurance Co	(3)
The Lincoln National Life Insurance Co	8.9	California-Western States Life Insurance Co	(4)
General American Life Insurance Co	(2)	Great Southern Life Insurance Co	10.0
Reliance Life Insurance Co. of Pittsburgh	8.0	Columbian National Life Insurance Co	2.9
Kansas City Life Insurance Co	16.4	Ohio National Life Insurance Co	19.5
Life Insurance Co. of Virginia	.6	Bankers Life Insurance Co	74.1
		Franklin Life Insurance Co	97.8
		Pan-American Life Insurance Co	14.1
		Monumental Life Insurance Co	35.4

[1] Includes only stock held of record in the names of officers and directors. Holdings of estates, corporations, or other organizations in which these officers and directors may be interested are not included.

[2] Company in process of mutualization.

[3] 100 percent of outstanding securities owned of record or beneficially by Transamerica General Corporation which in turn is owned 100 percent by Transamerica Corporation. The corporations are further tied together by interlocking directorships.

[4] Not supplied.

In general, the Commission's studies indicate that insurance stocks are closely held and traded primarily in over-the-counter markets. About three-fourths of the companies listed have less than 1,000 shareholders and even in those instances where shares are widely distributed it is still customary to find a controlling block closely held. Complete information is not available to indicate the extent to which the managements of the stock companies have participated in cash and stock dividends, but the closely held stock and the frequently high percentage of officers' and directors' holdings warrant the assumption that this participation has been substantial. A special study of the Monumental Life Insurance Co. of Baltimore demonstrated the generous amounts of company earnings disbursed to officers and directors. Commencing as a stock company in 1928 with a paid-in capital of one-half million dollars the company, in addition to increasing its surplus in a substantial amount, had paid

[4] Companies were asked to supply information concerning capital stock outstanding and amount held by officers and directors.

cash dividends totaling $1,830,000 up to December 31, 1938.[5] Of this amount, principal officers and members of their families have received amounts as follows:[6]

Paul M. Burnett, chairman of the board	$181,474
In trust	197,500
Milton Roberts, vice president and director	158,837
Howard M. Emmons, vice president and director	112,784
Stewart H. Clifford, vice president	34,606
Total	685,201

The original paid-in capital of the 25 now largest stock companies was $9,242,720. At the end of 1938 these companies had declared dividends totaling $173,563,434 and had accumulated a surplus of $137,913,582. A schedule reflecting original paid-in capital, cash, and stock dividends and surplus accumulations for each of these 25 companies is set forth below:[7]

Original capital, dividends, surplus—25 largest stock companies [1]

Company	Year organized	Organized paid-in capital	Dividends		Surplus as of Dec. 31, 1938
			Cash	Stock	
The Travelers Insurance Co.[2]	1863	$200,000	$17,754,000	0	$33,356,462
Aetna Life Insurance Co.[2]	1850	150,000	21,717,000	$4,100,000	20,386,975
Union Central Life Insurance Co. of Cincinnati	1867	100,000	4,285,735	2,400,000	8,197,514
The Connecticut General Life Insurance Co.[2]	1865	250,000	5,568,738	0	7,027,579
Equitable Life Insurance Co	1867	25,000	1,986,186	0	3,424,520
Western & Southern Life Insurance Co	1888	100,000	19,102,500	14,900,000	8,807,683
The Lincoln National Life Insurance Co	1905	110,300	6,442,423	0	3,500,000
General American Life Insurance Co.[2]	1933	2,000,000	142,500	0	1,960,684
Reliance Life Insurance Co. of Pittsburgh [2]	1903	2,000,000	1,500,000	0	3,637,012
Kansas City Life Insurance Co	1895	125,000	2,450,000	875,000	6,021,441
Life Insurance Co. of Virginia	1871	100,000	14,177,423	5,200,000	6,307,844
Jefferson Standard Life Insurance Co	1907	250,000	2,260,000	1,583,333	2,500,000
The American National Insurance Co	1905	100,000	3,795,000	1,750,000	9,776,550
Northwestern National Life Insurance Co	[3] 1885	1,100,000	165,000	0	2,329,048
Southwestern Life Insurance Co	1903	100,000	5,766,000	3,750,000	3,610,575
National Life & Accident Co.[2]	1900	15,500	6,693,348	3,934,500	4,060,613
Occidental Life Insurance Co	1906	225,000	431,000	0	1,731,332
California-Western States Life Insurance Co.[2]	1912	500,000	2,455,898	0	450,000
Great Southern Life Insurance Co	1909	119,690	5,735,000	1,200,000	1,000,000

See footnotes at end of table.

[5] Pt. 12, R. 5723.

[6] Pt. 12, exhibit No. 969.

[7] Pt. 12, exhibit No. 951; Best's life reports; spectator insurance year books, convention form annual statements. The figures representing original paid in capital may, in some cases, be larger than actually was the case. The information relating to the early history of some companies is meager, and possibly identifies authorized or subscribed capital, as paid in capital (pt. 12, R. 6613).

Original capital, dividends, surplus—25 largest stock companies—Continued

Company	Year organized	Organized paid-in capital	Dividends		Surplus as of Dec. 31, 1938
			Cash	Stock	
Columbian National Life Insurance Co.[1]	1902	$200,000	$2,866,111	0	$625,969
Ohio National Life Insurance Co.[2]	1910	106,400	1,146,731	0	1,000,000
Bankers Life Insurance Co	1887	100,000	576,260	$400,000	3,583,709
Franklin Life Insurance Co	1884	100,000	383,750	150,000	1,035,364
Pan-American Life Insurance Co.[2]	1912	665,830	2,590,000	0	1,006,536
Monumental Life Insurance Co	[4] 1858	500,000	1,830,000	1,500,000	2,576,172
Total		9,242,720	131,820,601	41,742,833	137,913,582

[1] Does not include data for departments other than life.

[2] Engaged in the sale of health. accident, fire, or casualty insurance, as well as life insurance.

[3] Stock company incorporated 1927.

[4] Stock company incorporated 1928.

SECTION X

Company Retirements—Reinsurance and Failures

During the 10 years, 1930–39, 188 life insurance companies discontinued operations as a result of reinsurance, merger or receivership.[1] These company retirements were distributed among the 48 States and the District of Columbia as indicated in the following table, which differentiates between those retirements resulting in loss to policyholders and those which did not.[2]

Company retirements, 1930–39

States	With loss to policyholders		Without loss to policyholders—domiciled [a]
	Domiciled	Doing business	
Alabama	3	10	4
Arizona	1	5	2
Arkansas	3	12	3
California	1	9	5
Colorado	1	9	4
Connecticut	0	0	0
Delaware	0	6	1
District of Columbia	2	9	2
Florida	0	12	1
Georgia	0	7	1
Idaho	0	4	0
Illinois	8	19	12
Indiana	1	15	4
Iowa	2	13	8
Kansas	2	13	4
Kentucky	1	9	4
Louisiana	0	6	1
Maine	0	0	0
Maryland	0	7	1
Massachusetts	0	0	1
Michigan	4	16	1
Minnesota	0	7	3
Mississippi	0	9	1
Missouri	5	13	8
Montana	0	6	1
Nebraska	0	10	17
Nevada	0	4	1

[a] Companies included under this column may in some cases have retired with a loss to policyholders. Wherever information was incomplete or doubtful, companies have been classified as retiring without loss. In addition at least 5 companies included under this column merged with or were reinsured by other life insurance companies which subsequently failed. Pt. 28, exhibit No. 2338.

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[1] Pt. 28, exhibit No. 2337.

[2] Ibid. The number of companies retiring each year during the period were as follows (Id.):

Year	Number	Year	Number
1930	22	1935	12
1931	32	1936	21
1932	27	1937	14
1933	24	1938	17
1934	11	1939	8

Company retirements, 1930–39—Continued

States	With loss to policyholders		Without loss to policyholders—domiciled
	Domiciled	Doing business	
New Hampshire	0	0	0
New Jersey	0	5	0
New Mexico	0	4	1
New York	0	1	3
North Carolina	0	6	5
North Dakota	0	5	1
Ohio	2	19	3
Oklahoma	0	14	6
Oregon	0	7	1
Pennsylvania	0	9	2
Rhode Island	0	1	0
South Carolina	0	4	2
South Dakota	0	5	0
Tennessee	1	9	1
Texas	1	15	26
Utah	0	5	0
Vermont	0	0	0
Virginia	0	7	1
Washington	0	3	6
West Virginia	1	12	0
Wisconsin	0	3	1
Wyoming	0	5	0
Total	39		149

Reinsurance is the most common form of company retirement.[3] Not to be confused with reinsurance of an individual policy, reinsurance of an entire company typically involves the assumption by the reinsuring company of all policy liabilities of the reinsured company and the taking over of assets equal to the accumulated reserves with which to meet obligations assumed under the reinsurance contract. The reinsured company ordinarily liquidates upon completion of the reinsurance, distributing to its stockholders, and in some rare instances its policyholders, the excess, if any, of its assets over its reserves, together with any consideration it may have received from the reinsuring company for its business. The reinsuring company continues as a going concern, collects premiums from the policyholders as they fall due and generally occupies the same position with respect to the policyholders as did the reinsured company prior to reinsurance.[4]

Reinsurance is not necessarily disadvantageous to the policyholder. There are situations where good management policy dictates the consolidation of two previously independent companies.[5] Moreover, it is not unusual for reinsurance contracts to grow out of receiverships

[3] The various retirements may be classified under the following categories: 91 companies retired through reinsurance without lien, 2 companies through reinsurance with lien, 21 companies through receivership, 31 companies through receivership followed by reinsurance with lien, 4 companies through receivership followed by reinsurance without lien, and 39 companies through merger (pt. 28, exhibit No. 2337).

[4] Pt. 28, testimony of Alfred M. Best, February 29, 1940.

[5] Pt. 28, testimony of Alfred M. Best, February 29, 1940. Reinsurance is often considered a relatively cheap method of acquiring new business and may bring about a reduction in expense. Ibid.

as a means of preserving for the policyholder of a failed company such equity as may remain after the receivership.[6] Even more frequently a reinsurance contract may be entered into in order to prevent a receivership, adjustment being made when necessary so that the reinsuring company will not undertake policy liabilities in excess of those which the acquired assets may justify.[7]

Reinsurance may be undertaken with or without a lien against the policy reserves involved. If no lien is placed against the policy reserves of the reinsured company, the reinsuring company assumes liabilities at 100 cents on the dollar and the policyholders of the reinsured company maintain their previous status in the reinsuring company. When the company to be reinsured is in financial difficulties it is customary to adjust policy provisions or subject the policy reserves to a lien in order that liabilities assumed will not be out of line with the true amount of the assets taken over under the reinsurance contract. More frequently, a lien is imposed. This lien is in effect a reduction of the policyholders' equity in the reserves of the company by the amount of the lien imposed. Unless the policyholder dies within a period specified in the reinsurance contract the lien is an obligation which he must ultimately satisfy, either by the payment of cash or by having the amount subtracted from the amount payable at death, surrender or maturity. In the meantime the policyholder must pay interest on the lien just as if it were a policy loan. Sometimes these liens are made flexible and are adjusted from time to time as the insurance situation works itself out and those policyholders who entered a reinsurance arrangement with their policies subject to lien at the outset, may even eventually hold unimpaired policies. In other cases the lien may have to be increased from time to time as assets taken over fail to justify the valuation placed upon them at the time they were assumed under the reinsurance contract.[8]

In many instances reinsurance contracts are the result of strictly promotional activities and are highly disadvantageous to the policyholders.

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[6] Op. cit. supra note 3 at p. 102.

[7] The present methods for liquidating insurance companies require improvement due primarily to the lack of coordination between the proceedings in the various States. At present, insurance companies are excepted from the provisions of the Federal bankruptcy law, and a receivership in a State court of an insurance company doing an interstate business is a chaotic affair. The receiver in the State of domicile, who is ordinarily the primary receiver, has no authority outside of the jurisdiction of the court which appointed him, with the result that ancillary receivers must be appointed in each State in which the company did business or had assets. Because of local interests and because of variations in State laws, these ancillary receivers often work at cross purposes with the primary receiver. In some States the receiver's fee is dependent on the amount of assets collected, and controversy develops as to the authority to collect. In many cases inequitable distribution of assets results because in some States the local receiver collects for the benefit of local creditors, while in other States the local receiver collects for the benefit of all of the company's creditors, pro rata. Some States require the company to keep a deposit with the State, and on the company's insolvency the deposit is available for creditors in that State only. Sometimes before ancillary receivers can be appointed separate proceedings are started in States other than that of domicile, and the confusion is multiplied. Not only is the lack of system in receiverships confusing, but it is also expensive, for each receiver, whether independent or ancillary, must be paid for his work and there is a tremendous duplication of effort. In 1935 the National Convention of Insurance Commissioners recommended the adoption of a uniform State insurance bankruptcy law. In 1939 it reported that "unfortunately, only a few of the States have enacted this law, New York, Indiana, California, Vermont, and Michigan." See address of George S. Van Schaick, superintendent of insurance of the State of New York at the sixty-fourth annual meeting of the National Convention of Insurance Commissioners, June 2, 1933 (pt. 13, exhibit No. 1348–9).

[8] Pt. 28, testimony of Alfred M. Best, February 29, 1940. For a form of reinsurance contract see pt. 13, exhibit No. 1348–17.

Public information on the subject of company retirements is sparse and in fact most State regulatory officials requested by the Commission to furnish facts relating to specific retirements within their States were unable to do so because of the unavailability of pertinent records or difficulties encountered in assembling material therefrom. The Commission was unable to make a thorough study of retirement cases since the amount of time and expense required was prohibitive. It was possible, however, to make special case studies of certain specific reinsurance deals and to examine several reinsurance promoters who were called to testify concerning their general activities. In the main the emphasis was placed upon that type of reinsurance contract which results purely from promotional activities and is most apt to work to the detriment of the policyholders involved.

Persons who pyramid life insurance companies through reinsurance follow a fairly uniform procedure. Practically no resources or showing of financial responsibility are required. The usual method is for the promoter first to organize a corporation for the purpose of acting as a holding company for insurance stock. Then with the promoter's own funds or with borrowed money,[9] the holding company buys enough of the outstanding capital stock of a small life insurance company to assure it of working control. The promotor then has himself and his associates elected directors and appointed executive officers of the insurance company, which proceeds to make a loan to the parent holding company. This loan may be secured by stock of the holding company or by overvalued mortgages and other collateral of dubious worth. With the money so secured the holding company then purchases working control of another insurance company. Having secured control of the second company, a list of stockholders is obtained from its files. These stockholders are offered an opportunity to exchange their stock for the preferred stock of the holding company. Usually the offer is accepted by a substantial number of stockholders, and the holding company thus gains control of the entire outstanding stock of the second company. Acting on behalf of both insurance companies, the promoter then arranges stockholders' meetings to approve a contract whereby the first company undertakes to reinsure the business of the second. This done, the first company either pays cash for the business of the second or gives it a participation certificate under which the stockholders of the second company are granted an interest in any mortality savings, excess interest earnings or other profits of the reinsured business. The reinsured company is then out of the insurance business altogether, having turned over its reserves and policy records to the reinsuring company. The holding company organized by the promoter is the controlling and frequently sole stockholder of the reinsured company and as such has an interest in the cash paid as consideration for the reinsurance contract. This cash can be used to purchase the controlling interest in another insurance company and the reinsurance process may then be repeated. If the consideration of the reinsurance contract was a participating certificate, this certificate can be discounted and the cash so obtained comes under the

[9] Sometimes even the insurance company's own funds are used for this purpose. The purchase of the Republic Life Insurance Co. of Dallas, Tex., was a case in point. The promoter, Paul Temple, bought a building in Dallas, having previously arranged, with the assistance of an officer of the insurance company, to sell the building to the insurance company at a substantial profit. With this profit he purchased control of the company (pt. 13, R. 6745, 6746).

immediate control of the holding company and may also be used for the purpose of continuing promotional activities. It is obvious that when four or five companies have been gathered together under the domination of a single holding company the possibilities of additional reinsurance arrangements and financial manipulations become innumerable.[10]

In most States the consent of the policyholders to a reinsurance contract is not necessary. It is conceived to be a transaction between the managements of the two companies, and the policyholder is given no voice in the matter.[11] The position of the policyholder was clearly described by Mr. Massey Wilson, a well-known insurance promoter, in the following terms:[12]

Mr. GESELL. So you would say that is one technique in acquiring a company, to buy a controlling interest, get a place in the management, switch the other policyholders out of their stock and into preferred stock of an affiliated organization?

Mr. WILSON. Yes; I had a dream of building another great company, and I thought by getting a whole lot of companies together and merging them into one I could finally build a greater company from that.

Mr. GESELL. In a transaction such as that the policyholders are not consulted are they?

Mr. WILSON. They have to be consulted when you finally reinsure it.

Mr. GESELL. They at that time are sort of in the position of having to jump from the frying pan into the fire, aren't they? If they go with the reinsurance contract, they must put their chances there, of if they stay, their interest is liquidated, isn't it?

Mr. WILSON. That is right.

Mr. GESELL. It isn't a very happy choice at that stage for any policyholder, is it?

Mr. WILSON. Usually they go along with the reinsurance.

Mr. GESELL. It isn't a very happy alternative for a policyholder to have to face?

Mr. WILSON. No; it isn't.

Mr. GESELL. Particularly when the reinsurance contract is being entered with a man who is, in effect, shaking hands with himself, having controlling interests in the two companies involved.

Mr. WILSON. No.

Mr. GESELL. So, would you say I was perhaps fair in my statement that the policyholder doesn't have much choice in a proposition like that?

Mr. WILSON. Yes; you are right about that, * * *

There may be one further step in perfecting a reinsurance arrangement. It must be recognized that after the terms of the reinsurance contract have been carried out the policyholders of the reinsured company still hold the same policies which they held prior to the execution of the contract. It frequently occurs that after the contract has been executed and the reserves transferred to the reinsuring company that the promoter arranges to rewrite the reinsured business. This rewriting operation, which is sometimes called transfer work, in its simplest terms involved switching policyholders from one form of policy contract to another. Policies may contain provisions disad-

[10] Pt. 13, R. 6663, 6664, 6669, 6670, 6697, 6698.

[11] Pt. 13, R. 6675–6676. Practically all States require that a reinsurance contract must be submitted to the commissioner of insurance for prior approval or review.

[12] Pt. 13, R. 6698, 6699.

vantageous to the reinsuring company at the time of reinsurance and if successful the transfer places the policies on a basis more advantageous to the reinsuring company. It also enables the promoter, who frequently appoints himself transfer agent, to collect substantial commissions on the rewritten business.[13] Rewriting is often accompanied by misrepresentation and it is not unusual for policyholders to agree to the rewriting plan without having an adequate understanding of the nature of the contract they are signing, due to the complicated manner in which the arrangement is presented to them.[14]

During the course of the hearings, Mr. Herbert G. Shimp, president of the American Conservation Co., of Chicago, Ill., was called as a witness.[15] Mr. Shimp is an important rewriting specialist and his activities demonstrate that the business of rewriting offers a field sufficiently lucrative to take up the entire time of a substantial organization. He testified he had been in the rewriting business for a period of approximately 22 years during which time he, or organizations with which he was associated, had rewritten about $1,300,000,000 of life insurance.[16] It appeared that the American Conservation Co. which had been formed as recently as 1930 had, in the period of 9 years, rewritten $183,000,000 of insurance for 23 separate insurance companies. Commissions of over $4,000,000 were received on this transferred business alone which represented a net profit of over one-half a million dollars for the American Conservation Co.[17] The size of the organization maintained by the American Conservation Co. is naturally determined by the amount of business available at any given time. On some occasions, however, the company had as many as 350 field men on its pay roll.[18] Methods used by American Conservation Co. to obtain business were of particular interest. In some cases commissions were split with persons who assisted in getting rewriting contracts. Thus, for example, Mr. Raymond T. Smith, vice president of Alfred M. Best Co., Inc., received a contract calling for payments equal to 5 percent of all first year premiums on rewritten business of Security Life Insurance Company of America which was reinsured by Central Life Insurance Co., in return for his efforts in getting American Conservation Co. the rewriting contract.[19] Similarly a Detroit law firm was given 10 percent of the first year premiums on the rewriting of policies of the Detroit Life Insurance Co. for its assistance in obtaining the rewrite contract.[20] Commissions were also paid former agents of the reinsured company to keep them from opposing the rewriting of policies in their territory[21] and former State insurance officials were sometimes employed to solicit business on the company's

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[13] This commission runs as high as 70 and 80 percent of the first year premiums collected from the business transferred. Mr. J. D. DeBuchananne, an insurance promoter, testified: (Pt. 13, R. 6670) "There was a profit in it, that was the greatest reason in rewriting; there is a profit in it." Incidental gains from the rewriting are the opportunities given to sell new insurance and to observe policyholders whose health is impaired, with a view to allowing those policies to lapse if possible. (Pt. 13, R. 6607, 6670, 6671.)

[14] Pt. 13, R. 6621, 6622; exhibit Nos. 1348-4, 1348-5, 1348-51, 1348-52, 1348-53, 1348-54, 1348-55, 1348-56.

[15] For a discussion of the transactions between American Conservation Co. and Illinois Bankers Life Assurance Co. of Monmouth, Ill., see pp. 81 to 86, supra

[16] Pt. 13, R. 6917, 6919.

[17] Pt. 13, R. 6920, exhibit Nos. 1348-58, 1348-70.

[18] Pt. 13, R. 6919.

[19] Pt. 13, R. 6923; exhibit Nos. 1348-60, 1348-61.

[20] Pt. 13, R. 6927; exhibit No. 1348-64.

[21] Pt. 13, R. 6925-6927; exhibit Nos. 1348-62, 1348-63.

behalf.[22] On at least one occasion the American Conservation Co. actually acquired a substantial stock interest in a life insurance company in order that it might control that company's policies to the end that it might direct reinsurance business to itself.[23]

A typical case of the use of the holding company device in promoting reinsurance arrangements was that of the Reserve Co. of Kansas City, Kans. This company was organized by Mr. E. W. Merritt, Jr., in 1927. Its first step was to acquire, for cash, the stock holdings of Mr. Clark Strickland, then president of the United States Reserve Life Insurance Co. of Kansas City. Thereafter, Mr. Strickland assisted the Reserve Co. in exchanging its stock for that of the United States Reserve Life Insurance Co., of which company it soon gained control. The Reserve Co., borrowed money from United States Reserve Life Insurance Co., which it used to aid it in obtaining control of Federal Reserve Life Insurance Co. Having gained control of Federal Reserve it caused the United States Reserve Life to be reinsured by the Federal Reserve Life, taking a participating certificate as consideration for the reinsurance contract. This certificate was discounted for cash which was used to pay outstanding obligations of the Reserve Co. On the completion of the reinsurance the Reserve Co. rewrote the business of United States Reserve Life for Federal Reserve Life.[24]

Another example of the activities of reinsurance promoters was found in the case of the Royal Union Life Insurance Co. of Des Moines, Iowa. This company failed in 1933 with an indicated initial loss to policyholders of over $11,000,000 after reinsuring or merging with more than a score of other life insurance companies located in 11 different States. One of the principal contributing causes of its failure was the tremendous draining of its assets by liberal commissions paid to reinsurance promoters. During the period from 1927 through 1931 alone, the company paid two promoters close to one-half a million dollars in commissions for their activities in locating companies which could be reinsured. In the words of a former Iowa insurance commissioner, the arrangements under which these commissions were paid "smelled bad." This commissioner said:

> It's just been a racket with a lot of them. They care nothing about anything but the money they could pull out of these people who were saving up for their death.[25]

In order to conduct a successful reinsurance operation the promoter must be able to locate companies which can be purchased and reinsured into other companies which he controls. Many methods are used to obtain information concerning companies which may be for sale or which the owners might be persuaded to sell. Such companies

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[22] Pt. 13, R. 6931, 6932; exhibit No. 1348–69.

[23] Pt. 13, R. 6941, exhibit No. 1348–69.

[24] Pt. 13, R. 6637–6641; exhibit No. 1348–2. The North American Co. was another holding company of this same type. Shortly after it was formed the North American bought the controlling interest in Kaskaskia Life Insurance Co. (later renamed the Mississippi Valley Life) for cash, then exchanged preferred stock of the North American for the remaining outstanding stock of Kaskaskia. The North American then bought the controlling interest in the Two Republics Life Insurance Co., of El Paso, Tex., exchanged preferred stock of North American for other outstanding stock of the Two Republics, and reinsured the Two Republics into the Mississippi Valley. Upon the completion of the reinsurance, the North American rewrote the policies of the Two Republics. At about the same time the Mississippi Valley reinsured the business of the Western Life Insurance Co., of Chicago. The Mississippi Valley subsequently failed. See pt. 13, R. 6662–6668.

[25] Pt. 13, R. 6751–6753, 6767. See generally pt. 13, R. 6751–6768; pt. 28, exhibit No. 2336.

are referred to as companies which are "ready for the doctor" and the search for companies which may be so taken over by the promoters is colloquially known as "bird dogging." Some individuals who are not interested in concerning themselves with company management devote their entire time to locating companies which can be brokered to reinsurance promoters. One promoter testified that he received much information concerning companies which might become the subject of his operations from State insurance officials, and in return for these tips he rendered political service through the insurance companies which came under his control.[26]

A. FEDERAL RESERVE LIFE INSURANCE CO.

Perhaps the best understanding of the reinsurance as practiced by promoters can be gained from an examination of the affairs of the Federal Reserve Life Insurance Co., of Kansas City, Kans., which failed in 1936. A special study of this company disclosed a series of reinsurance transactions which were rigged by the company's management for its own advantage and which eventually impaired the company's reserves to such an extent that the company was thrown into receivership.

The Federal Reserve Life Insurance Co. was organized under the laws of Kansas in 1920. At the time of its failure it had about $33,000,000 of insurance in force, assets of between eight and nine million dollars, and operated in seven States. Its home offices were located at Kansas City, Kans. The principal organizers of the company were Mr. Wesley Paul Gregory, an insurance agent, and Mr. D. H. Holt, a small-town Kansas banker. The company was formed under a plan whereby the stock was originally sold to a group of subscribers, who deposited it with a trustee, and it was then resold by the trustee to policyholders under an arrangement which enabled them to apply policy dividends against the purchase price of the stock. Pursuant to this plan the subscribers were eventually repaid their money with 6 percent interest.[27]

The first president of the company was Mr. Walter Payne, who was also president of a bank in Topeka, Kans., and treasurer of the State of Kansas. Though he was not active in the affairs of the company, Mr. Payne received a salary of $5,000 per annum. He resigned in 1924 as a result of charges that he held his position solely because of the political influence which he commanded with the Kansas Insurance Department.[28] He was succeeded as president by Mr. W. H.

[26] Pt. 13, R. 6671–6674, 6732. For a more detailed discussion of political activity see pp. 164 to 177, *infra*. Some individuals spent their entire time acting as brokers, trading insurance companies back and forth from one reinsurance to another. The usual commission for such brokerage service was paid at the rate of $2 per thousand dollars of insurance in force in the reinsured company at the time of the reinsurance contract (pt. 13, R. 6674, 6729, 6730).

[27] Pt. 13, R. 6602–6604. Best's Life Insurance Reports, 1936, p. 379. The original capital was $100,000, which was represented by 10,000 shares of stock. Mr. Gregory and Mr. Holt and a small group of other persons purchased the issue at $15 per share, and it was resold to policyholders at $25, the difference representing a policyholder's contribution to surplus. A few years later a second issue of 10,000 shares was marketed in the same manner. Mr. D. H. Holt, who became treasurer of the company, was made trustee of both issues (pt. 13, R. 6603, 6604, 6625).

[28] Pt. 13, R. 6611, 6612. Federal Reserve also paid a stenographer $43.43 a month for acting as Mr. Payne's secretary. She was never at the offices of the company and in fact resided at Topeka, Kans., where she was employed in the state house at a salary of $100 a month (pt. 13, R. 6612). The directors of Federal Reserve were figureheads who always passed on proposals the way the management desired (pt. 13, R. 6614).

Gregory. From the inception of the company Mr. Gregory held an exclusive agency contract under which he was entitled to receive a commission on all insurance sold by Federal Reserve in any State in which it was doing business. This contract he assigned to a corporation which he owned, the Federal Agency Investment Corporation, and this corporation thereafter acted as the sole selling agency of Federal Reserve until Mr. Gregory's resignation as president in 1928. The contract was very lucrative, providing for first-year commissions graded from 90 percent of the first-year premiums downward and renewal commissions as high as 15 percent. The amount paid the agency company over the 3 years from 1925–27, inclusive, during which time Mr. Gregory was also president of the insurance company, amounted to $666,790.51.[29]

The Federal Reserve grew rapidly. By 1928 it was operating in Kansas, Illinois, Missouri, Indiana, Ohio, Florida, and Michigan, and had assets of over $7,000,000. Much of this growth was the result of a series of reinsurance transactions. During the period 1926–28 it reinsured the following companies on the dates indicated:[30]

Company reinsured	Date	Assets
Providers Life Insurance Co., of Chicago, Ill	Apr. 30, 1926	$1,000,000
Union National Life Insurance Co., of Kansas City, Kans	Nov. 9, 1926	100,000
United States Reserve Life Insurance Corporation, of Kansas City, Mo	Apr. 30, 1928	333,000
Reserve Life and Accident Co., of Arkansas City, Kans	do	(1)
Farmers National Life Insurance Co., of Huntington, Ind	Nov. 30, 1928	3,000,000

1 The record does not disclose the assets of Reserve Life & Accident Co. of Arkansas City, Kans., at time of reinsurance. It had 136,000 policies in force. Pt. 13, R. 6608.

Federal Reserve acquired Providers Life Insurance Co. from two insurance promoters, Mr. J. D. DeBuchananne and Mr. E. W. Merritt, Jr. The background and previous insurance experience of these individuals is important. Mr. DeBuchananne started in the insurance business as an agent for the International Life Insurance Co. of St. Louis, Mo. There he met Mr. Massey Wilson, one of the company's principal officers, and later to be a co-owner of Federal Reserve. On leaving International Life, Mr. DeBuchananne associated himself with Mr. E. W. Merritt, Jr., a rewrite expert, and with him organized in 1923 the North American Co., a holding company formed "to hold insurance stock, to act as broker to buy one company and sell to another, and transfer business and rewrite business. * * *"[31] Some time after its organization, Mr. Paul L. Temple, who was also to figure in a subsequent Federal Reserve reinsurance deal, became associated with the enterprise. After promoting several reinsurance transactions of which the most important was the Mississippi Valley Life Insurance Co.,[32] Messrs. DeBuchananne, Merritt, and Temple sold out their interests in the North American Co. This was accomplished with the assistance of Mr. W. K. Herndon, then a special examiner of the Kansas Insurance Department, who received from $22,000 to

[29] Pt. 13, R. 6604, 6605, 6632.

[30] Pt. 13, R. 6607–6609.

[31] Pt. 13, R. 6662–6663.

[32] This company went into receivership April 1932 and was subsequently reinsured with a 100 percent lien at an indicated initial loss to policyholders of $2,970,000. Pt. 28, exhibit Nos. 2336, 2338. See also note 24, supra.

$23,000 for brokering the transaction.[33] Mr. Herndon was subsequently to become very active in the affairs of Federal Reserve to his great personal profit. Following the North American sale, Mr. DeBuchananne bought control of Providers Life Insurance Co. from its then officers and became president of that company. Shortly thereafter he was joined by Mr. Merritt, who put up some necessary capital and became half owner of the enterprise.[34] At the time Mr. Merritt took an interest, it was agreed that the Providers Life would either merge with some other insurance company or build up its business by acquiring other insurance companies. Efforts at acquisition having been unsuccessful, Messrs. DeBuchananne and Merritt decided to sell.[35]

It was at this juncture that the arrangement between Providers Life and Federal Reserve was worked out. Mr. W. K. Herndon, the special examiner of the Kansas Insurance Department, who had completed an official examination of Federal Reserve 2 months previously, was the principal go-between and acting as broker in the transaction arranged for Federal Reserve to purchase the controlling stock interest of Providers for approximately $190,000. For these services he received $9,500 from Federal Reserve and approximately $18,000 from Providers Life, or a total of $27,500.[36] With respect to the $9,500 payment, Mr. Vernon B Holt, a former officer and director of Federal Reserve, testified: [37]

Mr. GESELL. He got a dollar a thousand from you?

Mr. HOLT. A dollar a thousand from us.

Mr. GESELL. That is, a dollar per thousand insurance in force?

Mr. HOLT. Yes.

Mr. GESELL. How much was in force?

Mr. HOLT. Nine an a half million of insurance in force. A dollar a thousand would be approximately $9,500.

Mr. GESELL. He got about $9,500?

Mr. HOLT. Something like that.

Mr. GESELL. How was that paid to him?

Mr. HOLT. It was paid to him by check.

Mr. GESELL. Was that check drawn to his order?

Mr. HOLT. No.

Mr. GESELL. Was the check drawn on the Federal Reserve Life Insurance Co. funds?

Mr. HOLT. Yes.

Mr. GESELL. To whose order was it drawn?

Mr. HOLT. Carl Willbrand.

Mr. GESELL. Who is Mr. Carl Willbrand?

Mr. HOLT. An attorney in Kansas City, Mo.

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[33] Pt. 13, R. 6662, 6668.

[34] Mr. DeBuchananne testified that a Mr. Hill, president of the Abraham Lincoln Life Insurance Co. desired to buy Providers and insisted upon Mr. DeBuchananne selling his interest. An arrangement for the sale was made and a $80,000 down payment was made. After the formalities of the deal were well under way and stockholders meetings called to ratify the contemplated reinsurance transaction, Mr. Hill refused to pay further on the purchase price and demanded that the company be turned over to him for $80,000. Mr. Hill threatened to have the insurance examiners called in to examine the affairs of Providers. Mr. DeBuchananne refused to sell on Mr. Hill's terms and was obliged to bring Mr. Merritt in with him in order to raise the cash necessary to effect the $80,000 repayment (Pt. 13, R. 6679–6681).

[35] Pt. 13, R. 6682.

[36] Pt. 13, R. 6619, 6683.

[37] Pt. 13, R. 6619, 6620. In a subsequent official examination report which Mr. Herndon submitted to the Kansas Insurance Department this item was reported as "legal expense" without qualification or explanation (pt. 13, R .6620).

Mr. GESELL. Now, why was the check drawn to Mr. Willbrand's order?

Mr. HOLT. Mr. Herndon didn't want the records of the company to show that he received a commission in this reinsurance matter.

Mr. GESELL. Did he so state that to you?

Mr. HOLT. He stated that in a directors' meeting.

Mr. GESELL. And accordingly the check was made payable to this attorney?

Mr. HOLT. That is right.

Mr. GESELL. Did the directors approve of that procedure?

Mr. HOLT. Yes.

Mr. GESELL. How did that transaction appear on the books of the company?

Mr. HOLT. I don't recall. I imagine it was charged to the legal expense.

After the assets of Providers Life had been taken over pursuant to the reinsurance contract, it was found that they had been miscalculated and were deficient in the amount of $124,000. In addition certain securities in the Providers assets taken over pursuant to the contract were of poor quality and would have been found to be practically worthless if they had been inspected at the time in good faith. Of particular importance in this connection were certain mortgages on property in southeastern Missouri which came into the Federal Reserve portfolio at a valuation of $246,000. These mortgages were in the names of Negro straw men and when valued at the time of the Federal Reserve failure were written down by over $100,000.[38]

Immediately after the reinsurance of Providers, the Federal Reserve Life began to rewrite the Providers' policies in order to get them on a basis more favorable to itself. The rewriting contract was given to the Federal Agency Investment Co., which, it will be remembered, was owned by Mr. Gregory, president of Federal Reserve. The Agency Investment Co. employed Mr. E. W. Merritt, Jr., to do the rewriting. Commissions in the amount of $108,420, taken out of the reserve belonging to Providers' policyholders, were paid to the Agency Investment Co. for rewriting the business; of this amount Mr. Merritt got 85 percent; the Federal Agency Investment Corporation got 10 percent, and Mr. Herndon got approximately 5 percent.[39] Mr. Vernon B. Holt, formerly an officer and director of Federal Reserve Life, was questioned as to the reasons for Mr. Herndon's participation in this commission:[40]

Mr. GESELL. That $5,000 was in addition to the nine thousand five hundred odd dollars he got through the Willbrand transaction, was it not?

Mr. HOLT. Yes.

Mr. GESELL. Now, what did Mr. Herndon do to earn this $5,000?

Mr. HOLT. He got the insurance department of Kansas to approve the rewrite contract.

Mr. GESELL. That was the quid pro quo?

Mr. HOLT. Yes, sir.

Mr. GESELL. How do you know that, Mr. Holt?

Mr. HOLT. Well, I was active, with Mr. Gregory, in the management of the company and I had a thorough knowledge of that 5 percent.

Mr. GESELL. Were you present when the bargain was made? Did you hear Mr. Herndon say that that was what he would do for this quid pro quo?

Mr. HOLT. No; I don't recollect being present. It was just common knowledge between Mr. Gregory and myself.

[38] Pt. 13, R. 6620, 6621, 6651, 6681, 6682.

[39] Pt. 13, R. 6621, 6623, 6624, 6683.

[40] Pt. 13, R. 6623.

Mr. GESELL. Did Mr. Gregory tell you that?

Mr. HOLT. Yes.

Mr. GESELL. Did you talk to Mr. Herndon about it?

Mr. HOLT. I even gave him some checks from the agency on part of that commission.

Mr. GESELL. You remember giving him the checks?

Mr. HOLT. Yes.

Mr. GESELL. But did you talk to him about why he was getting it?

Mr. HOLT. Yes.

Mr. GESELL. What did he say?

Mr. HOLT. I don't remember. I know I talked to him, of course, but I can't remember any conversation like that.

Mr. GESELL. And you know from your acquaintance and transactions with Mr. Gregory and Mr. Herndon at that time that was the reason why he received this 5-percent participation.

Mr. HOLT. That is right.

Mr. DeBuchananne assisted Mr. Merritt with the rewriting work and was in charge of about 15 agents concentrating on the policy transfers in and around Chicago. He split a percentage of the commissions with Mr. Merritt.[41] Some policyholders involved in the operation complained. The reasons for these "kickbacks" as they were called were made apparent in a letter Mr. D. H. Holt wrote Mr. Merritt at the time. The letter stated in part:[42]

The representative in the field, as a rule, is interested only in the present and in his commission in the immediate placing of business. The transfer men are no exception to this rule. They are anxious to place a large number of new policies each day for the purpose of making the daily earnings more attractive. If they can put it over without a proper discussion of the principles back of it, they want to do that because it is traveling the road of least resistance. But this is where trouble for the Federal Reserve Life Insurance Co. begins.

We have them (Providers' policyholders) now coming into the office, telling us stories of seeming duress and without any knowledge of what the change means to them. These people, as a unit, believe that the management of the Providers has been to rob them of their rights and of their cash, and they believe that this transfer is the last stroke to take their money away from them and to put them in a position where their insurance will not be effective.

Some of the agents will go into a home with the policy of some member of the family, and if this policyholder be not present the agent will require some other member of the family to get the policy, get that member of the family to sign the cash surrender certificate, to sign all other papers in connection with the transfer take up the old policy, leave the new one, and return the case to the office here as a completed case and congratulating himself on the fact that he made a sale. Then the next day in comes the irate policyholder and states that the whole process was one of duress and he demands that the old policy be returned and that his status as before be established. I fear this process is being done in a more general

[41] Pt. 13, R. 6683, 6684. Mr. Merritt misrepresented the terms of his contract with Federal Agency Investment Co. to his associate, Mr. DeBuchananne, who understood that Mr. Merritt had only a 30-percent contract when in fact he had an 85-percent contract. Mr. DeBuchananne received a 3.75- or 4-percent commission. *Ibid.*

[42] Pt. 13, exhibit No. 1348–4.

way than is indicated by the specific case which turned up here at the office, and if it is sometime down the line, we may have serious trouble with these people whose policies have been taken up and new policies, by unauthorized signatures of people whom the agents know are not legally qualified to sign same.

This work can be done in the right way, and if it is, there will be scarcely any comeback and this is the way we want it done. Yesterday we had a case where the policy of Pavil Gofron, 2617 West Haddon Street, was brought into the office by a son. This young fellow said his father was very irate and wanted his old policy returned. He said the agent forced his mother to give up the old policy, the father's policy, in his absence—and sign all the papers. * * *.

The Providers rewrite was not unduly hindered by these objectors, however, and was completed in due course.

In November 1926 the Federal Reserve reinsured the business of the Union National Life Insurance Co. of Kansas City, Kans., another company which Mr. Gregory had organized. After it had been in business only a few years, Mr. Gregory had attempted unsuccessfully to merge it with the Federal Reserve. In this connection a third issue of 10,000 shares of Federal Reserve stock was authorized; 2,000 shares of this stock were issued to Gregory and others, and 8,000 shares were distributed to stockholders of Union National in exchange for their Union National stock. The Federal Reserve stock was issued on the basis of $15 a share, and it was planned that it should be trusteed following the exchange and sold to policyholders in the same manner as the first two issues. On the completion of the exchange the two companies were to be merged. At this juncture, however, the Kansas Insurance Department announced that such a merger was illegal under the Kansas statutes, and required that the exchange of stock be reversed and the affairs of the companies unscrambled.[43]

This left the Federal Reserve with 8,000 unsold shares of stock. They were promptly sold to Mr. Gregory for $10 a share.[44] A plan was then devised for Federal Reserve to reinsure the business of the Union National. In furtherance of this plan, Mr. Gregory personally exchanged Federal Reserve stock, at a valuation of $50 a share, for the stock of Union National. The stock for which he got $50 a share was the same which he had just bought from his company, Federal Reserve, for $10 a share.[45]

Although the Kansas Insurance Department had refused to approve the Federal Reserve-Union National merger, it interposed no objection to a proposal that the companies be consolidated through reinsurance. Mr. Herndon was very active at the time in assisting Mr. Gregory to work out these transactions. On November 26, 1926, Mr. Gregory wrote Mr. Herndon a letter which accompanied 1,000 shares of Federal Reserve stock. In this letter Mr. Gregory stated it was agreed that he might repurchase the shares before July 1, 1927,

[43] Pt. 13, R. 6621–6628.

[44] Pt. 13, R. 6626. Gregory did not have the $80,000 necesary to pay for the stock, so he borrowed $40,000 from a bank and gave the Federal Life four checks for $10,000 apiece for the other $40,000. These checks were carried by the company, as cash, until several months later when Gregory was able to make them good. Id.

[45] Pt. 13, R. 6627.

at $25 a share, or $25,000.[46] The record is not entirely clear on the consideration prompting this payment. Mr. Vernon B. Holt who wrote the letter for Mr. Gregory and who was present at the time the agreement was made between Mr. Gregory and Mr. Herndon testified that it was in consideration of Mr. Herndon obtaining the approval of the Kansas Insurance Department to the reinsurance agreement.[47] Mr. Herndon, on the other hand, though testifying that he was unable to recall definitely the circumstances surrounding the transaction said he assumed it had relation to expert assistance which he rendered Mr. Gregory in working out the arrangement for reinsurance and the unscrambling of the previous attempt at merger. He denied that the payment had any relation to influence which he was in a position to bring to bear on the Kansas Department and that he had no conversations with the Kansas Insurance Department in this connection.[48] It is clear, however, that Mr. Gregory did repurchase 500 of the 1,000 shares for $12,500 and that Mr. Herndon sold the remaining 500 shares for $10,000, thus realizing from the transaction a total sum of $22,500. Accounting for the Herndon payment as an expense, Mr. Gregory's profit on the Union National transaction was $80,000.[49]

In 1927 Mr. Gregory became ill and was unable to attend to the business of the company. Mr. Herndon, with the knowledge of the Holts, undertook to "broker" the company. In his search for men who would be willing to make the necessary investment, he first went to the Royal Union Life Insurance Co. of Des Moines, Iowa. He had reinsured other companies into the Royal Union in the past and was able to obtain a proposal which, however, did not meet the requirements of the Holts and which fell through partly for this reason and partly because the Royal Union wished to move the home offices of the company from Kansas to Des Moines, Iowa.[50]

It was at this juncture that Mr. E. W. Merritt, Jr., and Mr. Massey Wilson were brought into the negotiations.[51] Mr. Merritt, who will

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[46] Pt. 13, R. 6628. This letter read in its entirety as follows (pt. 13, R. 6629):

Colonel W. K. HERNDON *City.*

DEAR COLONEL HERNDON: I hand you herewith 10 certificates of capital stock of the Federal Reserve Life Insurance Co. numbered as follows, to wit: 1110, 1111, 1112. 1113, 1114, 1115, 1116, 1117, 1118, 1119, each for 100 shares—total 1,000 shares.

Said certificates stand on the books of the Federal Reserve Life Insurance Co. in my name, but said certificates have been signed in blank by me.

Said certificates shall be returned to me by you and shall remain in my possession until July 1, 1927, and then they shall be delivered to you. However, I am to have an option on these shares from you at the said date—July 1, 1927—at the price of $25 a share.

If for any reason I cannot raise the money at that time to take up all the said shares, you are to deliver to me, at the said price of $25 a share, all the said shares for which I can pay you, and then I am to have an option on any remaining shares, at the price of $25 a share, if I can arrange satisfactorily to you the payment for my remaining shares.

Sincerely yours,

W. H. GREGORY.

[47] Pt. 13, R. 6628.

[48] Pt. 13, R. 6712, 6713.

[49] Pt. 13, R. 6629, 6712.

[50] Pt. 13, R. 6634, 6635, 6720-6725; exhibit No. 1348-7. Mr. Herndon testified that at one time he was "bird-dogging" for Royal Union trying to find companies they might reinsure and that he was compensated by a salary contract which guaranteed him $50,000 at the rate of $1,000 a month and expenses of $35 per diem (pt. 13, R. 6730-6732). Several years later Mr. Herndon became chairman of the executive committee of Royal Union. The company was on the verge of receivership and extravagant expenditures were being closely watched by the insurance commissioner. The submission of a voucher for $1,902.32 to cover Mr. Herndon's expenses for medical treatment precipitated the receivership (pt. 13, R. 6755).

[51] Pt. 13, R. 6634, 6635, 6690, 6723.

be recalled as an old associate of Mr. DeBuchananne in transactions which have been previously described, was at this time owner of the Reserve Co. of Kansas City, Kans., a holding company which owned 100 percent of the stock of United States Reserve Life Insurance Co. Mr. Wilson, who will be recalled as a principal officer of the International Life of St. Louis, had sold out his interest in that company for one-half a million dollars profit after it had successfully completed approximately 20 reinsurance transactions and was at the time engaged in building up another "great company" operating through a holding company known as Insurance Investment Corporation.[52]

Mr. Herndon conferred with Mr. Merritt in January 1928, and after some negotiation Mr. Merritt agreed to purchase 8,000 shares of Federal Reserve stock for $375,000. These 8,000 shares were made up of two blocks, a block of 5,000 shares which was owned by Mr. Gregory, and a block of 3,000 shares which was held by Mr. D. H. Holt as trustee awaiting possible future sale to Federal Reserve policyholders. In order to put over the deal it was necessary to persuade Mr. Gregory to dispose of his 5,000 shares. In addition Mr. Gregory was still the beneficiary of the exclusive agency contract which had been made out in his favor and it was not expected that Messrs. Wilson and Merritt would be willing to buy into the management of the Federal Reserve unless this contract could be canceled. Mr. Herndon discussed the matter with Mr. D. H. and Mr. V. B. Holt, who agreed for a price to undertake to persuade Mr. Gregory to give up his interest in the block of 5,000 shares and to cancel his contract.[53] Mr. V. B. Holt described his activities in this connection as follows:[54]

Mr. GESELL. And I suppose the proposition was to get Mr. Gregory to let go of his shares.

Mr. HOLT. That was it.

Mr. GESELL. Will you tell us what took place in that connection?

Mr. HOLT. I went to Mr. Gregory's every day for months while he was ill. Finally we determined, Mr. Herndon and I determined, that I would tell him that the insurance department demanded his resignation, demanded that he give up his general agency contract, and that he sell 5,000 shares of his stock.

Mr. GESELL. You mean to say that Mr. Herndon told you to tell that to Mr. Gregory?

Mr. HOLT. That is right.

Mr. GESELL. Did you tell that to Mr. Gregory?

Mr. HOLT. Yes.

Mr. GESELL. Who was with you at the time?

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[52] Mr. Wilson sold International Life to a group which operated the company for 2 years and then sold the company in turn to a Mr. Toombs who took $5,600,000 of the company's money and caused it to fail. Mr. Toombs was convicted and Mr. Wilson appointed receiver (Pt. 13, R. 6701).

[53] Pt. 13, R. 6634, 6635, 6720–6726. In this connection Mr. Massey Wilson testified (Pt. 13, R. 6690):

"Mr. GESELL. Was it not at your instance that arrangements were made to get Mr. Gregory out of his contract with Federal Reserve?

"Mr. WILSON. Yes; I think before I was willing to go in as president I wanted that contract of Mr. Gregory's out of the way somehow, and there were negotiations about it.

"Mr. GESELL. You told Herndon that you wanted Gregory out of the way before you would buy in on the stock?

"Mr. WILSON. Before I was willing to loan the money on the stock I wanted that contract canceled.

"Mr. GESELL. Why was that?

"Mr. WILSON. It was a burden on the business, and with it out of the way it left the business that much more profitable to the company. The company had that much better chance to win with it out of the way."

[54] Pt. 13, R. 6636.

Mr. HOLT. Nobody.

Mr. GESELL. You went and saw Mr. Gregory alone?

Mr. HOLT. That is right.

Mr. GESELL. Did you tell him Mr. Herndon had told you the Insurance Department wanted him out of the picture?

Mr. HOLT. Yes.

Mr. GESELL. Mr. Herndon was at that time interested in this deal?

Mr. HOLT. That is right.

Mr. GESELL. What did Mr. Gregory say?

Mr. HOLT. Mr. Gregory said—he wanted to know what I was going to get out of it.

Mr. GESELL. Did you tell him?

Mr. HOLT. No * * *.

Mr. Gregory agreed to sell out his stock interest and to cancel his agency contract provided he could continue to receive the renewal commissions provided thereunder.[55]

Having obtained Mr. Gregory's consent the transaction was consummated. Three hundred and seventy-five thousand dollars represented by notes in the amount of $90,000 and cash in the amount of $285,000 was received from the Reserve Co., which, it will be recalled, was owned and controlled by Mr. E. W. Merritt, Jr. This sum was divided as follows:

To W. H. Gregory for 5,000 shares	$60, 000
To D. H. Holt for 3,000 shares	60, 000
To Vernon B. Holt and D. H. Holt as commission[56]	140, 000
To W. K. Herndon as commission	115, 000
Total[57]	375, 000

Coincident with the transaction Mr. Gregory resigned as president of Federal Reserve, his exclusive agency contract was canceled and Mr. E. W. Merritt and Mr. Massey Wilson became officers of the company at salaries of $18,000 and $7,500 per annum, respectively.[58]

It is of interest to trace the manner in which the Reserve Company obtained the money necessary to purchase this substantial stock interest in Federal Reserve. First it was arranged that its subsidiary, the United States Reserve Life Insurance Co., would sell mortgages to Federal Reserve for $107,0^0 and in this fashion cash became available to the United States Reserve Life Insurance Co., which enabled it to lend slightly over $100,000 to the Reserve Corporation.[59] In addition, the Reserve Co. borrowed $125,000 from Mr. Massey Wilson, who loaned this amount against the 8,000 shares as collateral. The sum loaned by Mr. Wilson was advanced in part from the Insurance Investment Corporation and the Reserve Co.'s note for $125,000, together with the 8,000 shares, passed to the Insurance Investment Corporation or one of its subsidiaries, thus bringing the Federal Reserve into common ownership with other life insurance companies

[55] Pt. 13, R. 6636.

[56] Mr. V. B. Holt gave $1,000 of his commission to a Mr. Harden, assistant secretary of Federal Reserve. Mr. Holt testified (pt. 13, R. 6639):

"He conceived an idea that he would like to be able to broker this insurance company, and I told him that if he would just leave it alone I would see that he got a little extra compensation. That was the extra compensation."

[57] Pt. 13, R. 6637, 6639, 6724–6726.

[58] Pt. 13, R. 6639.

[59] Pt. 13, exhibit No. 1348–2.

owned by the Insurance Investment Corporation.[60] An additional sum was obtained by arranging for the Federal Reserve to reinsure the business of the United States Reserve Life Insurance Co., thus enabling Mr. E. W. Merritt, Jr., who was in a position to control both the reinsured and reinsuring company, to obtain a contract to rewrite the policies of the United States Reserve Life. Mr. Merritt received commissions on this rewriting amounting to $83,997.48.[61]

The final and largest Federal Reserve reinsurance deal took place in 1929 when that company reinsured the policies of the Farmers National Life Insurance Co., of Huntington, Ind. This was a prosperous company which operated in five States and had assets in the neighborhood of $3,000,000 and insurance in force of approximately $24,000,000. The opportunity to acquire Farmers National was developed by Mr. Paul L. Temple, who, it will be recalled, had been associated with Mr. DeBuchananne in the North American Co. venture. Mr. Temple learned from a Mr. Presnall, an officer of the Farmers National, that the president of that company, Mr. Billiter, was anxious to dispose of his holdings at a price of $30 a share. Though Mr. Temple did not know Mr. Massey Wilson except by reputation, he telephoned him long distance and received Mr. Wilson's authority to negotiate the reinsurance on his behalf. As the first step in these negotiations a 30-day option in favor of Wilson was obtained for the price of $2,000.[62] In order to purchase control $400,000 was required and this was a sum in excess of that which Mr. Wilson and his associate, Mr. Merritt, were readily able to raise. Accordingly it was decided that Federal Reserve would lend $400,000 to Mr. F. E. Bushman, a Detroit real-estate operator, with the understanding that Mr. Bushman would in turn lend this sum of money to Mr. Wilson and Mr. Merritt to enable them to acquire an interest in Farmers National. The $400,000 loan was made, secured by grossly inadequate collateral and Mr. Wilson and Mr. Bushman went to Chicago to consummate the Farmers National transaction.[63]

During the period of the negotiations Mr. Temple was still in partnership with Mr. DeBuchananne, though Mr. DeBuchananne's association with Mr. Temple had not been revealed to the officials of Farmers National who stated that they were anxious to handle the transaction with responsible people and were not willing to deal with Mr. DeBuchananne or other persons of his ilk. As a result, Mr. DeBuchananne did not participate in working out the details of the reinsurance arrangement. Just prior to the completion of the formal papers, however, he declared himself in and shared commissions with Mr. Temple and Mr. John V. Sees, a director of the company and personal attorney for Mr. Billiter. Mr. Sees' participation in the arrangements was limited to the preparation of a letter to stockholders offering tc purchase their shares. Messrs. Temple, DeBuchananne and Sees each received a $27,000 commission from Mr. Wilson.[64]

60 Pt. 13, R. 6689, 6690. Having obtained access to the Federal Reserve stockholders' lists, Mr. Wilson was able to acquire additional shares of Federal Reserve stock by arranging for employees of Insurance Investment Corporation to approach Federal Reserve stockholders and switch them into preferred stock of Insurance Investment Corporation or purchase their holdings outright (pt. 13, R. 6690, 6691).

61 Pt. 13. exhibit No. 1348-2.

62 Pt. 13, R. 6738, 6739.

63 Pt. 13, R. 6641, 6647, 6648.

64 Pt. 13, R. 6739, 6740. Mr. Temple gave $1,500 of his commission to Mr. DeBuchananne's brother, George, who had not had any participation in the Farmers National negotiations (p. 13, R. 6741).

Immediately after Mr. Wilson and Mr. Merritt acquired control of the Farmers National, Mr. Merritt was made its president and shortly thereafter the company was reinsured into the Federal Reserve. Presumably to compensate Mr. Bushman, an arrangement was worked out appointing him an investment agent for Federal Reserve, which undertook to lend $1,750,000 on mortgages provided by Mr. Bushman. It developed at the time the company failed that losses of over one and a quarter million dollars were suffered on mortgages subsequently submitted by Mr. Bushman under this arrangement, which included mortgages made on properties in which he was personally interested.[65]

In addition to these various reinsurance transactions, other examples of mismanagement of the company were disclosed. Some of these examples may be mentioned briefly. It appeared that the company had failed to maintain a sufficient reserve deposit with the treasurer of the State of Kansas as required by Kansas law; that many improper mortgage loans had been made; that salary was paid to an officer of the company during a time he was not fulfilling the functions of his office; that numerous offices had been created and salaries paid to officers far in excess of the value of the services rendered; that large company balances were maintained in certain banks where officers of the company were heavily indebted personally; that $50,000 borrowed by the company was concealed on its books and records; that mortgages were released without collecting interest in full; that records were inaccurately and carelessly kept; and that a fee of $15,000 had been paid to an attorney who rendered no service to the company.[66]

One of the most striking features of the Federal Reserve failure was the laxness of State supervision and the extent to which mismanagement was able to continue under the very eye of representatives of the State insurance departments. It appeared that during the time from January 17, 1921, to April 1929, 7 separate and distinct examinations of the affairs of the company were made either by the Kansas insurance department acting alone or with representatives of a group of States in convention. In 6 instances these examinations were in charge of Mr. W. K. Herndon, special examiner for the Kansas department.[67] Mr. Herndon had had considerable experience as an insurance examiner, having represented the departments of the District of Columbia, Texas, Pennsylvania, Nebraska, Indiana, Wyoming, and Colorado, as well as Kansas.[68] There can be no question from the testimony that he was more interested promoting his personal advantage than he was in examining the affairs of the Federal Reserve to determine whether or not the interest of the policyholders were safeguarded and the laws of the State of Kansas complied with. The evidence reviewed above discloses that he received over $160,000 from transactions directly involving the Federal Reserve and other evidence introduced in the record made it clear that he was paid sums ranging as high as $50,000 for handling reinsurance transactions

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[65] Pt. 13, R. 6694, 6703, 6704. Mr. Wilson testified that this contract was sufficient to absorb all investment requirements of Federal Reserve and that in effect it made Mr. Bushman the company's investment agent. Mr. Wilson had had close business relations with Mr. Bushman prior to the execution of this contract (p. 13, R. 6694).

[66] Pt. 13, R. 6654–6657; exhibit No. 1348–3.

[67] Pt. 13, R. 6610, 6709.

[68] Pt. 13, R. 6708.

during this same period for other life insurance companies.[69] In fact, Mr. Herndon testified that in the period from 1920 to 1928 he had procured from 15 to 20 reinsurance deals and that he had gained information which was of assistance to him in this connection by reason of his access to company records as an official examiner for the Kansas Department.[70] He testified that his superior, Mr. William R. Baker, Commissioner of Insurance for the State of Kansas, had no knowledge of his personal transactions, and as has been indicated, Mr. Herndon was careful not to disclose these transactions in the official reports which he rendered on the company's activities.[71] The evidence disclosed, however, that Commissioner Baker was reelected several times during his incumbency partly through the efforts of Federal Reserve which campaigned on his behalf and it is clear that the Kansas insurance department treated the examination of the Federal Reserve in a perfunctory manner, being willing on occasions to accept reports from Mr. Herndon when these reports had been prepared for his private purposes and not commissioned as examinations to be made for the specific purpose of checking the company's activities.[72] It is also interesting to note that the Federal Reserve in 1929 unsuccessfully campaigned for Mr. John B. Smith as commissioner, and with Mr. Baker's retirement at the end of his term, Mr. Charles Hobbs, the present commissioner of Kansas, came into office. Mr. Hobbs had been an actuary in the Kansas department prior to this time and on the basis of information which had come to him from "stool pigeons who were in the company" he

[69] Pt. 13, R. 6618–6620, 6622, 6623, 6628, 6683, 6711, 6712, 6715, 6716, 6731.

[70] Pt. 13, R. 6729, 6730. Mr. Herndon testified in this connection (pt. 13, R. 6719, 6720):

"Mr. GESELL. And do I understand your position to be that the fact that you were also interested in the promotional activities of the company would be of no importance, provided your reports were fair and complete and accurate in every respect?

"Mr. HERNDON. That is right.

"Mr. GESELL. Is it your experience that that dual activity of insurance examiners is rather a frequent situation?

"Mr. HERNDON. Rather frequent, I would say; yes.

"Mr. GESELL. You found there were other examiners that were having personal transactions on the side as well as yourself?

"Mr. HERNDON. Yes; they only worked occasionally for these States.

"Mr. GESELL. As a matter of fact, I suppose these commissions you received in the Provider deal were far more lucrative than any per diem you received for the examination itself in the Kansas department.

"Mr. HERNDON. Much more so.

"Mr. GESELL. I was even wondering why you wanted to fool with the examinations.

"Mr. HERNDON. There is always that in-between time when we have to have bread and butter.

"Mr. GESELL. Yes; and then I suppose also you get to find out quite a lot about what companies are for sale and what companies are in difficulty if you are going around for the Kansas department examining them.

"Mr. HERNDON. Certainly you know all about the company you are examining and you hear about many others.

"Mr. GESELL. Did you quite frequently find that as a result of your entree to a company as the representative of the Kansas department you were able to set in motion a series of transactions which turned out to be to your personal benefit?

"Mr. HERNDON. No; I don't recall that generally.

"Mr. GESELL. It certainly happened here, did it not?

"Mr. HERNDON. Yes.

"Mr. GESELL. Were there any other companies? What about some of these Kansas companies you reinsured in the Royal Union, the same kind of situation there, wasn't it?

"Mr. HERNDON. Very largely so."

[71] Pt. 13, R. 6619, 6728, 6729. Mr. Herndon testified that he had some of his information "unofficially" and saw no reason for putting it in his official reports to the State (pt. 13, R. 6729).

[72] Pt. 13, R. 4719.

had knowledge of some of the transactions which have been reviewed above. Accordingly, he initiated a special examination of the Federal Reserve which was conducted by representatives of the Kansas department in conjunction with the representatives of the Kansas, Missouri, Illinois, and Indiana departments.[73] In spite of gross irregularities revealed by this examination the report was suppressed and not made public until the hearings before the Temporary National Economic Committee. A superficial change of management was made at the suggestion of the Kansas department following the examination. Messrs. Wilson and Merritt resigned as officers but were allowed to retain their stock control of the company.[74] The preferential loan agreement with Mr. F. E. Bushman remained in effect and Mr. F. E. Bushman's son, Mr. Frank Bushman, became president of the company, which continued in business. Another examination was made by the insurance department in 1933. This examination again revealed mismanagement but the report was also suppressed and no action was taken by the State commissioners to put the company into receivership. It was not until 1936 that a receivership was obtained in a Federal court action. After an expensive receivership the company was reinsured in the Occidental Life Insurance Co. with a lien of 50 percent on its reserves. The indicated initial loss to policyholders was $2,690,000.[75]

B. MISSOURI STATE LIFE INSURANCE CO. AND AFFILIATED COMPANIES

The failure of the Federal Reserve was but 1 of 19 life insurance company failures during the period from 1930 to 1939, each of which resulted in an indicated initial loss to policyholders of over $1,000,000 and, as has been indicated, but 1 of 39 company retirements during this period which brought a loss to policyholders.[76] The largest failure involved the 3 interrelated receiverships of the Intersouthern Life Insurance Co. of Louisville, Ky., The Security Life of America of Chicago, Ill., and Missouri State Life Insurance Co. of St. Louis, Mo., which resulted in a combined indicated initial loss to policyholders of $51,224,000.[77] The history of these failures is one of financial manipulation. Some of the more important transactions are reviewed below: [78]

The series of events which led to these failures may best be described by commencing with the organization of Caldwell & Co., on September 26, 1917. Caldwell & Co. was incorporated under the laws of

[73] Pt. 13, R. 6615, 6645, 6658, 6659.

[74] Pt. 13, R. 6644, 6645. Mr. Wilson contributed approximately $300,000 to surplus at about this time. This money was immediately loaned out under the Bushman contract. Mr. Wilson had business interests with Mr. Bushman at the time (pt. 13, R. 6646, 6694–6696).

[75] Pt. 13, R. 6644–6659, 6692, 6693; pt. 28, exhibit No. 2336. A civil suit was brought against various principals in the Federal Reserve transactions but was settled out of court. As to Mr. Herndon, the matter was settled for $5,000 (pt. 13, R. 6652, 6653).

[76] Op. cit. supra, note 3 at p. 102; pt. 28, exhibit Nos. 2336, 2338.

[77] Pt. 28, exhibit No. 2336; The Intersouthern Life Insurance Co. with assets of $22,201,913 and insurance in force of $111,396,660 went into receivership on April 16, 1932. The Security Life of America, with assets of $10,456,993 and insurance in force of $62,270,054, went into receivership on April 18, 1932. The Missouri State Life with assets of $155,248,182 and insurance in force of $673,776,412 went into receivership on August 28, 1933.

[78] The statement which follows is based upon an inquiry conducted by an attorney attached to the staff of the commission who made a special study of available records relating to the failures. Practically all information set forth herein is a matter of public record.

Tennessee for the purpose of dealing in stocks and bonds.[79] All of its capital stock was owned by Mr. Rogers Caldwell. During its early history it was active in handling municipal bond issues.

Caldwell & Co. became interested in the life insurance business as early as 1923.[80] In 1926 a syndicate consisting of Caldwell & Co., Fourth and First National Co. and the American National Co. was formed to purchase the control of Missouri State Life Insurance Co. The Fourth & First National Co. was a security affiliate of The Fourth & First National Bank of Nashville, Tenn., which in turn was controlled by Mr. James E. Caldwell, the father of Mr. Rogers Caldwell. The American National Co. was a security affiliate of the American National Bank of Nashville, Tenn., which was controlled by a Mr. Paul Davis.[81]

At this time the outstanding capital stock of Missouri State was 200,000 shares, par value of $10 per share. 86,000 shares were owned by the president, Mr. M. E. Singleton, and his family. During February 1926, Mr. Rogers Caldwell acquired the holdings of the Singleton family and other holdings totaling 148,000 shares.[82] The purchase price was $100 per share for the Singleton stock and $75 per share for other stock. An earnest money deposit of $2,000,000 was put up by Mr. Caldwell, each member of the syndicate furnishing one-third of the cash required. The stock received was pledged with a New York bank to guarantee full payment.[83]

To raise its share of the earnest money and for incidental expenses, Caldwell & Co. borrowed $1,190,000 from Missouri State,[84] the very company whose shares were being purchased.

The 148,000 shares of Missouri State stock acquired by the syndicate were placed in the Insurance Securities Corporation, a holding company organized January, 1927. Capital stock of this holding company consisting of 2,250 shares was divided equally between the three members of the syndicate.[85] On February 1, 1927, Insurance Securities Corporation issued $11,250,000 of 1-year notes and pledged

[79] Minute book containing minutes of meetings of board of directors of Caldwell & Co.

[80] In 1923 Caldwell & Co. entered the life insurance field through the purchase of the Cotton States Life Insurance Co. of Memphis, Tenn., a small company with insurance in force of about $8,000,000. In 1925 it acquired the North American Life Insurance Co. of Omaha, Nebr., a company with $13,000.000 of insurance in force.

[81] Price, Waterhouse & Co. audit report of Insurance Securities Corporation, dated June 30, 1928.

[82] Price, Waterhouse & Co. audit report of Caldwell & Co., dated June 30, 1926.

[83] Price, Waterhouse & Co. audit report of Insurance Securities Corporation, dated June 30, 1928.

[84] The records of Missouri State indicate that two collateral loans were made to Caldwell & Co. on February 15, 1926, one loan for $740,000 secured by 295,452.62⅞ shares of stock of the Inter-Southern Life Insurance Co., and another for $450,000 secured by 99,662 shares of North American National Life Insurance Co. stock.

Minutes of the executive committee of Missouri State, which was composed of Mr. M. E. Singleton and two other directors, reflect the approval of the $450,000 loan on February 16, 1926. On that date, however, Caldwell & Co. owned no Inter-Southern stock. The $740,000 loan is not shown in the minutes until the application appears on the minutes of April 14, 1926. These minutes show that Mr. Ben C. Hyde, superintendent of insurance for Missouri, was invited to the meeting and after a conference with him the loan of $740,000 to Caldwell & Co. was approved. The executive committee on April 14 was composed of Messrs. M. E. Singleton, Rogers Caldwell, J. S. Smith, Paul M. Davis, and Hillsman Taylor. Mr. Davis was president of American National Co. and Mr. Taylor was executive vice president of Missouri State and formerly an officer of other Caldwell-controlled companies.

These loans were made despite the fact that the bylaws of Missouri State specifically prohibited loans to officers or directors, whether made directly or indirectly. Section 26 of the bylaws of Missouri State Life Insurance Co. stated:

"No director or officer of the company shall directly or indirectly borrow the funds of the company or use the same except to pay losses and other obligations and expenses incurred by the company."

[85] The American National Co. sold its interest in Insurance Securities Corporation to Caldwell & Co. and Fourth & First National Co. in 1927 and its 750 shares were retired by cancelation.

the 148,000 shares of Missouri State stock as security, placing them with the First Savings Bank & Trust Co. of Chicago as trustee under the 1-year no es.[86] Coincident with this transaction, the balance of the purchase price was paid and Mr. Singleton retired from the presidency of Missouri State.[87] Mr. Hillsman Taylor was installed as president in his stead.[88]

Shortly after the syndicate purchase of Missouri State in 1926 the investment policy of that company shifted sharply from real estate mortgages to bonds and other securities. The majority of the bonds purchased by Missouri State during the period from 1926 through 1938 were obtained from sources closely allied to its ownership. Its total bond purchases from Mr. Rogers Caldwell, Mr. J. E. Caldwell, and their affiliates amounted to $26,887,544, or 60.5 percent of the total bonds purchased during this period. Many of these securities were purchased at a price higher than their current market price.[89]

The Missouri State was examined jointly as of the end of 1927 by the insurance departments of Illinois, Kentucky, Tennessee, and Missouri. The report of examination contained criticism of the company for purchasing such a high percentage of bonds from the Caldwell interests. Nevertheless, no action was taken to recover the excess payments and no action except the mild criticism contained in the report was taken to stop the practice, which continued.[90] In 1930 the company was examined again and the report of examination repeated the criticism. In later court proceedings when Mr. Hills-

[86] Testimony of Timothy Donovan and exhibit 30 in *General American Life Insurance Co.* v. *A. M. Anderson, Receiver of National Bank of Kentucky* (cited hereafter as Bank of Kentucky Case).

[87] Minute book containing minutes of meetings of board of directors of Missouri State Life Insurance Co.

[88] Taylor was made executive vice president when Caldwell acquired control. Previously he had been president of Cotton States Life. During this same year the capital stock of Missouri State was increased 100,000 shares. Stockholders were given an option to purchase one share for each two shares held at a price of $10, the par value. Under this option Insurance Securities Corporation purchased an additional 73,300 shares. In 1928 an additional 100,000 shares of Missouri State were issued. Under this issue stockholders were given an option to purchase one new share at $20 for each three shares held. The bulk of these new stock purchase rights, of course, accrued to Insurance Securities Corporation which increased its holdings proportionately. About this same time Insurance Securities Corporation sold 125,000 shares of Missouri State stock to Caldwell & Co. and Kidder Peabody Co., who were members of a joint account to sell and distribute such stock. Because of the stock purchased under the stock-purchase rights, however, Insurance Securities still retained control of Missouri State.

[89] Bond purchases by Missouri State Life Insurance Co. from certain vendors and total purchases from all sources for the years 1926 through 1930 as indicated below:

	Caldwell & Co.	Rogers Caldwell & Co.	Fourth & First National Co.	Nashville Trust Co.	Total purchases
1926	$148,389.72				$2,224,076.30
1927	4,454,216.94		$2,628,507.81		12,958,531.13
1928	7,391,313.08		3,852,900.72		13,637,610.05
1929	4,214,170.28		1,523,937.21		9,293,624.74
1930	1,111,513.73	$226,425	926,470.48	$409,699.68	6,324,842.09

[90] The preliminary report of this examination stated:

"As the amounts paid (for bonds) did not always agree with the current market value * * * your examiners secured * * * as accurate market prices for these bonds as of the date of purchase as can be obtained from the data at hand, and when these prices were applied to the individual bond purchases, the (net) overpayment above market price was $25,946.96."

man Taylor was questioned concerning these bond purchases from Caldwell & Co. and other associated enterprises, he stated: [91]

> I have never yet seen where a man should not trade with his friends as long as he gets as much value from them as he does from anyone else and the fact that Caldwell & Co. were interested in here was no reason that they should not do—that the purchase should not be made from them. I tried to deal with them just as I did with anyone else; they had been my friends; I had been their friend and because the insurance department criticized the purchase I did not see it was any reason why you should turn your back on your friends and go to somebody that you are not interested in.

Several other transactions which took place during this period deserve special notice particularly as they contributed in various ways to the ultimate failure of Missouri State Life. In connection with Caldwell & Co.'s early activities it had handled municipal bonds under depository agreements through which the purchaser agreed that the proceeds from the sale of bonds were left on deposit in banks acceptable to Caldwell & Co. until the funds were used to pay for actual construction of the projects being financed. In order to provide a depository for such funds as well as to obtain additional working capital for the expansion of Caldwell & Co., the Bank of Tennessee was incorporated in 1919. The capital stock of this bank was owned by Caldwell & Co.; it occupied the same offices and had the same personnel as Caldwell & Co.; its deposits came to it through bond issues written by Caldwell & Co., or from concerns in which that company had a stock interest. The bank did little if any public banking business.[92] At the time of the failure of Caldwell & Co. in November 1930, Missouri State had deposits in the Bank of Tennessee totaling $870,534.23. Those deposits were secured by certain bonds with a par value of $600,000 and 21,000 shares of the stock of Banco Kentucky Co.[93] The Bank of Tennessee was declared insolvent coincident with the Caldwell & Co. failure and the subsequent receivership of Banco Kentucky Co. and a general decline in the value of the bonds securing the deposit brought about a condition which prevented the bank receivers from being able to pay a dividend to common creditors. As a result, Missouri State lost approximately $700,000 of its deposit with the bank.[94]

In July 1929, Caldwell & Co. in conjunction with Mr. Carey G. Arnett, organized Associated Life Cos., which was authorized to act as a holding company for life-insurance stocks.[95] One of the first companies acquired by Associated Life Cos. was the Southeastern Life Insurance Co. of Greenville, S. C. The purchase of the stock of this company was arranged in the following manner: Caldwell & Co. loaned 120,172 shares of Inter-Southern stock to Associated Life, which the latter company pledged as collateral for a loan of $220,000

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[91] Deposition of Mr. Hillsman Taylor in *Bank of Kentucky case.* Caldwell & Co. made further use of its relation to Missouri State when it placed with it a mortgage on the Woolford Hotel of Danville, Ill. Caldwell & Co. had originally underwritten the bond issue on this property which defaulted and a bondholders' committee consisting of Mr. Rogers Caldwell and two other officers of Caldwell & Co. took over the property. This committee then secured a mortgage loan on the property of $400,000 from Missouri State.

[92] Deposition of Mr. J. D. Carter, p. 5 et seq., *Bank of Kentucky case.*

[93] 1930 Convention Form Annual Statement of Missouri State Life Insurance Co.

[94] Id.

[95] Testimony of Mr. Carey Arnett, *Bank of Kentucky case.*

obtained from outside sources.[96] In addition $383,000 was obtained when Caldwell & Co. caused Inter-Southern Life Insurance Co., which it owned and controlled, to advance this sum against the purchase price.[97] The advances made by Caldwell & Co. to Associated Life Cos. remained unsecured until 1930. At this time Associated Life Cos. borrowed $500,000 from the National Bank of Kentucky. This sum was represented by two $250,000 certificates of deposit in the bank, which certificates Associated Life Cos. turned over to Caldwell & Co. to be held as security against the prior advances. The National Bank of Kentucky was controlled by Banco Kentucky Corporation. Mr. Rogers Caldwell had obtained a 30 percent interest in the capital stock of this corporation several months prior to the National Bank of Kentucky's $500,000 loan to Associated Life Cos. by selling a one-half interest in Caldwell & Co. to Mr. James B. Brown of Louisville, Ky., in return for the 30 percent interest.[98] The certificate of deposit of the National Bank of Kentucky had been turned over to Caldwell & Co. with the written understanding that they were to be cashed only in reduction of the Associated Life Cos'. loan.[99] In spite of this understanding, however, Mr. Rogers Caldwell caused Missouri State to purchase the certificates for their face value of $500,000.[100] The National Bank of Kentucky failed November 1930, and the receiver refused to honor the certificates of deposit which were still held by Missouri State. The issue as to whether the receiver is obliged to honor these certificates remains in litigation at the present time and the ultimate loss to Missouri State and its policyholders from these transactions cannot now be determined.

Reference has already been made to the fact that Caldwell & Co controlled Inter-Southern Life Insurance Co. Its interest in this company was acquired during the spring of 1926 only a few months after the syndicate purchase of Missouri State. At that time Inter-Southern Life Insurance Co. had assets of $12,803,381 and insurance in force of $104,671,425. It was capitalized at $750,000 represented by 750,000 shares of $1 par value. Caldwell & Co. purchased 356,954 shares of this stock at a cost, including expenses, of $760,000 and it was this block which represented a controlling interest in the company.[101] Shortly after coming into the dominant position, Caldwell & Co. installed Mr. Carey G. Arnett as president and arranged for the company to reinsure the business of the Cotton States and the North

[96] Memorandum written by Mr. T. W. Goodloe, secretary, Caldwell & Co., obtained from files of receiver of Caldwell & Co.

[97] 1930 convention form annual statement of Inter-Southern Life Insurance Co.

[98] Contract and supplemental agreements dated May 28, 1938, relating to merger of Caldwell & Co. and Banco Kentucky Corporation.

[99] This is substantiated by the following letter dated August 21, 1930, appearing as exhibit 6 to deposition of Mr. Thomas W. Goodloe in *Bank of Kentucky case:*

NATIONAL BANK OF KENTUCKY,
Louisville, Ky.

DEAR SIRS: You have today granted loan of $500,000 to this company from which proceeds we have purchased two $250,000 certificates of deposit from your bank in the name of Caldwell & Co.

We hereby agree and guarantee that these certificates of deposit will not be cashed only in reduction of the above-mentioned loan.

Yours very truly,

ASSOCIATED LIFE COMPANIES, INC.,
By THOS. W. GOODLOE, *Secretary.*

[100] Exhibits 326, 329, 250, and 333, *Bank of Kentucky case.*

[101] Price, Waterhouse & Co. audit report of Caldwell & Co. dated June 30, 1926.

American National Life Insurance Cos.[102] which it will be recalled were the first two companies acquired by Caldwell & Co. in 1923 when its interest in insurance promotions became apparent.

On April 23, 1930, the executive committee of Inter-Southern authorized the purchase of 116,000 shares of stock of Missouri State at a price of $10,208,000 or $88 a share.[103] Of these 116,000 shares, 80,000 shares were to be purchased from Insurance Securities Co., 22,245 shares directly from Caldwell & Co. and the balance from the Fourth and First National Bank and individuals owning that bank.[104] At this date Caldwell & Co. owned 713,136.29 shares of stock of the Inter-Southern out of a total of 1,250,000 then outstanding.[105]

To finance the purchase of the Missouri State stock Inter-Southern increased its capital stock by over 1,000,000 shares.[106] Of the purchase price $4,988,000 was paid in cash and the balance of $5,220,000 was paid by 1,305,000 shares of Inter-Southern stock transferred on a basis of $4 per share. Inter-Southern did not have enough cash to meet the cash payment indicated above. This defect was cured in the following manner: $4,000,000 of bonds and mortgages from its portfolio were sent on May 21, 1930, to the Nashville Trust Co., of Nashville, Tenn.[107] This bank was a subsidiary of Fourth and First National Bank and acted as collection agent for Mr. Rogers Caldwell and others associated with him in the stock sale.

On May 22, 1930, the executive committee of Missouri State met at Nashville, Tenn., and approved the purchase for Missouri State of mortgage loans in the amount of $1,590,054.59 and bonds with an amortized value of $2,268,263.61 from the Nashville Trust Co.[108] These bonds were the same securities which had been used by the Inter-Southern to pay the Caldwell interests for their Missouri State stock and the Missouri State was thus indirectly financing Inter Southern's purchase of Missouri State stock. The executive committee of Missouri State which approved the purchase consisted of Messrs. Rogers Caldwell, James E. Caldwell, and Hillsman Taylor.

When the bonds and mortgages arrived in St. Louis, the home office of Missouri State, they were examined by officers of the company and it was learned that a number of the mortgages and some of the bonds were in default, in spite of the fact that the purchase price had been computed at par plus accrued interest. The officers became suspicious and presented their views to Mr. Hillsman Taylor, the Missouri State president, who called their attention to a promise of Inter-Southern to enter into an agreement to repurchase any securities on demand within 12 months.[109] This apparently satisfied the Missouri State officers but it did not satisfy some of its directors who demanded a rescission of the purchase.[110] Subsequently a demand to repurchase was made upon both Inter-Southern and Nashville Trust Co., but without success, although no further securities after the first

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[102] Minute books containing minutes of meetings of board of directors of Inter-Southern Life Insurance Co.

[103] Id.

[104] Testimony of Mr. Timothy Donovan, *Bank of Kentucky case.*

[105] Investment ledger sheets of Caldwell & Co. obtained from receiver of Caldwell & Co.

[106] *Op. cit. supra,* note 102.

[107] Minute book containing minutes of meetings of board of directors of Inter-Southern Life Insurance Co. and 1930 Convention Form Annual Statement of the company.

[108] Minute books containing minutes of meetings of board of directors of Missouri State Life Insurance Co.

[109] Testimony of Mr. Allan May, counsel for Missouri State Life Insurance Co., *Bank of Kentucky case.*

[110] Minute book containing minutes of meetings of board of directors of Inter-Southern Life Insurance Co.

shipment of $2,044,647.31 were accepted. On the bonds which were received in the first shipment and which the company was forced to retain, the Missouri State and its policyholders ultimately suffered a tremendous loss.

On the same date that Inter-Southern authorized the purchase of the Missouri State stock it also authorized the purchase of 18,000 shares of Home Accident Insurance Co., 18,000 shares of Home Fire Insurance Co., and 7,300 shares of Home Life Insurance Co. from Caldwell & Co. for an aggregate consideration of $3,877,098.31, of which $2,020,000 was in cash or securities.[111] The three Home companies' stock, which in each instance represented control, had been purchased by Caldwell & Co. in 1929.

The effect of these two transactions by which Inter-Southern acquired the holdings of Caldwell & Co. and its affiliates in Missouri State and in the Home companies, was that Caldwell & Co. was enabled to dispose of these holdings for cash and marketable securities and yet, through ownership of Inter-Southern stock retain control of the companies whose securities were involved. The effect on Inter-Southern was to increase its outstanding stock by 1,843,666⅔ shares and to cause a withdrawal from its portfolio of cash or securities in the amount of $6,845,098.31 and the substitution therefor of stock in other insurance companies. Furthermore, the high valuation of newly issued stock which had a par of $1 and was exchanged at $3.75 and $4 resulted in a write-up of surplus of $5,396,333. On the completion of these transactions Caldwell & Co. owned 1,456,178.21 of the 3,000,000 shares of stock of Inter-Southern then outstanding.

The events of the depression played havoc with the many intertwined business affairs of Caldwell & Co., and it went into receivership on November 13, 1930.

On December 22, 1930, the Keystone Holding Co., of Hammond, Ind., purchased from the receivers of Caldwell & Co. that company's holdings of Inter-Southern stock, carrying with it the actual or potential control of Missouri State, the Southwestern Life, the Home companies, and the Southeastern Life. At this point it will be necessary to review the activities of Mr. Machir Dorsey, president of the Keystone Holding Co.

In 1924 Mr. Machir Dorsey, who was at that time a real-estate promoter and president of Dorsey Land & Lumber Co. of Kansas City, Mo., acquired control of the International Life & Annuity Co. of Moline, Ill. The price of this controlling interest of 12,000 shares which he purchased directly from the company itself was $336,000 and was paid by a note of $120,000 secured by stock of Dorsey Land & Lumber Co. and other notes for $216,000 secured by the stock of the insurance company. Thus Mr. Dorsey secured control of the company without putting up any cash.[112] The next step in Mr. Dorsey's insurance activities was the acquisition of the Cresent Life Insurance Co. of Indianapolis in May 1925. This company which at that time had $316,421 assets and $4,952,950 insurance in force had 15,000

[111] 1930 Convention Form Annual Statement, Inter-Southern Life Insurance Co.

[112] Subsequently the Dorsey Land & Lumber Co. became the Dorsey Co. and the International stock was transferred to it and it assumed the liability on the stock. The Dorsey Co. was also given an agency contract with the International. Mr Dorsey's loan was later reduced by the transfer of a parcel of land from the Dorsey Co. to International and various changes in collateral were made. Objections filed by Mr. Machir Dorsey to findings contained in the report of examination of International Life & Trust Co. by the insurance department of the State of Illinois as of December 31, 1924.

shares of capital stock outstanding. Mr. Dorsey entered into a contract with the owners of a block of 10,000 shares under which contract he was to pay $225,000 for the 10,000 shares. Of this purchase price $95,000 was paid by transferring 1,900 shares of International Life & Trust stock (the name of the International Life & Annuity had been changed to International Life & Trust) and of the remainder $20,000 was paid in cash at the time of the transfer of the stock while notes were given for the balance.[113]

In December 1926 Dorsey and several of his associates, amongst them Mr. C. Edwin Johnson, Mr. Harry Tressl, Mr. Bertram Day, and Dr. J. W. Seids, formed the Keystone Holding Co.[114] and transferred to it the control of the International Life & Trust and the control of the Crescent. Shortly thereafter the Crescent reinsured the business of the International.[115] In 1928 the Keystone Holding Co. purchased the controlling interest, 15,535 shares, in the Northern States Life Insurance Co.[116] Northern States had assets of $4,103,465 and insurance in force of $35,320,809. On March 11, 1929 the business of Crescent Life was reinsured by the Northern States.[117]

In May 1930 the Keystone Holding Co. purchased the controlling stock of the Security Life Insurance Co. of America and the controlling stock of Reinsurance Life Insurance Co. from the New York-Hamburg Corporation.[118] The Security was a Virginia corporation whose home office was in Chicago. On December 31, 1929, it had assets of $9,410,627 and insurance in force of $64,378,924. The Reinsurance Life with assets of $1,945,917 and insurance in force of $65,687,690 was a company doing exclusively reinsurance business. On May 26, 1930, only a few days after Keystone acquired Security, it sold its stock of Northern States to it at a price of $80 a share, a profit to Keystone of about $18 per share.[119] On June 30, 1930, Keystone sold the control of Reinsurance Life to Security for $1,838,-370.28.[120] By these sales Keystone was able to sell its stock in these companies for cash and yet through its holdings of the control of the Security Life retain control over their affairs. It had been planned to merge Reinsurance with Security but for some reason this plan went awry and in 1931 Security, after having bought out the minority stockholders of Reinsurance, sold Reinsurance's business to Lincoln National Life at a tremendous loss.[121]

As has been stated, on December 31, 1930, Keystone purchased the holdings of Inter-Southern stock of Caldwell & Co. from the receivers. The purchase price of this stock was $2,192,000. At the same time Security purchased this stock from Keystone at a total cost of $2,841,525.01.[122]

Mr. Dorsey and certain of his associates found many ways to use the insurance companies under their control for their personal profit.

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[113] Purchase contract of May 1925 between Mr. Machir Dorsey, Bertram Day, Mr. W. W. Washburn, and Mr. C. B. Jenkins.

[114] Certificate of incorporation of Keystone Holding Co.

[115] Minute book containing minutes of meetings of board of directors of Crescent Life Insurance Co.

[116] Ledger and journals of Keystone Holding Co.

[117] Minute book containing minutes of meetings of board of directors of Northern States Life Insurance Co.

[118] Ledger and journals of Keystone Holding Co.

[119] Id.; minutes of meetings of board of directors of Security Life Insurance Co.

[120] Minute book containing minutes of meetings of board of directors of Security Life Insurance Co. of America.

[121] Id.

[122] Id.; and ledger and journal of Keystone Holding Co.

Numerous collateral loans secured by inadequate collateral were made to favored persons; mortgages and other securities were bought at highly inflated prices from investment firms closely allied with Keystone, notably Edwin A. Hult & Co.[123] At this stage the principal holdings of Keystone Holding Co. were as indicated in the accompanying chart.

Insurance departments of Virginia, Illinois, Kentucky, Michigan, and Tennessee conducted an examination of Security as of the end of 1930. A preliminary report of this examination dated March 3, 1931, stated that the company was impaired to the extent of $525,574.29. This impairment arose out of the examiners' valuation of the stock of Inter-Southern and Northern States held by the Security Life. The Inter-Southern stock which had been purchased in December 1930, had cost the Security $2,841,525.01 at which figure it was carried on the books of Security; it had cost Keystone $2,192,000 and the examiners refused to permit it to be carried at the higher valuation. Similarly Security was carrying the Northern States stock at $1,082,800. This was written down by the examiners to $690,285.

Security objected to these valuations and long, drawn-out hearings were held at Richmond, Va., before a group of insurance commissioners. Following these hearings, at which Security's valuations were allowed, the company was permitted to continue in business under various limitations. Some States granted it a full license, some permitted the company to operate at sufferance and others refused to license it or to permit it to operate within their borders.

In the meantime the Home Insurance companies failed and the Inter-Southern suffered a loss of $3,992,866.45 on its holdings of the Home stock. At about the same time it was forced to write its Missouri State stock down by $1,776,600.[124] The strain of these losses was more than it could stand and on April 16, 1932, it went into receivership.

The failure of Inter-Southern of course rendered its stock worthless and 2 days after its failure, on April 18, 1932, Security Life went into receivership. On June 21, 1932, the State of Indiana filed a petition asking for the receivership of Northern States, which had been greatly weakened by the management of Mr. Dorsey and his associates, and a receiver was appointed.

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[123] The receiver for Security Life concluded that the Keystone Holding Co., Security Life Insurance Co. of America, Northern States Life Insurance Co., Inter-Southern Life Insurance Co., and Edwin Hult & Co. were responsive to a common control. He sets out these transactions involving Edwin Hult & Co.:

"1. Securities in the face amount of $64,427.83 and cash in the amount of $11,922.97 were transferred by the Security Life Insurance Co. of America to the Northern States Life Insurance Co. for the account of Edwin Hult & Co.

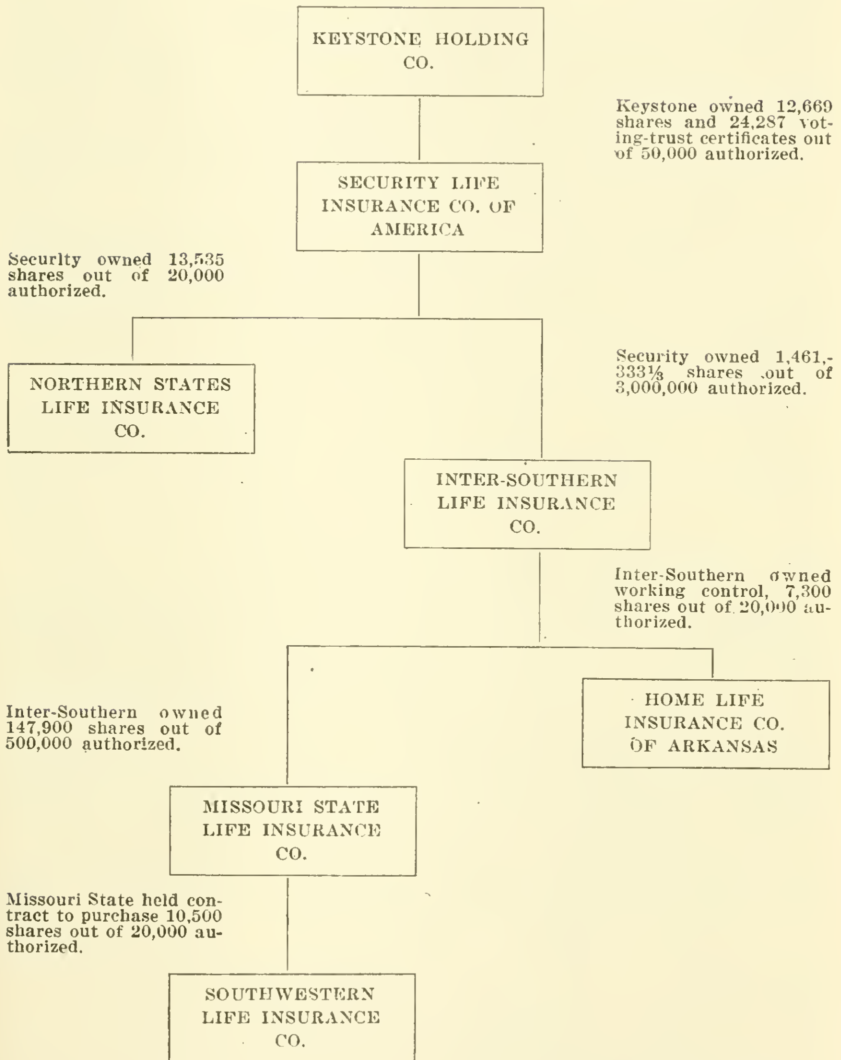
"2. $66,439.78 out of $67,000 paid by the Security Life Insurance Co. of America to Edwin Hult & Co. appears to have been advanced to the Keystone Holding Co. by Edwin Hult & Co.

"3. A loan in the amount of $85,000 which Edwin Hult & Co. had sold to the Security Life Insurance Co. of America that proved valueless was charged to the account of Edwin Hult & Co., and

"4. An overpayment in dividends in the amount of $9,869.25 made by the Security Life Insurance Co. of America was subsequently charged to the account of Edwin Hult & Co." On the failure of Security it had in its portfolio a collateral loan of Edwin Hult & Co. in the amount of $329,926.68. $306,338.68 of this loan was subsequently written off as loss. It also had $450,000 of mortgages of the Manufacturers Terminal Co., of Waukegan, Ill., in which Edwin Hult & Co. was interested and which had been sold to it by Edwin Hult & Co. This entire mortgage was written off as loss.

On the failure of Northern States it had in its portfolio $817,000 of the Manufacturers Terminal bonds which had been sold to it by or through Edwin Hult & Co. On December 31, 1934, these mortgages were appraised at $68,000.

[124] 1931 Convention Form Annual Statement of Inter-Southern Life Insurance Co.


KEYSTONE HOLDING CO.
Keystone owned 12,669 shares and 24,287 voting-trust certificates out of 50,000 authorized.
SECURITY LIFE INSURANCE CO. OF AMERICA
Security owned 13,535 shares out of 20,000 authorized.
NORTHERN STATES LIFE INSURANCE CO.
Security owned 1,461,333⅓ shares out of 3,000,000 authorized.
INTER-SOUTHERN LIFE INSURANCE CO.
Inter-Southern owned working control, 7,300 shares out of 20,000 authorized.
HOME LIFE INSURANCE CO. OF ARKANSAS
Inter-Southern owned 147,900 shares out of 500,000 authorized.
MISSOURI STATE LIFE INSURANCE CO.
Missouri State held contract to purchase 10,500 shares out of 20,000 authorized.
SOUTHWESTERN LIFE INSURANCE CO.

As we have seen, the portfolio of Inter-Southern contained 148,000 shares of Missouri State representing about 30 percent of the total outstanding. Mr. Dorsey sought to name men of his choice to the board of directors at the annual election of directors in January 1930. He was opposed by the St. Louis directors who had been serving, but under the cumulative voting law of Missouri he was enabled to elect four directors.

In the fall of 1931 an open fight broke out between the home office and St. Louis directors on one hand and the Dorsey group on the other for stockholders' proxies of the annual meeting in January 1932. Letters were written to stockholders soliciting their proxies. There was much public abuse and unfavorable publicity.[125]

Before the meeting was held a compromise was effected whereby each side elected four directors and a new president was to name three compromise directors.

In 1931 a stockholder of Missouri State filed a suit for an accounting alleging mismanagement. He later amended his petition to allege insolvency and on March 29, 1932, filed a bill for appointment of receiver. A receiver was appointed but on the same day attorneys from Missouri State sought and were granted a writ of prohibition to prevent the receivers from taking possession of the property. Further unfavorable publicity emanated from this action.

After the failure of Inter-Southern, its business was reinsured in the Kentucky Home Life Insurance Co., a company organized for that purpose and controlled by Mr. Frank Cohen and Mr. Albert Greenfield. It was contemplated that the Missouri stock in the Inter-Southern portfolio and the stock controlled by the St. Louis directors of Missouri State would be placed in a voting trust to prevent further proxy fights and to stabilize control.[126]

However, the voting trust was not effected. The superintendents of insurance of Missouri and Kentucky differed over the manner of setting up the trust, negotiations were carried on for several months without success, and in November 1932 the superintendent of insurance from Missouri issued an ultimatum that the voting trust with trustees acceptable to him must be completed within 30 days or he would move to take over the company under the Missouri liquidation statutes. Within the period set Mr. Frank Cohen agreed to buy the Greenfield interests in Kentucky Home Life Insurance Co. He had no funds to finance this purchase but succeeded in borrowing part of the money required from the Continental Bank of New York, pledging Kentucky Home Life Insurance stock for the loan; $800,000 more was needed and Mr. Cohen agreed to trustee the Missouri State stock in the Kentucky Home Life portfolio if he could borrow the necessary money from Missouri State. The superintendent of insurance from Missouri agreed to this proposition and the loan was made to Insurance Equities Co., a corporation controlled by Mr. Cohen, and was secured by stocks of other life insurance companies.[127]

The approval of the above loan by the board of directors of Missouri State precipitated a new fight. Four directors voted against approval and shortly thereafter five directors resigned in protest.

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[125] From memorandum entitled "History of Missouri State Life Insurance Co." prepared by Mr. Allan May, counsel, from files of that company.

[126] Id.

[127] Minute books containing minutes of meetings of board of directors of Missouri State Life Insurance Co.

Although Mr. Cohen's interests had purchased control of Kentucky Home they had overlooked the matter of obtaining the resignation of the Greenfield directors and were not able to dictate the policies of that company until the next election of directors and the voting trust was not completed until that election which was held in January 1933.

The difficulties of Missouri State had a discouraging effect on its policyholders and had a demoralizing influence on the agency force. The proxy fight in the fall of 1931 generated a run by the policyholders for cash surrenders and policy loans. This was further aggravated by the suit for receivership in December 1931, the appointment of receivers in March 1932, the failures of Inter-Southern and Security Life, the granting of the $800,000 loan to Mr. Cohen, and the subsequent protest resignations of five directors, who, by resigning on successive dates, spread this unfavorable publicity over a longer period of time.

The table below indicates the inroads made on insurance in force and the cash surrenders and policy loans requested by policyholders.[128]

	Insurance in force	Cash and loans outstanding end of year	Decrease in insurance in force during year
1929	$869, 324, 264	$5, 675, 603	$5, 331, 491
1930	849, 897, 519	6, 825, 737	19, 426, 745
1931	780, 479, 320	10, 074, 508	69, 418, 199
1932	673, 776, 412	16, 729, 733	106, 702, 908

A convention examination of Missouri State was instituted during December 1932 and was approximately completed early in 1933. It disclosed an insolvent situation but the examiners were in disagreement as to the degree of insolvency. In view of this the commissioners of insurance instructed their examiners to continue the examination and to bring it down to midyear June 30, 1933.

On August 23, 1933, the examiners completed their report on Missouri State. There was still a disagreement on the degree of insolvency but the superintendent of insurance of Missouri announced that inasmuch as everyone agreed that the company was insolvent the degree of insolvency and any action taken thereafter was his concern and on August 26, 1933, he filed a suit to have the company declared insolvent. On August 28, 1933, the company filed an answer confessing insolvency and placing its business and assets in the hands of the superintendent of insurance of Missouri.

C. COMPANY FAILURES WITH LOSS TO POLICYHOLDERS

It was impossible for reasons already indicated to conduct a survey of other principal failures and the foregoing comprise the only case studies that can be presented. The 19 principal failures to which reference has already been made and which resulted in a combined

[128] 1938 conventions form annual statements.

total indicated initial loss to policyholders of $138,000.000 are listed below:

Policyholders losses in life-company failures[1]*—period of Jan. 1, 1930, to Jan. 1, 1940*

[Includes only companies where initial loss is estimated to be in excess of $1,000,000—All figures are in thousands as of last statement available]

Name of company and date of reinsurance	Date of receivership or retirement	Date of last statement available	Gross life reserve	Policy loans and premium notes	Net life reserve (less policy loans and premium notes)	Rate of lien, percent	Indicated initial loss
1930 [2]							
1931							
Home Life Insurance Co., Little Rock, Ark.—reinsured in Central States Life Insurance Co., St. Louis, Mo., Mar. 31, 1931.	January 1931	Dec. 31, 1929	$3,436	$997	$2,439	50	$1,220
National Benefit Life Insurance Co., Washington, D. C. (Negro company).	Sept. 24, 1931		(3)	(3)	(3)	(3)	(3)
1932							
Inter-Southern Life Insurance Co., Louisville, Ky.—reinsured in Kentucky Home Life Insurance Co., Louisville, Ky., Aug. 8, 1932.	Apr. 16, 1932	Dec. 31, 1931	18,043	5,082	12,961	[4] 50	6,481
Mississippi Valley Life Insurance Co., St. Louis, Mo.—reinsured in 3 companies—American Life & Accident, St. Louis, Mo.; Detroit Life Insurance Co. of Michigan; and Republic Life Insurance Co., Dallas, Tex.	Apr. 25, 1932	do	3,663	693	2,970	100	2,970
Old Colony Life Insurance Co., Chicago, Ill.—reinsured in Life & Casualty Co., Chicago, Ill.	Sept. 20, 1932	do	4,577	858	3,719	100	3,719
Security Life Insurance Co. of America, Chicago, Ill.—reinsured in Central Life Insurance Co., Chicago, Ill., Sept. 15, 1932.	Apr. 18, 1932	do	8,979	2,253	6,726	100	6,726

[1] Pt. 28, exhibit No. 2336. This exhibit was prepared by Mr. Alfred M. Best of Alfred M. Best, Inc., who testified that because of reserves on registered policies amounting to $2,000,000 for the Continental Life and $6,000,000 for Missouri State, the total indicated initial loss is reduced $8,000,000 to $130,000,000. For a running discussion of the causes for these failures and methods used in computing indicated initial loss, see pt. 28, testimony of Alfred W. Best, Feb. 29, 1940.

[2] None.

[3] Details not available but loss probably well in excess of $1,000,000.

[4] Increased to 60 percent in 1939.

Policyholders losses in life-company failures—period of Jan. 1, 1930, to Jan. 1, 1940—Continued

Name of company and date of reinsurance	Date of receivership or retirement	Date of last statement available	Gross life reserve	Policy loans and premium notes	Net life reserve (less policy loans and premium notes)	Rate of lien, percent	Indicated initial loss
1933							
Illinois Life Insurance Co., Chicago, Ill.—reinsured in Central Life Assurance Society, Des Moines, Iowa, July 1933.	Nov. 28, 1932	Dec. 31, 1931	$29,796	$7,973	$21,823	70	$15,276
Northern States Life Insurance Co., Hammond, Ind.—reinsured in Lincoln National Life Insurance Co., Fort Wayne, Ind., March 1933.	Dec. 13, 1932	do	7,791	1,664	6,127	60	3,676
Missouri State Life Insurance Co., St. Louis, Mo.—this company was taken over by the newly formed General American Life Insurance Co., St. Louis, Mo., Sept. 7, 1933.	Aug. 28, 1933	Dec. 31, 1932	123,583	47,550	76,033	50	38,017
National Life Insurance Co. of U. S. A., Chicago, Ill.—taken over by Hercules Life Insurance Co., Chicago, Ill., January 1934.	Oct. 17, 1933	do	47,705	14,608	33,097	50	16,549
Royal Union Life Insurance Co., Des Moines, Iowa—reinsured in Lincoln National Life Insurance Co., Fort Wayne, Ind.	June 26, 1933	do	33,094	9,647	23,447	50	11,724
Peoria Life Insurance Co., Peoria, Ill.—reinsured in Life & Casualty Co., Chicago, Ill.—combined company continued under title Alliance Life Insurance Co., Peoria, Ill., Aug. 13, 1934.	Nov. 15, 1933	do	19,208	6,049	13,159	50	6,580
1934							
Independent Life Insurance Co., Nashville, Tenn.—taken over by Standard Life Insurance Co., Jackson, Miss., May 1934.	Feb. 19, 1934	do	1,417	238	1,179	100	1,179
Register Life Insurance Co., Davenport, Iowa—taken over under management contract by Guaranty Life Insurance Co., Davenport, Iowa, Sept. 26, 1934.	Apr. 8, 1934	Dec. 31, 1933	5,166	1,608	3,558	50	1,779

Policyholders losses in life-company failures—period of Jan. 1, 1930, to Jan. 1, 1940—Continued

Name of company and date of reinsurance	Date of receivership or retirement	Date of last statement available	Gross life reserve	Policy loans and premium notes	Net life reserve (less policy loans and premium notes)	Rate of lien, percent	Indicated initial loss
1935							
Pacific States Life Insurance Co., Denver, Colo.—reinsured in Occidental Life Insurance Co., Los Angeles, California & Life Insurance Co. of America. May 18, 1935.	Apr. 20, 1935	Dec. 31, 1933	$3,686	$1,000	$2,686	100	$2,686
1936							
Federal Reserve Life Insur- Co., Kansas City, Kans.—reinsured in Occidental Life Insurance Co., Los Angeles, Calif., June 14, 1936.	May 25, 1936	do	7,318	1,938	5,380	50	2,690
Continental Life Insurance Co., St. Louis, Mo.—reinsured in Kansas City Life Insurance Co., Kansas City, Mo., July 26, 1936.	May 1934	Dec. 31, 1935	13,076	3,912	9,164	50	4,582
Detroit Life Insurance Co., Detroit, Mich.—taken over by the newly organized Life Insurance Co. of Detroit, Mich., Mar. 2, 1936.	June 1935	Dec. 31, 1933	7,616	1,876	5,740	60	3,444
1937 [2]							
1938 [2]							
1939							
American Life Insurance Co., Detroit, Mich.—taken over by the American United Life Insurance Co., Indianapolis, Ind., Nov. 17, 1939.	June 7, 1939	Dec. 31, 1936	13,894	3,624	10,270	75	7,702
			352,048	111,570	240,478	57.4	138,000

[2] None.

Failures in the legal reserve life insurance company field have been confined almost entirely to companies which were the victims of flagrantly bad investment policies, policies which in many cases were tantamount to fraud and breach of trust on the part of company managements. More specifically it appeared that companies failed because their affairs were commingled with those of banks or because of extravagant investment in home office buildings, pyramiding and excessive or unwise investments in shares of other life insurance companies, efforts of directors to further their personal interests, and generally bad management.

The total assets of the above 19 companies amounted to only from one-half to three-fourths of 1 percent of the average amount of large insurance assets during the period. It should be noted, however, that the amount of money lost was sizable and the number of policy holders involved considerable, since the companies in question had gross reserves of approximately $332,000,000.

D. CONVENTION VALUES

Whatever the underlying causes of their failures, most of the insurance company failures of recent years were directly precipitated by the depression. Two artificial protective devices, convention values and moratoria, were called into play to meet the situation growing out of the depression, and undoubtedly were instrumental in preventing the failure of many other companies.

Convention values for securities are values assigned by State insurance commissioners to securities held by insurance companies. During the time when market values were fluctuating rapidly the values assigned were arbitrary. In most cases they were based on actual market values, or averages of market values, at periods of time prior to the date of the balance sheet for which they were used. As a result of their use, it was possible for insurance companies to carry their securities in their annual statements at a valuation in excess of their then market.

Convention values for securities were established by the National Convention of Insurance Commissioners [129] and were placed in effect by insurance commissioners in the principal States where life insurance companies were domiciled. The institution of convention values with respect to the State of New York was explained by George S. Van Schaick, former commissioner of insurance of the State of New York, and now vice president of the New York Life Insurance Co. Mr. Van Schaick's testimony, in part, was as follows: [130]

> * * * The matter of convention values which confronted insurance commissions in 1931, came to a head in October of that year, as I recall it, due to a particularly low day on the exchange, when I as a new superintendent had the chief examiners come in and say, "What will we do with these companies?"—not life companies, it was the casualty companies and the fire companies that were particularly affected because of the large portfolios of common stock which were held at that time.

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[129] Convention values for 1932 were prepared in accordance with the following resolutions adopted by the National Convention of Insurance Commissioners on December 9, 1931:

"Whereas exceptional fluctuations of value of stocks and bonds as reflected on the exchanges have led to the inquiry as to whether the market price quotations for stocks and bonds on any particular day are indicative of the fair market value of such securities; and

"Whereas under similar circumstances it has been the policy of the National Convention of Insurance Commissioners to endorse and recommend the substitution of the range of the market and the average of prices thus found running through a reasonable period of time as a fair basis of market value of stocks and bonds:

"*Resolved*, That the Committee on Valuation of Securities of the National Convention of Insurance Commissioners is of the opinion that under present conditions the market quotations on stocks and bonds for a particular day are not a fair standard for the ascertainment of fair market value of such securities and recommends as a present substitute therefor the average price of stocks and bonds as reflected by the exchanges for a range of five quarterly periods ending September 30, 1931.

"*Further resolved*, That since the fair average thus ascertained is approximately the closing price of securities on June 30, 1931, the prices of June 30, 1931, be taken as the fair market value during the current year and that such standard be accepted for the annual statements due as of December 31, 1931, except that securities should not be valued at more than the purchase price if purchased since June 30, 1931.

"*Further resolved*, That in cases where the condition of companies may require the immediate disposition of securities at present prices it is the opinion of this committee that the discretion of a commissioner of insurance should be exercised to vary the general formula herein set forth so as to adopt the prices then reflected by the exchanges.

"*Further resolved*, That in the valuation of bonds which have defaulted in principal or interest since June 30, 1931, and in the valuation of stocks and bonds of corporations in receivership since June 30, 1931, the convention value shall be the exchange quotations of December 31, 1931, instead of the average value as provided in the principal resolution."

[130] Pt. 28, testimony of George Van Schaick, February 20, 1940.

It was a question which was put up almost in a moment as to whether at that critical time there was to be a wholesale taking over of essentially sound companies because of, you might almost term it, gyrations of a stock exchange, and after canvassing the matter very carefully, it happened that the New York commissioner, then, as now, the chairman of the committee on valuation of what was then the National Convention of Insurance Commissioners, now called the National Association of Insurance Commissioners, called in the commissioners who were near at hand, Massachusetts and Connecticut and New Jersey, Pennsylvania, Illinois, and we worked it out. I used as the basis of it the very best thought I could get hold of, some of which went back to the World War days, when they had similar problems. * * *

First it was presented to the executive committee of the committee of valuations of the convention by telegram; they acquiesced in it. I put it into effect in New York immediately because I had to do something, and by early December of that year we presented it to the convention and it was passed with only three dissenting votes.

In the case of the 26 largest companies the method of valuation used resulted in carrying bonds and stock as of December 31, 1932 at $6,670,131,000. On that date the actual market value of these securities amounted to $5,545,727,000. Thus, the balance sheet value exceeded market value by $1,124,406,000 so that the balance sheet value of bonds and stocks was carried in company balance sheets at 20.28 percent in excess of market value. In succeeding years, convention values have gradually been adjusted toward market so that at the present time there is no substantial difference between market values and convention values.

Presumably the action of the National Association of Insurance Commissioners was taken not only for the purpose of protecting some companies in financial distress but by reason of the fact that the securities held by life insurance companies were then as now in general of high quality and sound character, and, therefore, not necessarily of an ultimate value as low as that represented by the prevailing market prices at the time. Events of subsequent years have, of course, confirmed their judgment.

E. MORATORIUM LEGISLATION

During the period of the banking difficulties in 1933 moratorium legislation and rulings limiting cash withdrawals and other demands on life insurance companies, were put into effect in many States.

With respect to the introduction of moratorium legislation in New York, Mr. Van Schaick testified:[131]

* * * You will recall that as we left '32 behind and got into January, I think it was in February that the Michigan situation arose, the Michigan moratorium came along, and then you had your situation in Maryland and Indiana and several other States, leading right up to Inauguration Day and then when New York came on with its moratorium on March 4 the President's proclamation

[131] Pt. 28, Testimony of George S. Van Schaick, February 20, 1940.

followed on the Monday following Inauguration, when all the banks were closed and we had the bank holiday, where were people going to go for their funds? [132]

Here was the banking burden of the country thrown on the life insurance companies, and as liquid as they were, and in as fine condition as they were, no company that invests money can be enough liquid to take care of a situation like that, and consequently I remember one instance of a man coming from the West by airplane to get there and get his money out of one of the large companies. It had the characteristics of a run. What did we do? As I came back from Washington, I talked with the Governor over the phone. We got together on Sunday morning and decided that we needed emergency legislation. We continued that on Monday. We had the legislative leaders of both parties there. We drafted this legislation known as chapter 40 of the Laws of 1933, afterward known as that; we had some of the insurance executives in at the Governor's home, we had advisers of various kinds we got the legislative leaders there from Albany that night; we had to send the bill up by plane, it went through the Legislature that night, they stayed in session that night, it came down by plane was signed the next day, and it was only then we had the authority to go ahead and declare a moratorium.

It was pretty sweeping legislation, but it was carefully drawn.

This special legislation was passed on March 7, 1933, and by virtue thereof the New York superintendent of insurance issued the first moratorium regulation under date of March 9, 1933. The superintendent's ruling provided that no cash-surrender values should be paid and that no loans should be made except for the purpose of and to the extent of covering payment of premiums or any obligations to

[132] Banking authorities in the different States had found it necessary to adopt emergency measures from the beginning of February. On February 4, 1933 a 1-day holiday was declared in Louisiana. On February 14 a 4-day banking holiday was declared in Michigan but a satisfactory settlement of the difficulties was not reached and the holiday was extended. On February 25 the Governor of Maryland declared a bank holiday and at the same time restrictions were authorized on withdrawals of bank deposits in Indiana, Arkansas, and Ohio. On March 1 Alabama, Kentucky, Tennessee, and Nevada declared bank holidays and similar action was taken by 6 other States on March 2, and 7 others on March 3. On March 4, the Governor of the State of New York issued a proclamation declaring that day, Saturday, March 4, and Monday, March 6, to be bank holidays. Similar action was taken in Illinois, Massachusetts, New Jersey, Pennsylvania, and elsewhere. On March 6 the President issued a proclamation declaring a Nation-wide bank holiday to continue through March 9. At the same time the President called a special session of Congress to meet on March 9 to enact such legislation as might be needed. After the Emergency Banking Act of March 9, 1933, the President issued a proclamation indefinitely extending the bank holiday and on Friday, March 10, gave the Secretary of the Treasury power to license members of the Federal Reserve System found to be in a satisfactory condition to continue a usual banking business, with the exception of paying out gold or furnishing currency for hoarding. Similar power was granted State banking authorities with respect to institutions under their supervision. On Monday, March 13, the Federal Reserve banks were reopened for the performance of usual banking functions. During the 3 days following March 9, the Secretary of the Treasury had licensed many banks to reopen. On March 13 such banks located in the 12 Reserve cities were reopened. On March 14 licensed banks in approximately 250 other cities having recognized clearing houses were reopened and on March 15 licensed banks in other places. At this time 4,507 national banks and 751 State member banks, or about 75 percent of all member banks of the Federal Reserve System, were reopened leaving unlicensed 1,400 national banks and 221 State member banks. By April 12, State banking authorities had licensed approximately 7,400 nonmember banks, or about 71 percent of such banks. The resources of such banks represented $23,000,000,000, or 90 percent of the resources of such member banks. By the end of the year, licensed member banks had increased to 6,011, while the number of nonmember banks operating without restrictions had increased to 8,200, leaving unlicensed 512 members of the Federal Reserve System and approximately 1,400 nonmemberbanks (Twentieth Annual Report of the Federal Reserve Board covering operations for the year 1933).

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the insurance company by the policyholder. This latter provision was inserted, Mr. Van Schaick testified, for the reason that:

We didn't want, as a result of this thing, people to lose their insurance * * * [133]

The only exceptions permitted to this ruling were in cases of extreme need. In such cases the companies were permitted to pay each individual not in excess of $100 in the aggregate as cash-surrender or loan values on all policies of ordinary insurance carried by him. Also in cases of extreme need the holder of industrial insurance was allowed to receive a cash-surrender value on his industrial policy or on the industrial policies of his immediate family, provided the extreme need was ascertained from personal investigation by a representative of the insurance company. In addition it was provided that companies could not disburse any sums on deposit except in cases in which sums were stipulated by contract and did not require the exercise of the option to withdraw by the insured. However, the companies were authorized to pay the interest on such sums on deposit when the interest became due in the regular manner.

On March 17, 1933,[134] the original rules were amended to permit the payment of the full cash or loan value if such payment were necessary for the continuance of pay-roll expenditures. A further modification was made at that time because of the anomalous situation which had been created due to the fact that the New York regulations in their original form were made to apply to the entire business of all companies licensed in New York State. The regulations of other States with respect to moratoria had conflicted with the rules of the New York department and therefore in the amendment of March 17 it was provided in general that the rules of the New York department should be modified to permit the company involved to comply in another State with the requirements of the supervisory authority of such other State. On April 3, 1933,[135] the restrictions of the New York Insurance Department were further lifted by an extension of the extreme-need category. Withdrawal was permitted for various purposes, including taxes, interest, rent, hospital, and medical expenses, food for the insured or his dependents, educational purposes, agricultural purposes, and in order to avoid penalties on prior commitments. On April 11, 1933,[136] the restrictions were further relaxed, and on September 9,[137] all restrictions were removed by the superintendent of insurance.

Only one State, Kansas, passed insurance-moratorium legislation before New York. This law was enacted March 6, 1933. Morato-

[133] Pt. 28, testimony of George S. Van Schaick, February 20, 1940. Nine States took care of this problem by granting policyholders what amounted to a moratorium on the payment of premiums. This was accomplished by granting extensions to the grace period provided in the policy for the payment of premiums. These extensions of the periods within which premiums were payable were: Iowa, 30 days; Kansas, 31 days; Maine, 31 days; Massachusetts, 31 days; Minnesota, 30 days; Nebraska, 30 days; Tennessee, 30 days; Vermont, 30 days; Wisconsin, 30 days.

The ruling of the State of North Carolina granted no grace period but suggested that policyholders write checks for premium payment on banks which would open when the banking holiday had terminated. From insurance department rulings dated as follows: Iowa, March 14, 1933; Kansas, March 7, 1933; Maine, April 5, 1933; Massachusetts, March 10, 1933; Minnesota, March 13, 1933; Nebraska, March 30, 1933; Tennessee, April 8, 1933; Vermont, March 23, 1933; Wisconsin, March 20, 1933; North Carolina, March 13, 1933.

[134] New York Insurance Department ruling, amendment No. 1, March 17, 1933.

[135] New York Insurance Department ruling, amendment No. 2, April 3, 1933.

[136] New York Insurance Department ruling, amendment No. 3, April 11, 1933.

[137] New York Insurance Department ruling, September 9, 1933.

rium legislation was passed the following day in New York, North Carolina, and Ohio. Indiana's law was enacted March 8, and Arkansas, Connecticut, Massachusetts, New Jersey, and Vermont followed on the 9th. Iowa's law was enacted March 11 and that of Minnesota the 13th. These 12 States were the only ones which had moratorium laws affecting life insurance before the Secretary of the Treasury began issuing licenses for the reopening of banks found to be in satisfactory condition on March 13 in the 12 Reserve cities; on March 14, in 250 clearing-house cities, and in other places on March 15. Nine other States enacted moratorium legislation affecting life insurance during the remaining days of March, and three others were added in April, one in May, and one in June.[138]

In Delaware, Michigan, Pennsylvania, Illinois, and West Virginia insurance commissioners themselves proclaimed a state of emergency and issued moratorium rulings which were subsequently confirmed by legislative action. In Florida a moratorium was similarly declared but was not confirmed by the legislature. The insurance commissioners' moratoria rulings first issued were similar to that of New York State which was issued on March 9, modifications, however, soon became necessary. Only Connecticut,[139] Delaware,[140] and New

[138] The following list shows the States which enacted moratorium laws affecting life insurance and gives the dates on which the legislation was enacted and the dates on which regulations were issued by the respective State departments of insurance:

State	Moratorium legislation	Insurance department
Alabama	Mar. 17, 1933	Mar. 17, 1933
Arkansas	Mar. 9, 1933	Mar. 9, 1933
California	Apr. 6, 1933	Apr. 6, 1933
Connecticut	Mar. 9, 1933	Mar. 9, 1933
Delaware	Mar. 18, 1933[a]	Mar. 17, 1933
Florida	([b])	Mar. 13, 1933
Illinois	May 11, 1933[a]	Do.
Indiana	Mar. 8, 1933	Mar. 10, 1933
Iowa	Mar. 11, 1933	Mar. 14, 1933
Kansas	Mar. 6, 1933	Mar. 11, 1933
Maine	Mar. 31, 1933	Apr. 5, 1933
Maryland	Mar. 28, 1933	Mar. 29, 1933
Massachusetts	Mar. 9, 1933	Mar. 9, 1933
Michigan	Apr. 28, 1933[a]	Mar. 29, 1933
Minnesota	Mar. 13, 1933	Mar. 13, 1933
Nebraska	Mar. 28, 1933	Mar. 30, 1933
New Hampshire	Mar. 16, 1933	Mar. 16, 1933
New Jersey	Mar. 9, 1[illegible]3	Mar. 10, 1933
New York	Mar. 7, 1933	Mar. 9, 1933
North Carolina	do	Mar. 13, 1933
Ohio	do	Mar. 10, 1933
Pennsylvania	Apr. 26, 1933[a]	Do.
Tennessee	Mar. 23, 1933	Apr. 8, 1933
Vermont	Mar. 9, 1933	Mar. 10, 1933
Texas	Mar. 29, 1933	Mar. 30, 1933
West Virginia	June 3, 1933[a]	Mar. 10, 1933
Wisconsin	Mar. 17, 1933	Mar. 20, 1933

[a] Ruling made prior to emergency legislation.

[b] No enactment.

[139] Connecticut Insurance Department ruling, March 28, 1933.

[140] Delaware Insurance Department ruling, March 18, 1933.

Jersey[141] followed New York in lifting restrictions on cash payments required for pay-roll purposes on March 17. The commissioner of insurance in Kentucky announced on March 21, 1933,[142] that the commissioners of other States could not promulgate any rules and regulations that could be legally maintained in the State of Kentucky as the law of that State provided that the payment of cash surrender values may not be deferred for more than 3 months. Accordingly, therefore, most States which had enacted moratoria restricting cash transactions by life insurance companies incorporated a reciprocity clause in their rulings stating that—

> * * * where the emergency rules and regulations of a supervising authority or the law of any other State of the United States shall require conditions or action in conflict with the foregoing rules and regulations of this department, then, in that event, such rules and regulations of this department may be modified to permit the company to comply in good faith with the requirements of the supervising authority of such State.[143]

By the 1st of April, 24 States had moratoria in effect while the remainder and the District of Columbia had none. In an attempt to obtain a solution to this dilemma, the insurance commissioners met in Chicago on April 7, 1933, and proposed a uniform set of regulations. At this time, 21 States and the District of Columbia decided to remain free of any moratorium regulations and Florida and Alabama withdrew all restrictions previously invoked. West Virginia, Kansas, Maine, Nebraska, and Wisconsin adopted the resolution proposed by the insurance commissioners in full. Illinois, Maryland, and North Dakota added amendments, while Connecticut, Delaware, Massachusetts, Michigan, Ohio, Pennsylvania, Vermont, and Texas accepted the joint resolution in part only. Life insurance companies doing interstate business, therefore, were faced with a complicated situation brought about by differing and even conflicting regulations in moratorium States, and no restrictions in others. By this time, however, the greatest danger was over, and the restrictions in effect in the most populous States, where the most insurance was in force, were sufficient to assure the safety of the companies, although at the cost of some discrimination amongst policyholders.

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[141] New Jersey Insurance Department ruling, March 18, 1933.

[142] Kentucky Insurance Department ruling, March 21, 1933.

[143] Sec. 10 of resolution adopted by the National Convention of Insurance Commissioners in Chicago, April 7, 1933.

SECTION XI

Intercompany Agreements To Eliminate Competition

As has been indicated earlier, the principal insurance companies are not linked by common directorships. Although a single banking or industrial interest may have its representatives on the boards of two or more insurance companies, the insurance companies themselves rarely interlock. This is not to say, however, that the companies have no interests in common; on the contrary, evidence before the committee demonstrated the frequency with which concerted action is undertaken among large companies in order to arrive at a common understanding on vital matters of policy.

Prior to the hearings upon which this report is based, it was generally believed that the life insurance business was not subject to anti-competitive agreements. Although it has long been known that in determining rates, the companies pooled their mortality experience in order to get the widest possible base for mortality tables,[1] it was supposed that the other two rate-making factors, i. e., loading (expense) and the guaranteed interest rate, were independently determined by each company on the basis of its own experience.

It now appears however that the principal life insurance companies have for several years undertaken to eliminate rate competition by means of intercompany agreements and "gentlemen's understandings." Efforts in this direction have been highly successful and, as might be expected, the agreements have been extended to bring about uniformity in certain underwriting practices and in certain policy provisions as well. The full extent of these activities is unknown as the testimony was limited to agreements in which the larger eastern companies participated. These agreements, summarized below, affecting companies writing the bulk of the business are sufficient, nevertheless, to indicate the nature, prevalence, and effect of anticompetitive and monopolistic practices in the field of life insurance.

A. THE GROUP ASSOCIATION

The first agreement considered was one to fix rates and underwriting practices among companies selling group insurance. Group insurance is of comparatively recent development. Its rise has been meteoric. Prior to 1915, the amount of group life insurance in force in the United States was negligible. At the end of 1919, there was $1,102,466,000 of group life insurance in force in United States companies. By the end of 1937 this amount had increased almost 1,100 percent, to $12,957,266,000, with contracts then in force covering an estimated 9,000,000 lives.[2]

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[1] The American Men Table of Mortality, for example, was compiled from the combined experience of 59 companies doing ordinary business. In the group insurance field, [illegible] the major companies doing group business combine their experience at irregular intervals. See vol. XXVI at p. 332 and vol. XXXIII at p. 333 of the Transcations of the Actuarial Society of America. The standard annuity tables, now widely used as the basis of annuity rates, are also based on intercompany experience.

[2] Pt. 10, R. 4155, 4156, exhibit No. 641. For a definition of group insurance op. cit. infra, p. 177 at note 4. For tables reflecting number of group policies in force, amount of group life insurance in force, premium income from group policies, total income from group policies, dividends paid group policies, and net changes in group surplus before and after dividend declarations, for 26 principal companies during period 1929 to 1938, inclusive, see pt. 10A, R. 45–52. For similar information on group annuities see pt. 10A, R. 60–66.

Group insurance was still in its infancy when the principal companies selling this form of insurance entered into agreements to control competition. In 1917 there were but five or six principal companies writing group insurance. Following a meeting of company actuaries called by State insurance officials in that year to assist in formulating a definition of group insurance, actuaries of the group companies continued to meet in informal gatherings to discuss group rates and underwriting practices. The association had no permanent officers, no minutes of the meetings were kept nor were state insurance departments formally advised of the results of the discussions. The agreements entered into were usually in the nature of mutual understandings or so-called gentlemen's agreements, rather than formal undertakings. From its beginning, this informal association was dominated by the large eastern companies, smaller companies being allowed to participate on the understanding that they would follow the leadership of the large companies.[3]

When the association was first formed, the practices of the companies were not standardized and competition was "severe." The informal gatherings were successful in bringing about the desired uniformity.[4] Within 2 years, "gentlemen's agreements" had been formulated establishing uniform rates, uniform underwriting practices, and maximum commissions. The question of rates was apparently a matter of primary concern.[5] The uniform rate established, known as the "T" rate, was fixed as the minimum initial group life rate to be quoted by Aetna, Travelers, Connecticut General, Metropolitan, and Prudential,[6] with the provision that the two latter companies, which at that time wrote group life insurance on a participating basis, were to quote a rate 5 percent higher than that of the other nonparticipating companies in order that the payment of dividends might not give them a competitive advantage.[7]

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[3] Mr. Benedict D. Flynn, vice president and actuary of Travelers Insurance Co., testified (pt. 10, R. 4158, 4159):

"Mr. GESELL. Then, can you tell us whether there were invited into these conferences some of the smaller companies which were writing group life insurance?

"Mr. FLYNN. Any company that started to write group insurance which wanted to come in would be invited to these meetings.

"Mr. GESELL. I read you a bit from a memorandum from yourself to Mr. Butler under date of September 30, 1924, in which you say: 'There is the general feeling among all of the smaller companies, based upon that which has been said in the actuarial society and other meetings that all are invited to cooperate to obtain policy forms, underwriting rules, etc., if they will be good.' What did you mean by that?

"Mr. FLYNN. If they agreed to follow good practices.

"Mr. GESELL. You mean not if they would agree to follow the practices which the larger companies had established.

"Mr. FLYNN. I don't want to evade. I would say that the larger companies' main object was to establish sound practices and, having had perhaps more experience than the smaller companies, they would like to lead along that line, and that was what I meant in saying 'if they will be good'."

[4] Pt. 10, R. 4158.

[5] Pt. 10, R. 4162, 4163.

[6] Since at that time (1919) the rates of the Equitable, the only other member of the informal association, were considerably higher than those of other companies and did not, therefore, constitute a competitive menace, the Equitable was not included in the rate agreement (pt. 10, R. 4164.)

[7] Pt. 10, R. 4165. In all cases in which the companies writing group life insurance agreed to rates, these were initial rates, that is to say, the rate to be quoted the prospective purchaser of the master contract. This contract provides that at the end of the year the purchaser will receive a rebate based primarily on mortality savings computed for each group contract separately on the basis of the year's experience for the group. Although the ultimate rates could thus differ, the association members agreed to rigid restrictions regarding rebate estimates to be made to prospective group contract purchasers. From a merchandising point of view, therefore, the establishment of uniform initial rates to all intents and purposes eliminated competition (pt. 10 exhibit No. 658, rule 9A).

For extra hazardous industries, graded rates at levels higher than the "T" rate were set, again on a uniform basis. Further elimination of competition resulted from the establishment of maximum commission scales, the promulgation of underwriting rules limiting the size of the group which could be written under the master contract, the prohibition of transfers of business from one company to another,[8] and from the setting of a maximum amount of insurance which could be granted on the lives of group members.[9]

The net effect of these agreements which were elaborated from time to time during the next 7 years was cryptically summarized by the then actuary of the Travelers, who stated in a letter to the president of that company as follows:[10]

It would seem, therefore, that the action which has been sought by the Hartford companies involving an understanding as to rates and maximum commissions is now possible and that competition on the basis of rates and underwriting, as well as commissions, will in the future be avoided by an agreement of the three Hartford companies, the Metropolitan, and the Prudential.

Companies participating in these anticompetitive agreements had occasion to consider the possible illegality of their activities in this connection from time to time. It appeared there were serious misgivings on the part of some members who feared that the "gentlemen's agreements," particularly in fixing rates, were in violation of certain State antitrust laws.[11] Representatives of the Metropolitan were particularly concerned about this matter and indicated that their company might withdraw from any participation in the "informal get-togethers." [12] When the question first came up in 1922, Mr. Flynn, then secretary of the Travelers, sought Mr. William BroSmith, vice president and general counsel of that company, for his opinion on the legality of the informal Group Association's activities. In an

[8] Testimony on this point illustrated the effect of this prohibition (pt. 10, R. 4161):

"The CHAIRMAN. Your feeling is that those who are handling group insurance ought to be in a position to raise obstacles to the free transfer by the insured of their policies? You moved affirmatively?

"Mr. FLYNN. Yes.

"Mr. FRANK. May I ask, purely out of ignorance, would your rules be designed to prevent a transfer, even if in the particular case the cost to the employer was less? * * * What I am getting at is, might M not the cost to the employer, regarding him as distinguished from the insurance company that lost the business, be to the advantage of the employer in that he might in a particular case get a lower cost?

"Mr. FLYNN. That is right.

"Mr. FRANK. Assuming that that were true, would your rules nevertheless be designed to discourage the transfer?

"Mr. FLYNN. They would in that no commission would be paid to the agent effecting the transfer."

[9] Pt. 10, R. 4173.

[10] Pt. 10, exhibit No. 643.

[11] A number of States, particularly Arizona, Georgia, Kansas, Nebraska, Oregon, South Carolina, Texas, and Washington, have antitrust statutes which affect life insurance companies. See Revised Code, Arizona, 1928, sec. 3212; Georgia Code, 1933, secs. 56-219 (2466); General Statutes of Kansas, Annotated, 1935, secs. 50-101; Compiled Statutes of Nebraska, 1929, secs. 59-101; Oregon Code, Annotated, 1930, secs. 46-140; Code of Laws of South Carolina, 1932, sec. 6620; Vernon's Annotated Texas Statutes (Civil) vol. 20, arts. 7429-7437; Vernon's Annotated Criminal Statutes of the State of Texas (Penal Code), vol. 3, arts. 1632-1640; and Remington's Revised Statutes of Washington, sec. 7076 (pt. 10, exhibit No. 646).

In Arizona the definition of a trust includes: "* * * a combination of capital, skill, or acts, by two or more persons * * * to control the cost or rates of insurance * * *" Revised Code, Arizona, 1928, sec. 3212. (Ibid.)

The Georgia statute states: "No insurance company authorized to do business in this State, or the agent thereof, shall make, maintain, or enter into any contract, agreement, pool, or other arrangement with any other insurance company or companies, licensed to do business in this State, or the agent or agents thereof, for the purpose of, or that may have the tendency or effect of, preventing or lessening competition in the business of insurance transacted in this state." Georgia Code, 1933, secs. 56-219 (2466). (Ibid.)

[12] Pt. 10, R. 4166-4170.

evasive memorandum to Mr. BroSmith, he stated the substance of the Association's activities to be as follows:[13]

The recommendation of the informal committee of representatives can be adopted or rejected by each company, but as a general rule no recommendation is adopted by the committee unless the vote is unanimous. There is nothing binding upon any company to follow the underwriting rule, the recommended commission scales or the rates which are recommended, but each company appreciates the advantages of cooperation to such an extent that it follows its own rules, which are generally based upon the recommendations of the committee.

With respect to this memorandum, Mr. Flynn frankly testified:[14]

Mr. Arnold. This certainly was drawn with the idea that there was a real danger of violating the antitrust laws and it was drawn for the purpose of obtaining the benefits of combination for your company and at the same time not appearing to violate the law.

Mr. Flynn. I think that is right.

Needless to say, Mr. BroSmith's legal opinion was discreet.[15] The question of legality was again raised in 1925 when certain officers of the Metropolitan voiced that company's objection to continuing its membership in the informal association.[16] Mr. Flynn again asked Mr. BroSmith for a legal opinion, remarking that: [17]

* * * it would also be much better to clear up the question of legality of our meetings as some of the other companies may also become frightened if they feel that the Metropolitan really have some legal grounds upon which to stand.

In his responding opinion, Mr. BroSmith said: [18]

In many of the States the laws which prohibit trusts and combinations in restraint of trade have been held to apply to insurance companies * * *.

To the extent that these laws apply to insurance companies it would seem that they apply equally well to life insurance and accident insurance and to the organizations of companies which care for the interests of life and accident insurance companies so that a company official who is fearful of the results should avoid membership on the part of his company or of its officers in the Life Presidents, American Life Convention, Actuarial Societies, and kindred organizations, which all have more or less to do with the establishment of the right premium rates for insurance and the maintenance of right practices. * * *

To sum up, in many States there is no real risk at all. In some States there is a technical risk but this is no greater than all of the companies are taking every day in the year with regard to some requirement or other.

In other words, Mr. BroSmith came to the conclusion that the gatherings and agreements probably constituted "technical" violations of some State antitrust laws. Nevertheless, no forthright steps were taken to disband the organization or to change the direction of its activities. The Metropolitan never followed its convictions to the point of withdrawing from the association. It continued to gather with representatives of the other companies to discuss all matters but

[13] Pt. 10, R. 4166, exhibit No. 644.

[14] Pt. 10, R. 4167.

[15] Pt. 10, exhibit No. 644.

[16] Exhibit No. 645.

[17] Pt. 10, exhibit No. 645. It is clear that this objection on the part of the Metropolitan was prompted by the advice of Mr. Leroy A. Lincoln, then general counsel for the company, and did not emanate from a desire of the Metropolitan "to break over the traces." Id.

[18] Pt. 10, exhibit No. 645.

rates, in respect to which agreements were reached in special informal meetings not attended by Metropolitan representatives.[19]

For a time, the informal association of companies writing group insurance accomplished the purposes for which it was organized, but as group insurance increased in importance there appeared a tendency for companies to break away from the rules and rates agreed upon. By 1926 the situation became acute. The Travelers Insurance Co. had cut rates, the Aetna had violated the rules and other companies threatened to withdraw from the association entirely.[20] At this point it became apparent to the companies interested in maintaining the agreements that a more formal arrangement must be worked out if the association was to survive. Accordingly, plans for a more binding organization were laid. On March 5, 1926, a formal constitution was adopted by 10 companies [21] who thus became the charter members of the Group Association.[22]

Following the adoption of this constitution, underwriting rules were drawn on the pattern of rules previously adopted by the informal association. The constitution provided that these underwriting rules, first drafted in mandatory language, were to be binding on members. In the statement of the rules as finally adopted, an effort was made to make the rules appear to be less binding. This was accomplished by the simple process of changing the word "shall" to "should" whenever it appeared.[23] By this bit of grammatical jugglery it was hoped to avoid appearances of combination in restraint of trade.

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[19] Pt. 10, R. 4170.

[20] Pt. 10, R. 4174, 4175. Indicative of the situation which then existed are the vigorous disciplinary measures taken against the Aetna for practicing a rate-cutting device contrary to the association's rule. A memorandum written by the Travelers' representative states (pt. 10, exhibit No. 647):

"In the course of the discussion a large number of cases where Mr. Cammack (E. E. Cammack, Aetna vice president and actuary) had strained the rules for his company's advantage were brought out * * * I am referring to the above matter as an important possible cause for trouble in the conference which was successfully cleared up and matters put in good shape in short order. It illustrates the willingness of the companies to play together on the basis of an honest interpretation of the rules. The meeting was unfortunate in that the discussion became somewhat heated and personal and undoubtedly scandalized the John Hancock representatives who were present. Clearly Mr. Cammack was being badly chastised and it was apparent to all that upon the basis of his improper practices during the past 6 or 12 months he deserved the rough handling that he was getting. The measures which were necessary to whip the matter in shape left some of the weaker company members, such as the Connecticut General and the Missouri State, at the point where they were hinting at getting out of the conference in order to enjoy cut-rate opportunities."

[21] Aetna Life Insurance Co., Canada Life Assurance Co., Connecticut General Life Insurance Co., Equitable Life Assurance Society, London Life Insurance Co., Metropolitan Life Insurance Co., Missouri State Life Insurance Co. (General American Life Insurance Co.), Prudential Insurance Co. of America, Travelers Insurance Co., Sun Life Assurance Co. of Canada. According to available figures, member companies had in 1926, 95.2 percent of all group insurance written in the United States. By 1937 the number of members had grown to 25, and, according to available figures they had 94.3 percent of all the business. Pt. 10, exhibit Nos. 654, 656.

[22] The constitution sets forth the objects of the association as follows: "(1) To promote the welfare of holders of group policies; (2) to advance the interests of group insurance; (3) to promote economy and reduce expense in the matter of general administration by an interchange of views on practice among insurance companies which issue contracts of group insurance; (4) to represent the members of the association in matters pertaining to, or which may affect, group insurance before the insurance departments and other public and quasi public official bodies; (5) to collect and analyze the group experience of the members of the Association, but nothing in this constitution, or in any rule adopted subordinate thereto, shall be held to authorize the making or promulgation of premium rates." Pt 10, exhibit No. 651.

[23] Pt. 10, R. 4177.

In this connection the following testimony of Mr. Flynn, actuary for Travelers Insurance Co., is revealing: [24]

Mr. GESELL. You recall this letter to Mr. Beers, that you wrote on March 12, do you not?

"Mr. BroSmith has redrafted the rules adopted by the Group Association at its meeting held March 5, 1926, as per copy attached.

"As I told you the other day, his feeling was that the association should be careful in putting out its rules or its minutes of meetings to steer clear of any indication of combination in restraint of trade.

"My suggestion would be that you send out new set of rules in accordance with Mr. BroSmith's draft to be used in place of the earlier set."

Mr. FLYNN. Yes, sir.

Mr. ARNOLD. Am I correct in assuming that the phase "to steer clear of any indication of combination in restraint of trade" means that you wanted the combination, but you wanted to steer clear of the indication of the combination?

Mr. FLYNN. Yes; I think that is correct.

The association's position on the question of rate fixing further demonstrates that its basic purpose was to cultivate the benefits of combination while avoiding the appearances of such combination. The constitution of the association specifically disowned all rate-making activities in the following terms:

* * * nothing in this constitution or in any rule adopted subordinate thereto, shall be held to authorize the making or promulgation of premium rates.[25]

In the light of the association's activities, however, this phrase must be considered mere camouflage. Mr. E. E. Cammack, the chairman of the Group Association, made this patently clear. He testified that some member companies felt that antitrust legislation made rate-fixing activities "dangerous" and that, therefore, these activities were conducted on an informal basis. Mr. Cammack stated:[26]

The constitution of the association provides that we cannot fix rates, so that it has been done informally through committees that have recommended rates on the basis of the experience compiled.

It appears, moreover, that rate-fixing activities were contemplated from the very outset. The minutes of one of the first formal meetings of the association state:[27]

Mr. Bassford said the Metropolitan could not consider entering if rates were discussed, for some commissioner asks a question every year about collaborating with any other company on the subject of rates. It was felt that the subject of rates might be handled by a temporary committee which might suggest rates and then dissolve.

Mr. Cammack explained that [28] "the association as such does not fix the rates, but we have informal discussion and somebody suggests

[24] Pt. 10, R. 4177. At a slightly earlier date an officer of the Prudential, in a letter to Mr. BroSmith of the Travelers Insurance Co., had stated that he had "been wondering whether a written constitution does not contain seeds of difficulty for the future," for the reason that he was afraid "the proposed Group Life Association would be found only too satisfactory as evidence that the companies were combining to prevent such freedom of competition as would result in the maximum service being offered for the premiums collected" (pt. 10, R. 4176, 4177).

[25] Pt. 10, exhibit No. 651.

[26] Pt. 10, R. 4205.

[27] Pt. 10, R. 4205, 4206.

[28] Pt. 10, R. 4199.

they are going to adopt a rate and all the other companies follow so in a sense they do fix the rate * * *." He admitted that the section of the constitution specifying that the association would not fix rates was more or less moribund though he pointed out that since the fixing of rates was unofficial and not recorded in the association's minutes, the companies were bound only by a "gentlemen's understanding."[29] The association, adopting this indirect procedure, established uniform initial rates for group death and dismemberment insurance, group accident and health insurance, and group annuities.[30]

In the case of group life rates, the rate-fixing activities of the association take a slightly different form. Sometime after the organization of the Group Association, a law [31] was passed in the State of New York giving the superintendent of insurance authority to establish minimum initial group life rates. The enactment of this law was opportune for the group companies which were experiencing difficulties in preventing rate-cutting activity. The association immediately recommended the "T" rate to the superintendent who adopted it without modification and invested it with all the sanction of the statute. Member companies not subject to the jurisdiction of the New York Superintendent of Insurance agreed that they would not quote initial rates below the minimum set under the New York statute.[32] Since the members of the association underwrite over 90 percent of the group life insurance in force in the United States, this understanding resulted in the New York rates becoming the established rates for the entire country.

With the rate question settled, the association was free to direct its activities toward the elimination of underwriting practices which might in any way enable a member company to circumvent the established rate or otherwise obtain competitive advantages. It therefore adopted and perfected rules [33] designed to prevent undercutting or the raiding of member companies' business. Agents' commissions were fixed on a uniform basis and actually prohibited in cases involving the transfer of business from the books of one member company to another. Allowances, premium reductions, credits or any special services in connection with the installation or administration of a group-insurance plan were prohibited. In order to control competition on the basis of anticipated dividends, a rule was adopted which

[29] Pt. 10, R. 4215. Other rules adopted are given a more formal and binding effect. The constitution of the Group Association, art. V, secs. 4 and 5 read as follows (pt. 10, exhibit No. 651):

"SEC. 4. The association may recommend rules for the conduct of the business. If unanimously approved by all members present at a meeting, such recommendation shall be submitted in writing by the secretary to all members, who must record with the secretary their votes in writing. Unanimous approval by all members, who record their votes within 10 days from the date of notification by the secretary of a recommendation, shall make such recommendation binding until changed by the vote of the association, except as provided in sec. 5 following.

"SEC. 5. No member shall change or present any plan for future offer involving a change in a practice required by any rule adopted, except after 60 days' notice has been served upon the secretary of the association who shall notify all members immediately."

[30] Members of the Group Association have written practically all the group annuity business in recent years; there being only one group annuity contract issued by a company not a member of the association during 1938 (pt. 10, exhibit No. 659).

[31] McKinney's Consolidated Laws of New York (Ann.) sec. 101-a (3), Insurance Law.

[32] Pt. 10, R. 4179.

[33] Pt. 10, exhibit No. 658. Mr. Flynn in a memorandum to Mr. BroSmith, dated April 21, 1933, stated (pt. 10, R. 4160): "These rules have not dealt with the minor detailed features of the underwriting but with the important matters upon which the companies should be together in order to prevent ruinous competition."

provided that no overhead cost, dividend, or rate reduction should be estimated by size or risk, either directly or indirectly, by statement of cost of operation or otherwise and that the only data to be furnished a prospective buyer should be actual past experience on actual cases.[34]

The establishment of extra hazardous rates may be taken as another example of the manner in which the association fixed uniform group life rates. In certain industries where the mortality experience is greater than usual by reason of the occupation of the employees, extra rates are charged. These so-called extras are an addition to the basic initial rate and, like it, are promulgated by the New York superintendent of insurance.[35] To determine the rate needed, a committee of the association considers the combined experience of its six largest member companies in a given industry [36] and reaches an agreement as to the interpretation of that experience. A rate recommendation is approved [37] at a meeting of the association and is transmitted to the superintendent, who "invariably" adopts the recommendation and establishes the extra in accord with the association's wishes.[38] Official action is practically automatic. The extra rate is agreed upon by the association's committee, recommended to the superintendent, and promulgated within a few days' time. In fact, this formal promulgation is frequently in the identical language of the recommendation.[39]

The association is still very active. Its controlling position in the field of group insurance cannot be gainsaid. During the 12 years, 1926 through 1937, more than 80 percent of the group life insurance written in the United States was written by association members. In fact, six of these member companies alone (Aetna, Connecticut General, Equitable, Metropolitan, Prudential, and Travelers) controlled throughout this period approximately 85 percent of the total group life insurance in force in this country and wrote during the same period more than 70 percent of the group life insurance written in this country.[40] These six companies which have also been dominant in the other fields of group insurance have at all times since 1917 controlled the association's activities.[41] Without exception,

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[34] Underwriting rules adopted by the Group Association cover almost every aspect of the business. The rules establish the following (pt. 10, exhibit No. 658): The established rate of interest which shall not be exceeded in the calculation of payments by installment instead of in one sum; first-year and renewal commissions to be paid agents; the period of time for which rates charged labor union groups, employers' groups or association groups shall be guaranteed; maximum contribution from employees per thousand dollars; provision for the issuance of group policies covering employees sick at the time insurance becomes effective; provisions governing the transfer and replacement of group insurance; the maximum amount of insurance which shall be issued to any group; conversion privileges of policies; etc.

[35] Pt. 10, R. 4179.

[36] Pt. 10, R. 4191.

[37] In this instance only a majority vote rather than unanimous approval is necessary (Pt. 10, R. 4189, 4190, 4191).

[38] Pt. 10, R. 4188, 4189, 4192.

[39] Pt. 10, exhibit No. 657. As in the case of the basic initial rate, those members of the association who are not operating in New York are bound by an agreement to follow the rates fixed by the New York superintendent (pt. 10, R. 4192, 4193).

[40] Pt. 10, exhibit No. 656.

[41] "Mr. GESELL. I notice that with respect to both of these documents (Schedule of Officers of Association and of List of Standing Committees, pt. 10, exhibits Nos. 652, 653) the principal officers and the chairmanships of the principal standing committees has been in the past almost uniformly allocated to one of the larger companies. Has that been by chance, or what is the reason?

"Mr. CAMMACK. Well, the reason is, I think, that 5 companies have such a large proportion of this business that I think it is naturally assumed they know more about it. Perhaps that is the reason." (pt. 10, R. 4185).

their representatives have occupied the major offices in the association and have been the most consistent in attending the regular meetings.[42] It is these six major companies who decided to curb competition; it is they who were powerful enough to do so.

B. RATE AGREEMENTS FOR ORDINARY INSURANCE

Among other agreements entered into by the principal eastern companies are agreements to fix ordinary insurance rates. Though some of these agreements affect both participating and nonparticipating ordinary insurance, those with respect to nonparticipating insurance appeared to be the more significant.

The three largest companies issuing nonparticipating life insurance have their home offices at Hartford, Conn. These companies, the Travelers, Aetna, and Connecticut General, have approximately 31 percent of the nonparticipating insurance in force in United States companies on their books.[43] Prior to April 1, 1933, they sold nonparticipting ordinary insurance at different rates and gave different, surrender values.[44] Travelers had last changed its rates in 1929 and the Aetna and Connecticut General had not modified their rates since 1926 and 1928, respectively.[45] Commencing in the summer of 1932, however, the actuaries of these three companies held discussions with a view to bringing about rate increases and at the same time placing their rates and surrender values on a uniform basis. A memorandum, dated June 22, 1932, from the actuary of the Travelers to Mr. L. Edmund Zacher, president of that company, referred to a conversation which the actuary had had with Mr. Cammack, vice president and actuary of the Aetna, in the following terms: [46]

> Cammack stated that they would like to go ahead with the idea of increasing rates, but, of course, would be embarrassed if the Travelers did not do likewise. I told him that I did not see why the three local nonparticipating companies could not get together on a joint program, for if he was agreeable, we were willing, and from what Actuary Henderson said the other day the Connecticut General are thinking along the same line.

Another memorandum in the files of the Travelers written 3 days later stated: [47]

> Nonparticipating companies, American Life Convention, appear to want to increase rates but are waiting to see what the three companies in Hartford will do.
>
> In discussing the situation with Mr. Laird, he said that the Connecticut General was waiting to see what the Travelers and Aetna would do.

Thus it appears that in June 1932, the smaller nonparticipating companies scattered throughout the Middle West and belonging to the American Life Convention were looking to Hartford for action on a rate increase; the Connecticut General, the smallest of the three Hartford companies, was awaiting action by the larger two, and the second largest company, the Aetna, was unwilling to go ahead unless the Travelers expressed itself in favor of an increase.

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[42] Pt. 10, exhibits Nos. 652, 655.

[43] Pt. 10, exhibit No. 679.

[44] Pt. 10, R. 4228, exhibit No. 922.

[45] Pt. 10, R. 4229.

[46] Pt. 10, R. 4229.

[47] Pt. 10, R. 4230. The nature and activities of the American Life Convention are described at note 1 p. 164 and note 18 at p. 176, infra.

No adequate justification was offered as to why the three Hartford companies should embark on a uniform program after competing side by side for so many years. By way of explanation, Mr. H. S. Beers, vice president of the Aetna, stated: [48]

> We had been competing in the past, because every now and then we would come to the conclusion that we could write the business a little cheaper than we had, and we wanted to cut the rate first to get a competitive advantage. When it came to raising rates for the sake of safety and not to increase profits but to cut our losses, we very much hated to be the first company, and we were all waiting for each of the other two, so the only thing to do was to get together * * *

It appears, however, that only one of the three companies, the Aetna, had lost money on its nonparticipating business during 1931 and 1932. Its losses, amounting to $5,818,474, contrasted sharply with the Connecticut General's profits of $949,841 and the Travelers' profits of $5,207,039 during this same period.[49] It is clear, therefore, that any agreement to increase rates would be to the decided advantage of the Aetna, and it cannot be overlooked that the other companies would be favorably affected.

The actuaries of the three Hartford companies first met on June 28, 1932, at the office of the Travelers to consider the prospective increase of nonparticipating rates.[50] There was no unanimity of opinion at the time, divergence of opinions being expressed on interest rates, surrender charges, and the mortality factor to be used.[51] The discussion at the meeting was friendly and cooperative, however, in spite of these differences, and Mr. Flynn, of the Travelers, was able to state at the close of the meeting that [52]—

> The general conclusion from today's meeting would be that material progress has been made, and we can with fair assurance assume that the local nonparticipating companies will act together in an increase in life rates at the end of this year.

Efforts to bring about a final agreement were impeded by the unwillingness of the Aetna to apply the new proposed rates to its modified life policy, a form of policy which, though not written by the other two companies competed with their term policies. The Connecticut General felt that the stand the Aetna had taken would be [53] "a very serious matter from a competitive standpoint" and that [54] "unless the Aetna Life will change its rates upon the modified

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[48] Pt. 10, R. 4247.

[49] Pt. 10, exhibit No. 662. In the 10-year period from 1929 to 1938, the 3 companies paid dividends to stockholders totaling $51,075,000. The Aetna passed a dividend in 1933, which was the only year any of these companies failed to pay annual dividends during the entire period (pt. 10, exhibit No. 661). For the years 1929 to 1938, the annual statements of the companies show the following operating results from the sale of ordinary nonparticipating business: Aetna, $13,295,108; Connecticut General, $2,282,242; and Travelers, $17,513,974 (pt. 10, exhibit No. 662).

[50] Pt. 10, R. 4232.

[51] Both the Travelers and the Aetna wished a guaranteed interest rate of 4 percent, whereas the Connecticut General felt a guaranteed interest of 4½ percent was proper. The Aetna was against increasing surrender charges, whereas the other 2 companies were agreeable to such increases, particularly in the early years. Sharp divergences of opinion also existed on the question of the proper mortality factor. The Connecticut General felt that the mortality should be computed on the basis of 75 percent of the American Men's Table commencing at age 20, increasing to 100 percent at age 50 and possibly higher beyond. The Aetna, on the other hand, desired to compute its mortality on the basis of 90 percent of the American Men's Table to age 75, with a 2-percent increase each age to age 80. The Travelers opinion, though differing slightly from the Aetna, did not closely approach that of the Connecticut General (pt. 10, exhibit No. 665).

[52] Pt. 10, exhibit No. 667.

[53] Pt. 10, exhibit No. 667.

[54] Pt. 10, exhibit No. 669.

life contract it practically nullifies the entire program."[55] Apparently 100 percent cooperation had been assumed. The presidents of the three companies then met on November 16, 1932, to consider the proposed program of rate increases but failed to give their final approval in view of the Aetna's position. Thereafter, the actuaries of the interested companies held three additional meetings and reached a compromise understanding.[56] The representative of the Aetna testified that he had compromised his position for the sake of uniformity[57] and agreed that this was because all three companies would be more comfortable in their minds if competition was eliminated.[58]

The uniform rate increase finally became effective April 1, 1933, and coincident with its announcement the three companies also announced uniform agreements on surrender charges and surrender values.[59] Since that time all three companies have operated on the basis of uniform rates.

Once the companies had worked out this increase and placed their rates on a uniform basis additional rate increases were immediately discussed. By December 1933 negotiations for a new increase were under way, it being the opinion of some of the company representatives that competition from participating companies would be less strenuous and that consequently "the traffic might stand a rate increase."[60] On January 1, 1935, the second increase went into effect, to be followed by still a third on March 1, 1937. The extent of these increases over the years from 1933 to 1937 is indicated by the fact that the premium for an ordinary $1,000 policy taken out at age 35 in one of the three companies increased $1.71 per year as a result. Taking into consideration changes in uniform surrender values, the resulting reduction in policy cash values might be shown to have increased the net cost of the insurance still further. In the case of the Connecticut General, for example, the surrendered net cost of a $1,000 ordinary policy at age 35, computed on a 10-year basis, was increased by over $40 or $4.11 a year.[61]

In connection with the 1935 rate increase, a novel situation was presented. In the course of conferences among representatives of the three companies, it appeared that the new rates would closely approximate the gross rates then being offered by several participating

[55] Mr. John M. Laird, vice president and actuary of the Connecticut General, testified (pt. 10, R. 4241):

"Mr. Gesell. * * * though your company and the Travelers did not write this modified life form your term forms were so near to the modified life form that the Aetna's failure to apply the new program to its modified life form gave it a competitive advantage.

"Mr. Laird. Well, the 2 situations were sufficiently close that the agents would make comparisons and it could be shown that the Aetna was offering lower-priced insurance."

[56] Pt. 10, exhibit No. 668.

[57] Pt. 10, R. 4244, 4247.

"Mr. Beers. Failure to agree would be a failure to agree, and that, of course, would nullify the agreement.

"The Chairman. And you felt it very desirable that there should be an agreement?

"Mr. Beers. Yes, sir.

"The Chairman. And therefore you agreed to abandon your position and to raise the rates in accordance with the modified suggestions of the other 2 companies.

"Mr. Beers. We compromised; yes, sir" (pt. 10, R. 4247).

[58] Pt. 10, R. 4245.

[59] Pt. 10, R. 4239.

[60] Pt. 10, R. 4259, 4160; exhibit No. 670.

[61] Pt. 10, exhibit No. 677.

companies, notably, Metropolitan, Prudential, and Provident Mutual. In fact, at some ages and on some forms, the proposed nonparticipating rate would actually have exceeded the gross rates of the participating companies, causing some companies, particularly the Connecticut General, to feel that an increase in rates would make competitive conditions too difficult.[62] The Connecticut General, therefore, refused to agree to a change in rates, and for a short time the rate increase was blocked.

At this point the Hartford companies appealed to the three participating companies mentioned, suggesting that they raise their rates, and a conference between representatives of the six companies for a discussion of the rates and surrender values was arranged.[63] As a result of this and subsequent conferences, all six companies announced an increase in rates early in 1935, the three nonparticipating companies on a uniform basis, the participating companies on a basis calculated to lessen competition as between themselves.[64]

One of the reasons for the willingness of the participating companies to join in these discussions and the subsequent rate increase is revealing. In a memorandum written March 6, 1934, Mr. James Little, vice president of the Prudential, stated the matter thus:[65]

> In the opinion of the two larger companies (nonparticipating companies) which raised their rates at certain ages about a year ago, the necessity for a further increase in premiums has become quite acute. They are, however, very much hampered in the matter of premium rates by the fact that the premiums of the three participating companies referred to are so low that a moderate increase in the nonparticipating rates would bring them very close to the participating rates of the companies mentioned, and at some ages even above these rates. From the point of view of this and the other participating companies concerned, therefore, we are in the position, by reason of our present premium rates, of holding down the rates of the nonparticipating companies. If insufficient rates should eventually result in the wrecking of these great nonparticipating companies, a very severe blow would be given to the life insurance business, so that, for our own protection, it is desirable that our gross rates should not be so low as to make it difficult for the nonparticipating companies to increase their premiums to rates which shall be adequate and still appear less to a reasonable extent than the rates of any responsible participating company.

The participating companies thus found themselves holding an umbrella over the nonparticipating companies, and even protecting

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[62] Pt. 10, R. 4262.

"Mr. GESELL. Was it not a fact that the Connecticut General did not want to go along with those rates because it was fearful of the competition which it would receive from the Metropolitan, the Prudential, and the Provident Mutual?

"Mr. FLYNN. Right."

[63] In a memorandum written at the time, Mr. Flynn said: "* * * it was decided to call a conference with those participating companies whose gross rates, in our opinion, should be increased, particularly at the older ages" (pt. 10, exhibit No. 672). The point was commented upon at the hearings (pt. 10, R. 4262):

"Mr. GESELL. In other words, here you are actually going to the extent, you nonparticipating companies, of approaching your principal participating company competitors in an effort to get them to increase their rates, were you not?

"Mr. FLYNN. Correct."

[64] In a memorandum Mr. Valentine Howell, actuary of Prudential, wrote (pt. 10, exhibit No. 674):

"Following conferences with the actuaries of the Metropolitan Life and the Provident Mutual, we have tentatively decided on schedules of increased ordinary premium rates as shown in the attached illustration. * * *"

"The rates described above are believed to be reasonably consistent with those tentatively decided upon by the Metropolitan and by the Provident Mutual."

[65] Pt. 10, exhibit No. 673.

the nonparticipating companies.[66] Moreover, the agreement between the Hartford companies resulted in a rate increase and considerable uniformity in rates throughout the nonparticipating field.[67]

As in the case of the group association, no state insurance official participated in these conferences. Mr. Valentine Howell, the actuary of the Prudential, testified: [68]

Mr. ARNOLD. To have this power to fix the rate in private hands without public supervision is the way you would have it?

Mr. HOWELL. Yes.

It should be observed, in conclusion, that no publicity was given the methods or circumstances pursuant to which the uniform results were achieved. Mr. Beers testified that this was out of deference to those who were worrying most about the anti-trust laws and stated: [69]

Mr. ARNOLD. You thought it wise, in view of that split of opinion, then, in your group as to whether the antitrust laws applied, to conceal this machinery?

Mr. BEERS. To avoid publicizing, absolutely. That is, our lawyers did not feel absolutely sure that they knew the answer; they thought the courts might have to decide something.

C. HUNTER CONFERENCES

For nearly 20 years actuaries representing the principal life insurance companies have met at the home offices of the New York Life to discuss annuity rates, policy provisions, underwriting problems, dividends, and similar matters.[70] Inasmuch as these conferences have resulted in the elimination or reduction of intercompany competition in many important phases of the life insurance business, they deserve special consideration in this discussion.

The conferences take place from two to four times a year in the office of Dr. Arthur Hunter, chief actuary and vice president of the New York Life.[71] Usually representatives of about 20 of the largest companies are present.[72]

Notices of the meetings, frequently accompanied by an agenda, are forwarded company representatives in advance. The proceedings are informal. At the conferences intensive discussions of the problems covered by the agenda ensue, following which the participants vote to commit their companies to a recommended course of action or indicate what representations they will make to their fellow executives with respect thereto.[73] Conferees are generally authorized to speak

[66] This fact is in direct contradiction to statements made by Mr. F. H. Ecker of the Metropolitan and Mr. T. A. Buckner of the New York Life as to the position of the mutual companies in the determination of rates in the industry. Mr. Ecker said (pt. 4, R. 1246): "Competition * * * compels the stock companies to come pretty close to meeting the cost of insurance issued by mutual companies." Mr. Buckner's statement was even more positive (pt. 4, R. 1423): "The mutual life insurance companies are the factor that keep down the cost on stock companies as well as the mutual companies. In other words, they are the bulwark: stock companies have to meet the issue or go out of business."

[67] Pt. 10, R. 4277.

[68] Pt. 10, R. 4274.

[69] Pt. 10, R. 4257.

[70] Pt. 10, R. 4508, op. cit. infra: notes 552, 562, 576.

[71] Pt. 10, R. 4509. See exhibit Nos. 754, 799.

[72] Pt. 10, R. 4509. On occasion companies represented at the conference have accounted for over 80 percent of the admitted assets of all United States companies (pt. 10, exhibit No. 754).

[73] Pt. 10, R. 4510, 4511, 4517, 4518.

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for their companies,[74] and quite often a formal vote by show of hands is taken.[75] It is not infrequent that companies qualify their agreement to a particular recommendation by indicating that their actions will be premised upon other companies taking similar action.[76]

Following a conference, Dr. Hunter, by prearrangement, acts as a sort of "clearing house"; representatives not authorized to bind companies at the conference may report back to him the substance of their talks with their superior officers and the nature of the final decision reached by their companies with respect to a proposed line of action.[77] Thereafter, follow-up letters keep every company informed of the action taken by other companies participating in the conference. Successive meetings are sometimes necessary to crystallize opinion. On occasions special subcommittees have been chosen to explore a problem and report back the most likely basis upon which a uniform agreement can be reached.[78]

No minutes are kept of the proceedings and at the end of each year Dr. Hunter's files relating to any subject upon which discussion has been closed are destroyed.[79] No publicity is given the deliberations and no representative of any State insurance commission or other governmental authority is present or invited to attend. All communications relating to the activities of the conferences are sent under confidential cover.

In the course of the hearings special consideration was given to conferences held for the purpose of fixing uniform annuity rates and establishing uniform surrender values and settlement options. The nature of these conferences will be discussed below in some detail.

1. Uniform Annuity Rates

Annuities have been a "problem child" to the insurance business for many years.[80] Companies first started writing annuities on a large scale in 1927,[81] but it was not until 1933 that the heaviest selling took place. From then on through 1937 the premium income from personal annuity contracts amounted to $1,758,500,000 which is equal to 68 percent of total premium income received from personal annuities during the entire period 1913–37.[82] Of this amount, during the years 1935, 1936, and 1937 over 90 percent was received by companies attending the Hunter conferences.[83]

[74] Pt. 10, R. 4522. After preliminary conferences, representatives were sometimes given special encouragement to attend with full authority to speak for their companies. For example, a memorandum, subtitled "Steps in Preparation for Intercompany Conferences on June 3," prepared by Mr. Ray D. Murphy, vice president and actuary of the Equitable, states in part as follows (pt. 10, exhibit No. 785): "Progress can only be made if individual companies are willing to waive small differences in viewpoint because of the much greater advantage which will accrue to all through the sound solution of these problems. At this stage it is most desirable that each representative come to the conference invested with authority to speak for his company as to its willingness to accept each of the above rules individually, provided that the great majority of the other companies are willing to do likewise."

[75] Pt. 10, R. 4517.

[76] Pt. 10, R. 4520, 4522.

[77] Pt. 10, R. 4510, 4511.

[78] Pt. 10, R. 4510, 4511, 4517, 4535, 4575, 4576, 4585.

[79] Dr. Hunter stated (pt 10, R. 4511): "It never crossed my mind for a moment that anyone, including such a body as this, would be interested in notes made in connection with informal discussions."

[80] For a discussion of the history of annuities and some of the principal operating problems created by their sale see pp. 328 to 336, infra.

[81] Pt. 10, R. 4506.

[82] Pt. 10, exhibit No. 751.

[83] Pt. 10, exhibit No. 780.

Up until 1932 the principal companies broke about even in the sale of annuities. In 1932, however, 17 of the 24 largest companies experienced losses, and since that time losses totaling over $75,000,000 have been incurred.[84] The "Big Five" companies have been the largest losers during the last 10 years, the New York Life showing losses aggregating $36,882,535 for the period.[85]

Companies were just commencing to feel the strain when the first annuity conferences were held in March 1933. The New York insurance commissioner had suggested revision of mortality and interest factors used in computing annuity rates, and the companies themselves, with the 1932 losses in mind, were beginning to recognize the error of the original annuity calculations.[86] From March 1933 to October 1938, a series of 14 conferences of the principal United States and Canadian companies were held.[87] For the most part these conferences convened at the offices of Dr. Hunter, though occasionally elsewhere.[88]

At the conferences all factors to be considered in computing annuity rates were discussed, including mortality, interest, and loading.[89] It was the purpose of these meetings to reach as near as possible a uniform program for increasing annuity rates.[90] In the period of 5 years during which these 14 conferences were held, 4 rate increases for immediate annuities were agreed to and put into effect by principal companies. These increases became effective July 1, 1933,[91] January 1, 1935,[92] January 1, 1936, [93] and July 1, 1938.[94] In addition, many other phases of the annuity problem were discussed and efforts made to standardize practices.[95] Most important were the efforts to establish uniform commission rates for agents in the sale of annuities. Two such agreements entered into by a substantial number of companies became effective coincidently with the announcement of the first two rate increases.[96]

The Metropolitan, Prudential, New York Life, Equitable, and the Mutual Life, leaders in the sale of annuities, appointed themselves a steering committee of the Hunter annuity conferences. In advance

[84] Pt. 10, exhibit No. 753.

[85] Pt. 10, exhibit No. 752. For information indicating individual annuities in force and annual income payable thereunder, first-year and total premium income received from individual annuities, dividends paid annuitants, and changes in total annuity surplus, see pt. 10A, R. 53-59.

[86] Pt. 10, R. 4509, 4510, exhibit No. 753.

[87] Pt. 10, exhibit No. 754.

[88] Pt. 10, R. 4509; 5 of the conferences were steering committee conferences at which only the 5 largest companies were represented (pt. 10, exhibit No. 754).

[89] Pt. 10, R. 4515.

"Mr. Gesell. * * * you were considering at these meetings * * * not only questions of mortality experience but also loading and interest rates.

"Dr. Hunter. That is true.

"Mr. Gesell. Those are the 3 factors which go to make up the annuity rate.

"Dr. Hunter. Yes."

[90] Pt. 10, R. 4513.

[91] Pt. 10, R. 4517.

[92] Pt. 10, R. 4531.

[93] Pt. 10, R.4534–4537.

[94] Pt. 10, R. 4540, 4541.

[95] Among other annuity problems considered at the conferences were the following: Retirement annuity rates, survivorship annuity rates, checking more carefully evidence of date of birth of annuitant applicant, the desirability of participating or nonparticipating annuities, limitations on the amount of single premium annuities, the desirability of continuing the issuance of single premium annuities on the same life without medical examination, the elimination of single premium retirement annuities, cash refund installment and temporary annuities, the desirability of dispensing with combined single premium and annuity contracts and mortality experience on annuities of various types (pt. 10, exhibits Nos. 755, 766, 767, 772, 774).

[96] Pt. 10, R. 4518, 4533, 4534, exhibits Nos. 762, 763, 764.

of meetings at which important matters were to be considered, representatives of these companies would meet, compromise their own differences, and arrive at a tentative decision on the matters under discussion.[97] This tentative decision would then be recommended at the larger meeting of company representatives.[98] In this manner the five companies were often able to dominate and give direction to the program.

The record is replete with evidence that company representatives surrendered their individual judgments for the sake of fixing a uniform rate. Some of the companies even yielded their right to an individual opinion in advance, indicating that they would go along with whatever the majority chose to do.[99] Notes of the meetings are profuse with such statements as "We expect to go along with the majority of the companies and certainly will if the Travelers and Connecticut General fall in line." [100] "Three others preferred not to change now but would probably fall in line later: Connecticut Mutual, New England Mutual, State Mutual." [101] "Guardian: Thinks increase too great, but probably will go along with other companies after further discussion with officers." [102] With respect to the 1936 rate increase, at least seven companies indicated that their action was premised upon the action of other companies. A memorandum by Dr. Hunter records the following company attitudes:[103]

New England Mutual, if there is any general trend in that direction.

Sun Life, anxious to adopt if 10 companies of importance in the annuity field are willing to do so.

Home Life, would follow if one-half of the companies in the Little Entente did so.

Guardian Life, will probably follow the action of the majority of the other companies.

Provident Mutual, are sympathetic and would like to adopt the new basis if a substantial number of companies do so.

Prudential, are awaiting to know more definitely which companies will make the change indicated.

Phoenix Mutual, depends on the action of the other companies, including the two participating companies.

Efforts were made to induce these companies which had not indicated a ready willingness to go along on a proposed program to conform. For example, of the meeting on May 18, 1933, Mr. Flynn, of the Travelers, wrote:[104]

* * * The general feeling was that if some missionary work were done on the Connecticut Mutual, Phoenix Mutual, and New England Mutual, practically all important companies, with the possible exception of the Provident Mutual, would go along on the proposed program.

Self-solution of problems was discouraged. In the interest of the elimination of competition, it was important that all companies of any one competitive class adopt the uniform program. By continu-

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[97] Pt. 10, R. 4528, 4529, exhibit No. 754.

[98] Pt. 10, R. 4529.

[99] Pt. 10, exhibit No. 756.

[100] Pt. 10, exhibit No. 777.

[101] Pt. 10, exhibit No. 762.

[102] Pt. 10, exhibit No. 756.

[103] Pt. 10, exhibit No. 768.

[104] Pt. 10, exhibit No. 756.

ous conference, compromise, and persuasion, uniformity was in fact achieved.

2. Uniform surrender values and surrender charges

Another instance of the elimination of intercompany competition is found in agreements bringing about an increase in surrender charges and a corresponding reduction of cash-surrender values. For many years prior to the depression, there had been competition among the companies on the matter of cash surrender values.[105] In 1933 discussions were initiated at the Hunter conferences looking toward a reduction of surrender values and an increase of surrender charges. These discussions were led by the five largest companies, who apparently took the position that when any conservative action is taken the larger companies have to lead the way.[106] A plan for increased surrender charges was prepared by Mr. James Little, actuary of the Prudential. The plan was not, however, immediately submitted for approval to the Prudential board of directors because apparently it was thought best not to follow the procedure which the actuary thought best unless similar programs were adopted by its principal competitors. A memorandum of Mr. Little, written with respect to this matter, stated: [107]

> It probably would not be feasible for any one company to start alone along the path indicated, but if the Prudential, jointly with the four large New York companies, adopted the plan, it would unquestionably be followed by many other companies who at the present time are very anxious to provide, as far as possible, against a recurrence of the extremely difficult situation which they have suffered from for the last year or two. It is suggested, therefore, that if the plan is felt to be desirable the matter should be discussed with the four other companies indicated (i. e., Metropolitan, Equitable, Mutual, and New York Life) to see what possibilities of joint action may exist.

A meeting of representatives of the five named companies was held and a tentative decision reached. This decision, embodying a complete new scale of surrender charges,[108] was then submitted to a larger meeting of the representatives of the principal companies. Final action on the recommendation was not taken until after a series of intercompany conferences stretching over a period of approximately a year.[109] These conferences were carried out along lines which marked the general path of the Hunter conferences already discussed.

In the course of the conferences it was revealed that in 1932 the Northwestern Mutual, Provident Mutual, Massachusetts Mutual, National of Vermont, Connecticut Mutual, and State Mutual had adopted a program fixing uniform surrender values and charges.[110] As

[105] Pt. 10, exhibit No. 807. A memorandum written by Mr. William A. Hutcheson, actuary of the Mutual, in speaking of the enormous demand for cash values states that (pt. 10, exhibit No. 807): "The Federal banking holiday of March 1933 was followed by numerous State embargoes on cash values and loans. Had it not been for these embargoes many life companies would have gone under, and once this had happened there is no saying where it would have stopped."

[106] Pt. 10, exhibit No. 807.

[107] Pt. 10, exhibit No. 801. In another memorandum Mr. Little writes (pt. 10, exhibit No. 802): "* * * it (is) felt that the new schedule of surrender values would be undesirable unless adopted by at least 3 or 4 of the 5 large companies. If substantially reduced values are adopted by the very large companies, it is almost certain that many of the smaller companies will be glad to follow suit."

[108] Pt. 10, exhibit No. 806.

[109] Pt. 10, R. 4619-4632; exhibits Nos. 801-807.

[110] Pt. 10, exhibit No. 802.

has already been indicated, the three nonparticipating companies at Hartford, Conn., adopted a uniform basis of their own at about the same time.[111] The surrender values adopted by these two separate groups of companies were not strictly in accord with the plan proposed by the five principal participating companies. The first group declined to make any immediate change. However, the Hartford companies revised their procedure, adopting higher surrender charges, and the five largest companies entered into a joint program which resulted in an announcement by these companies of a new surrender value program substantially identical for each company.[112] A memorandum of the Mutual Life's actuary stated the tenor of the conferences indicated that the scale adopted by these larger companies would soon be followed by other companies participating in the conferences. The memorandum stated: [113]

> It may, therefore, be said that there is a general movement throughout the United States, and Canada as well, to go back to a more conservative scale of cash values than those now guaranteed in present contracts.

3. Uniform Settlement Option Provisions

Practically all ordinary life insurance policies contain provisions granting a choice as to the manner in which the proceeds of the policy are to be paid if other than a lump sum settlement is desired. Under these options the proceeds may be left at interest with the company, may be used to purchase an annuity, or may be held to the use of the beneficiary in innumerable other ways.

Prior to 1935, the comparative liberality of the companies in the number and provisions of the options allowed was undoubtedly an important factor in competition.[114] Over the course of years these settlement options grew increasingly numerous and complex as companies strove to meet the varied needs and demands of policyholders or to present some new settlement device not used by their competitors.[115] Settlement option forms had become so varied and complicated by 1935 that it became apparent to the actuaries of several companies that the continued extension of settlement privileges was certain to bring about serious underwriting problems and was not good business.[116]

It was recognized that the insurance companies were being forced to act as executors and trustees for the estates of their deceased policyholders,[117] but it appears to be a phenomenon of the insurance business that where a proposed change in practice would touch upon matters affected by competition, no company is willing to act alone. True to form, therefore, in an attempt to secure a uniform practice

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[111] Ibid.

[112] From company rate books.

[113] Pt. 10, exhibit No. 807.

[114] Pt. 10, R. 4570, 4571, 4584.

[115] Pt. 10, R. 4570, 4571.

[116] Mr. J. F. Little, of the Prudential, stated in a letter written to Dr. Hunter on November 12, 1935, as follows (pt. 10, exhibit No. 782):

"I have felt for a long time that we, under the stress of competition, have become rather too liberal in 2 directions: First, in undertaking certain arrangements that, perhaps, we should refuse; and second, in allowing very complicated and intricate settlements, some of which have already come through to the claims department and had that department very much concerned as to just what the complicated settlement really meant."

[117] See e. g. pt. 10, exhibit No. 785.

among the leaders of the industry, the technique of the Hunter conference was again called into play.[118]

Discussions commenced in October 1935 and continued in a series of 11 meetings until May of 1938, when final agreements were reached on a uniform settlement option program.[119] When the conferences first got under way there was a general feeling that options should be curtailed, but beyond that there was such a wide divergence of opinion that agreement was impossible. Dr. Hunter testified: [120] "* * * so far as I remember, the differences were so great that we didn't come to any common understanding." A subcommittee, composed of actuaries and lawyers, was formed to make specific recommendation, but by 1937 it had produced no results, and consequently a second subcommittee, headed by Mr. Ray D. Murphy,[121] vice president and actuary of the Equitable, was appointed by Dr. Hunter to formulate a set of rules for recommendation to the companies.

At about this time the problem was being considered by the superintendent of insurance of New York who proposed to study the situation with a view to making recommendations for provisions to be included in the New York Insurance Code then being drafted. On learning that the insurance companies would prefer to handle the matter themselves, he obligingly left it to them. The testimony on this point deserves particular attention: [122]

Mr. MURPHY. * * * I had a subsequent discussion with the superintendent which verified the fact that the question in his mind was whether such provisions should be put in because, very obviously, in his opinion, the companies through this, what I may call compounding of beneficiary clauses, had gone further than appeared in his opinion to be good practice, considering the general welfare and safety of the whole body of policyholders.

Mr. GESELL. He was interested in writing provisions into the New York law which would eliminated some of the abuses which he thought might have developed.

Mr. MURPHY. He was until I told him about our meetings and what we were studying and that the problem seemed so complicated that it might be rather difficult to draft statutory provisions which would turn out to be wise, and that it seemed to me that it might be more practicable to let the companies see whether they could not come to a reasonable consensus of opinion as to what

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[118] The reason for the desire for uniformity was brought out in testimony (pt. 10, R. 4584):

"Mr. GESELL. Am I correct in gathering from the last letter which I read that this question of settlement options did have some competitive importance? In other words, that companies with more liberal settlement option provisions stood, perhaps, to gain in the sale of insurance as against companies which had stricter provisions?

"Dr. HUNTER. Yes.

"Mr. GESELL. If that is correct, I take it, it is also correct that one of the great interests of the companies attending these conferences was to bring about a uniformity of position on the part of the companies so that competitive advantage would not accrue to any particular company.

"Dr. HUNTER. To such an extent as it was possible.

[119] Pt. 10, R. 4617, 4618, exhibit No. 799.

[120] Pt. 10, R. 4572.

[121] Pt. 12, R. 4575. Mr. Murphy testified (pt. 10, R. 4577): "My best recollection is that in discussing the matter, it was very difficult, with a large group, to consider all possible suggestions for reasonable limitation on these combinations of modes of settlement that would still preserve the essential services to the beneficiaries and yet not go to what a great many people considered a bit dangerous point, and in order to have a working basis that was more practicable, it was felt that if they had a committee, a subcommittee, that they could probably in a more intimate way discuss the matter and get to some sort of recommendations which they could in turn pass over to the group." The other members of this committee were representatives of the Prudential, Connecticut General, Mutual, and Provident Mutual. Ibid.

[122] Pt. 10, R. 4578, 4579.

limitations would be wise, and then follow that process of, what I may call, voluntary action rather than specific statutes at a time when it is very difficult to tell just what these specific statutes should be.

He thereupon said that he thought that that probably was a satisfactory way to handle the matter, and would I keep him advised as to what the recommendations of this group were, which, of course, I duly did.

Having thus forestalled legislation, Mr. Murphy's subcommittee continued its efforts to formulate a uniform program.

On May 28, 1937, the subcommittee issued its report entitled "Revision of practice on optional settlements." The first paragraph of the report read as follows: [123]

There is a growing realization that current practices under optional settlements need revision. Many companies now desire to solve the problems of unsound practice which have been encouraged by unwise competition in the past and greatly accentuated by the conditions of the last 3 years.

Twelve specific settlement option rules were recommended in the body of the report and each company was requested to send a representative to a conference scheduled for June 3, 1937, in Dr. Hunter's office, to vote on the adoption of the recommended rules.[124] Some 20 companies were in attendance. A few companies indicated their disapproval of the specific recommendations, and in almost every instance a number stated that they "were on the fence." [125] Nevertheless, there were indications that the program would in the main be put into effect by the great majority of the companies present.[126] Subsequent to the meeting the rules were revised and again sent out to each company representative.

Two months later, it appeared that the program was not going through as anticipated. Many companies had not adopted the rules and the New York Life, which had gone ahead apparently on the assumption that other companies would follow, stated that it was "finding it very tough in competition." [127] At least one smaller company requested an additional meeting "to clear the air." [128] At the semiannual meeting of the Actuarial Society of America at Swampscott, Mass., the following October, a group of interested companies again set in motion efforts to bring about greater uniformity and a conference was scheduled in the offices of the Metropolitan for the middle of the following November.[129] According to a letter of Mr. E. W. Marshall, vice president of the Provident Mutual, written at the time to Mr. Murphy, it appeared that—[130]

Quite a number of the representatives at the conference indicated the readiness of their respective companies to adopt the rules provided a majority of the companies of their own group did likewise. Some of them however were reluctant to "pioneer" in the absence of definite information regarding the official attitude and intentions of other companies.

In order to overcome the reluctance of the individual companies to "pioneer," Mr. Marshall sent out a questionnaire to each company

[123] Pt. 10, exhibit No. 785.
[124] Pt. 10, exhibit No. 785.
[125] Pt. 10, R. 4581, 4582, exhibit No. 787.
[126] Pt. 10, R. 4582.
[127] Pt. 10, R. 4583, 4584.
[128] Pt. 10, exhibit No. 789.
[129] Pt. 10, exhibit No. 790.
[130] Pt. 10, exhibit No. 790.

requesting it to state with respect to each of the 12 proposed rules whether or not it would adopt the same, provided: [131] "At least 75 percent of the companies of your group will do so." Each company was further requested to name those of its competitors whose approval would be considered a condition precedent to its own adoption of the rules. An intercompany conference was held November 15, 1937, "for the purpose of stimulating the adoption of settlement rules by additional companies" and certain modifications made to effect greater harmony. A revised schedule of questionnaire replies which included the results of the intercompany conference was sent under cover marked "Very confidential" to each of the 27 interested companies. It indicated that on almost every rule as finally proposed there was little or no disagreement and that the adoption of all such rules by a great majority of the companies was certain. One factor apparently contributing to this great uniformity was the understanding voiced at the meeting that any company subscribing to the rules need not feel bound in competition with a company which had declined to adopt them.[132]

Immediately after this agreement was effected, the companies turned their efforts toward eliminating from competition other settlement option problems and under the guidance of Mr. Marshall, some 20 companies reached substantial agreements on 5 additional points of controversy, including the guaranteed rate of interest, the interest option, and the bases to be used in computing the life income option, the maturity settlement endowment option, the fixed income until proceeds and interest exhausted option, and the installments certain option; these being the 5 principal optional modes of settlement.[133]

D. OTHER INTERCOMPANY AGREEMENTS AND ANTICOMPETITIVE UNDERSTANDINGS

Space does not permit a full discussion of other forms of intercompany agreements in the life insurance field which tend to stifle competition. A brief reference to certain agreements not already considered must suffice.

1. Reinsurance Conference

The reinsurance conference is an informal organization of companies writing life and accident reinsurance which was formed in 1929 to "encourage constructive rather than destructive competition between the respective companies" writing this type of insurance.[134] The principal efforts of the organization have been to eliminate rate cutting activities; and the president of the largest member company was able to testify that these efforts have been successful to the extent that price competition is no longer a factor in the reinsurance field.[135] In addition, the conference has promulgated and enforced rules governing underwriting practices many of which are, as was found in the case of the Group Association, designed to prevent indirect rate cutting by the offering of special services to companies purchasing

[131] Pt. 10, exhibit No. 790.
[132] Pt. 10, R. 4598, exhibit No. 793.
[133] Pt. 10, exhibit Nos. 795, 796.
[134] Pt. 10, exhibit No. 824.
[135] Pt. 10, R. 4681.

reinsurance.[136] No public regulatory body has participated in the determination of the rates or the underwriting rules established by the conference.[137]

2. Replacement Agreement

The anti-twisting laws of almost every State prohibit one life insurance company from taking insurance away from another by means of misrepresentation or omission to state a material fact.[138] These laws usually leave open to any company the right to represent its policies truthfully to the policyholder of another company and thereby to attempt to transfer the business of that policyholder. To prevent this kind of competition and to supplement the antitwisting laws, about 90 of the principal American and Canadian companies in 1931 entered into the so-called replacement agreement.[139] This agreement is officially known as "A plan for discouraging the replacement of life insurance of one company by new insurance in another company." [140] It provides that all signatory companies should ask the prospective policyholder to state in his application whether the policy applied for is intended to replace another. If such is the case, the company receiving the application agrees to notify the other company whose policy is being replaced and to delay issuance of a new policy for 2 weeks in order to give the latter company an opportunity to prevent a transfer by discussing the matter with its policyholder.[141]

3. The Medical Information Bureau

The medical information bureau is designed to facilitate the interchange of information bearing on the insurability of persons seeking insurance.[142] There are 100 life insurance companies which are regular members of the bureau and 115 additional companies which are associate members.[143] At present on file with the bureau are approximately 6,700,000 names of individuals who have physical impairments making them undesirable or questionable risks. Whenever any member of the bureau receives information indicating a medical impairment of any policyholder or prospective policyholder, it reports this information to a central clearing office which makes up a card containing the name of the individual reported and a code statement of his impairment.[144] Copies of these cards are then distributed to all members of the bureau. In this manner the competitive advantages adhering to any company by reason of careful medical selection are almost entirely eliminated.[145]

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[136] Pt. 10, R. 4677, exhibit No. 825.

[137] Pt. 10, R. 4678.

[138] Pt. 10, R. 4649. New York, ch. 28, Consolidated Laws (1940) sec. 127; Connecticut, sec. 4140, General Statutes, 1930 (Pam. 1938, p. 23); Massachusetts, sec. 181, ch. 175 General Laws 1932, amended, ch. 395, L. 1939; and New Jersey, sec. 2: 142-1 Revised Statutes, 1937.

[139] Pt. 10, exhibit No. 817. Some companies instruct their agents that any kind of policy replacement is undesirable and illegal. See, e. g., Replies of Business Men's Assurance Co. (Supplemental Training Plan pt. 4) and West Coast Life Insurance Co. (A Preliminary Guide) to commission's sales questionnaire.

[140] Pt. 10, exhibit No. 815.

[141] Of similar effect is an agreement among 4 of the 5 largest companies not to take business from another's agents without first giving notice to representatives of that agent's company, (pt. 13, R. 6564).

[142] Pt. 10, R. 4634.

[143] Pat. 10, exhibit No. 810.

[144] Pt. 10, R. 4636-4638

[145] Pt. 10, R. 4641, 4642.

4. Committee on Underwriting Large Risks

The committee on underwriting large risks is a committee composed of actuaries and medical officers of the principal companies who have joined together for the purpose of establishing uniform underwriting rules applicable to the issuance of policies in amounts in excess of $50,000.[146] These rules have been adopted by most of the leading life insurance companies and, in general, are designed to require more rigid medical examination and more extensive inquiry into the background of applicants for large policies.[147] The committee also maintains a central clearing office to which is reported all insurance taken in blocks of $50,000 or more.[148] Information thus reported is available to member companies.

5. Agency Practice Agreement

In 1935 the principal legal reserve life insurance companies entered into a declaration of 10 guiding principles which they agreed to practice in the conduct of their agency departments.[149] By 1938 some 62 United States and Canadian companies were signators to the agreement which, in general, was intended to eliminate the employment of part-time agents in cities of 50,000 persons or more and to establish certain general criteria for the selection and training of new agents.[150] The ninth provision to the agreement to which most of the 68 companies have subscribed provides that no signatory company will make a contract with an agent of another company without first communicating with the agent's home office.[151]

Thus we have seen that the principal legal reserve life insurance companies have entered into formal agreements and "gentlemen's understandings" to fix the rates for ordinary insurance, group insurance, reinsurance, and annuities as well; and have, by intercompany conferences, established a uniform basis for surrender values, settlement option provisions and the underwriting of large risks. In addition they have sought to control the transfer of business as between one another, to regulate the exchange of medical information and to control commissions and agency practices. Though this field has not been entirely explored, the evidence is adequate to demonstrate that as a result of these activities competition has been seriously limited in many important areas of the business.

The intercompany agreements invariably originate with the largest companies who are anxious to keep their dominant position intact. In the interests of uniformity, companies participating in the agreements have been willing to surrender their individual judgments for the sake of harmony. Without regard for existing antitrust statutes and sometimes apparently in spite of such statutes, the companies have carried on their anticompetitive undertakings in the absence of participation from any public authority and in a manner which has kept secret both the fact of the agreements themselves and the methods by which they were reached.

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[146] Pt. 10, R. 4642-4644, exhibit No. 811.
[147] Pt. 10, R. 4644.
[148] Ibid.
[149] Pt. 13, exhibit No. 1337.
[150] Pt. 13, exhibit No. 1337, 1338.
[151] Pt. 13, exhibit No. 1337. For a discussion of Equitable's withdrawal from this agreement see Ibid.

SECTION XII

The Life Insurance Company Lobby

Another form of intercompany activity may be found in the combination of life insurance companies for the purpose of defeating or influencing State and Federal legislation. The principal legal reserve companies conduct their legislative activities through an association known as the Association of Life Insurance Presidents.[1]

This association was organized December 21, 1906.[2] At the present time, 67 legal reserve life-insurance companies representing approximately 85 percent of the legal reserve life-insurance business in the United States are members.[3] Over 60 persons are employed by the

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[1] The Association of Life Insurance Presidents is perhaps the principal trade association in the legal reserve life insurance field. Among other important trade associations are the following which reported to the Department of Commerce in response to a questionnaire sent trade associations in connection with special studies being conducted for the Temporary National Economic Committee:

American Life Convention.—A voluntary, unincorporated association of legal reserve life insurance companies engaged in collecting and distributing to its members information on all subjects pertaining to life insurance. It has 150 members, which members underwrite about 40 percent of all life insurance in force. It maintains a legal section, which reports legal news of interest to life insurance companies. Its cash receipts for 1938 were $119,852.71. Almost $50,000 were paid in salaries. The Convention has a vice president in each State in which a member is domiciled, and through these vice presidents it renders legislative service to its members. For further discussion of the legislative activities of the Convention, see p. 176, infra.

National Association of Life Underwriters.—An association of general agents, managers, superintendents and agents engaged in the sale of life insurance and annuities. Its 1938 membership was 26,094. Its principal activities are arranging of conventions, recommending or disapproving proposed legislation, and publicising life insurance. It maintains a New York office, with a staff of 15 full-time paid employees. Additional information on the purposes and activities of this association may be found in pt. 28, exhibit Nos. 2329, 2330, 2333.

Industrial Insurers' Conference.—An organization of 35 insurance companies writing industrial life insurance, designed to exchange information and improve practices in the industrial field. Members are almost all stock companies.

Life Office Management Association.—An association of 143 members, formed to forward research in management problems of life insurance companies. Annual conferences are held as open forums for the presentation of member company operating routines and practices. It conducts the Life Office Management Association Institute, which gives educational courses in various insurance company management subjects.

Association of Life Agency Officers.—An association formed for the purpose of the consideration and interchanging of opinion on distribution problems in life insurance. It has 130 company members.

Life Insurance Sales Research Bureau.—This is an organization formed for the purpose of studying the selling conditions in life insurance and to act as a medium for the exchange of ideas between members. It is supported by 130 members, representing over 90 percent of the life insurance in force in the United States. Its income for 1938 amounted to over $200,000. It has made a great many detailed studies of many angles of life insurance marketing. See testimony of Mr. John Marshall Holcombe, manager of the Life Insurance Sales Research Bureau, pt. 10, R 4317–4339.

Institute of Home Office Underwriters.—An association of 42 company members. It was organized for the purpose of developing sound and uniform underwriting practices among its members by means of discussions and interchange of information and ideas.

National Negro Insurance Association.—An organization of 39 legal reserve companies controlled by Negroes.

National Association of Insurance Brokers, Inc.—An association of members who are licensed to act as insurance brokers in any capacity. Its stated purposes are to arrange trade-practice conferences, to combat unfair competition, to represent its members before legislative bodies, and to furnish information and legal service to its members. Almost 2,500 brokers and brokerage firms are members.

[2] See pt. 10, exhibit No. 690 for minutes of organization meeting.

[3] Pt. 10, exhibit No. 691. The association's constitution provides that any legal reserve life insurance company of the United States or Canada, which has operated on a legal reserve basis for at least 10 years, is eligible for membership. Pt. 10, R. 4347. Technically, the president of such a company applies for membership, but practically, the company itself becomes and is the member.

association, which maintains offices in New York City.[4] Its policies are determined by an executive committee of 11 members, among whom are the presidents of the five largest companies and Mr. L. Edmund Zacher of the Travelers, the seventh largest company.[5] The association is financed by initiation fees, dues and in greater part by contributions of its members, upon whom "calls" computed on the basis of relative size and first-year premium income, are made for their pro rata share of the expenses.[6] Just as the largest companies dominate the executive committee, so also do they make the largest contributions to the association's income. In 1938, the Metropolitan alone contributed $76,195 and the six largest member companies contributed $257,474, an amount equal to approximately 59 percent of the entire income of the association.[7]

The association has three principal activities: [8] to assemble statistical information for the benefit of the member companies,[9] to participate in or give financial support to "test litigation" affecting insurance companies,[10] and to engage in legislative and lobbying activities on behalf of its members. The predominant importance of the latter activities is evidenced by the fact that in 1937, disbursements for lobbying expenses totaled $181,246 out of a total disbursement by the association of $398,380. A similar heavy expenditure in other

[4] Pt. 10, R. 4348.

[5] Pt. 10, R. 4349, 4350. The Northwestern Mutual is the sixth largest legal reserve company and the only large company not a member of the association. Mr. Cleary, president of that company, stated that there was no particular reason why it had not joined the association and testified: "We are a bit far away and we maintain very friendly and satisfying contact with the association" (pt. 4, R. 1499).

[6] Pt. 10, R. 4348. Once a member, it is difficult for a company to differ from the general policies formulated by the association inasmuch as a dissenting member refusing to cooperate in a particular venture is, nevertheless, assessed its share of expenses (pt. 10, R. 4351).

[7] For information indicating initiation fees, dues, and contributions paid by the association's member companies, see pt. 10, exhibit No. 691.

[8] The association's guiding principles which it was stated have been followed ever since its origination are (pt. 10, exhibit Nos. 690, 692):

(1) To promote the welfare of policyholder;

(2) To advance the interests of life insurance companies in the United States by the intelligent cooperation of officers in charge;

(3) To prevent extravagance and reduce expenses by encouraging uniformity of practice among life insurance companies in matters of general administration;

(4) To consider carefully measures that may be introduced from time to time in legislative bodies with a view to ascertaining and publicly presenting the grounds which may exist for opposing or advocating the proposed legislation; and

(5) To consider anything that may suitably be a matter of general concern to the life insurance business.

[9] Pt. 10, R. 4351, 4352.

[10] Pt. 10, R. 4352–4355. The association has been active in this field of test litigation. During the period from 1934 to 1938, it gave financial support to 30 different actions and paid legal fees of over $197,000 and expenses of over $27,000 in connection therewith, hiring such well known firms as Davis, Polk, Wardwell Gardiner and Reed; Root, Clark, Buckner and Ballantine; and Bruce and Bullitt (pt. 10, exhibit No. 693). The most important test litigation in recent years involved the association's participation in litigation testing the constitutionality of the Frazier-Lemke Act. The executive committee of the association felt that this act, which it had opposed unsuccessfully in the Congress, might cause grave danger to the security behind many mortgages owned by the insurance companies and consequently hired attorneys to represent the Louisville Joint Stock Land Bank, one of the parties to the litigation. The association's participation in this litigation was not disclosed although the legal fees expended by the association in 1935 in this connection totaled $60,000 (pt. 10, R. 4352–4354, exhibit No. 693).

legislative years is apparent from an examination of the association's accounts.[11]

In an "on year," that is, the odd-numbered years when most State legislatures meet in regular session, the association is particularly active in the legislative field. In each of recent years the staff of the association has examined and classified approximately 10,000 bills having some bearing, direct or indirect, on the conduct of the life insurance business.[12] Special attention is given those bills which are deemed "objectionable" or which might become "objectionable" at some later date.[13] Policyholders are not consulted as to what bills should be deemed "objectionable," the association taking the position that "obviously anything that would be to the detriment of a company * * * would also be to the detriment of the policyholders." [14] That the association has given the broadest possible interpretation to its assumed prerogative is indicated by the great variety of legislation in which it interests itself. Confidential reports customarily sent to member presidents at the end of each legislative year indicate that the association has opposed, among others, bills raising premium taxes, compulsory-investment bills, bills reducing policy-loan interest rates, savings bank life insurance, bills requiring examination of agents prior to licensing, mortgage moratorium, and loan bills of many types, net and gross income and sales-tax measures, and proposals for premium notices, attorney's fees and penalties, bills

[11] Some idea of the total disbursements and legislative disbursements of the association in recent years may be obtained from the following table (pt. 10, R. 4355, 4356, exhibit No. 694):

Year	Amount of all disbursements	Amount of legislative disbursements
1935	$480,783	$139,601
1936	331,260	91,241
1937	390,380	181,246
1938	505,344	147,683
Total	1,715,777	559,751

This amount of $559,751 includes the fees, compensation, and expenses of the association incurred in connection with legislation and appearances before Government departments as follows:

Year	Fees and compensation	Expenses
1935	$46,085	$44,154
1936	13,850	13,997
1937	39,675	34,381
1938	8,950	14,551

For a detailed schedule reflecting the amount of money spent by the association for legislative purposes in each State during each year 1934–38, see pt. 10, exhibit No. 694.

[12] The number of bills examined in legislative years since 1925 are as indicated: 1925, 2,626; 1927, 3,045; 1929, 4,336; 1931, 5,739; 1933, 10,427; 1935, 10,876; 1937, 11,047 (pt. 10, exhibit Nos. 695, 696).

[13] Pt. 10, R. 4358.

[14] Id.

requiring sale of term insurance, and for the appointment of certain life companies' directors by a State insurance commissioner.[15]

As an analysis of its expenditures for legislative years indicates, there is no State in which the association is not active; [16] in fact it has a representative in every State.[17] Most of these representatives, or legislative correspondents as they are called, are "voluntary workers"; that is to say, representatives of life insurance companies who donate their services and who bill the association only for limited amount of their expenses.[18] The correspondent may be a general agent of a member company, a company official, or an officer of the local agents' or underwriters' association.[19] Occasionally the association employs local counsel to represent its interest and it is not unusual for a staff member of the association to go to the field to supervise or "coordinate the local activity." [20]

The association conducts only a limited amount of its lobbying activities in its own name. It does, however, keep in touch with its local representatives and directs them as to which proposals to urge for adoption and which bills to oppose. Choice of tactics is generally left to the discretion of the individual representative. In addition to furnishing expense money, the association prepares arguments for its legislative correspondents and on occasion prepares comparative statistical studies for presentation to interested legislators. Whenever hard put to defeat a particular bill, due to the fact that it has been voted out of committee and has reached the floor of the legislature, for example, the association communicates with the member companies and requests them to cooperate through their local representatives with the representative of the association.[21] In such cases a form letter similar to the one set forth below, which was sent to 47 member companies operating in the State of California, is mailed out by the association. The letter read as follows: [22]

Re California Senate bill No. 460—Segregation of Assets

Dear Sir: Section 8 of the above bill would require segregation of certain life insurance assets by all companies doing business in California. It is actively sponsored by Insurance Commissioner Carpenter and has been vigorously opposed by the association since its introduction in January.

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[15] For types of bills opposed by the association, see pt. 10, exhibit Nos. 695 and 696. Special reference to opposition to savings bank life insurance may be found infra p. 312.

[16] Pt. 10, exhibit No. 294.

[17] Pt. 10, R. 4359.

[18] Pt. 10, R. 4357.

[19] Pt. 10, R. 4359. Concerning the association's cooperation with underwriters' associations, Mr. Whitsitt testified (pt. 10, R. 4368, 4369):

"Mr. Gesell. There is one part of this problem that I would like to ask you a few more questions about before we finish. You have spoken of your cooperation with underwriters' associations and may I ask whether you have any formal agreement or understanding with the underwriters' association that they will cooperate with you or is it a matter which is dependent upon the particular circumstances in every case?

"Mr. Whitsitt. We have no agreement whatsoever.

"Mr. Gesell. By and large you are able to call upon the underwriters' associations for assistance, are you not?

"Mr. Whitsitt. Their interests are largely the same as ours on most propositions.

"Mr. Gesell. You have worked rather closely with them, have you not?

"Mr. Whitsitt. At times, in some States, yes—in some States not so much."

[20] Pt. 10, R. 4360.

[21] Pt. 10, R. 4360.

[22] Pt. 10, exhibit No. 697.

The section has passed through several drafts, and a copy of the latest redraft is attached hereto. While still vague and ambiguous, it would now be applicable not only to companies doing an accident and health business, as originally contemplated, but also to companies writing life insurance only.

A Senate hearing, which has been postponed twice, is now set for Monday, April 12. Mr. Shepherd—now in the fourth week of his second trip to California on this bill—advises that the commissioner is under the impression that our opposition is solely in behalf of a few member companies doing an accident and health business. In order to reinforce the association's opposition and dispel any misunderstanding, it would be most helpful if, at your early convenience, you would

(1) Telegraph to Insurance Commissioner Samuel L. Carpenter, Jr., 417 Montgomery Street, San Francisco, advising that you fully concur in the opposition of our association to this measure;

(2) Telegraph to your general agents or managers in the San Francisco and Los Angeles areas, asking their active cooperation with Mr. Bruce E. Shepherd, St. Francis Hotel, San Francisco, and Mr. Karl L. Brackett, president of the State Life Underwriters Association, 1122 Russ Building, San Francisco, and

(3) Send air-mail confirmations of the telegrams to the law firm of Pillsbury, Madison & Sutro, attention Mr. L. B. Groezinger, Standard Oil Building, San Francisco, which firm has been specially retained by the association to oppose this measure.

With much appreciation for your assistance and cooperation, I am,

Sincerely yours,

——— ———,

Manager and General Counsel.

As this method of approaching legislative problems suggests, the association has conducted its affairs without revealing the full extent of its efforts in combating legislation which it considers objectionable.[23] To appreciate the influence the association exerts, therefore, it is necessary to review its activities in some detail, in particular the conduct of its field representatives.

As has been indicated, the association on occasion sends its own executives to the field for the purpose of coordinating lobbying strategy in a particular State. Some idea of its policy and procedure in such cases may be gained from a memorandum written by the

[23] The Armstrong report severely criticized the "clandestine activities" then pursued by lobbyists acting for the insurance companies. The report stated (vol. X, p. 399):

"It has been insisted that the insurance companies have been so continuously menaced by the introduction of improper and ill-advised legislative measures in many States that they have been compelled to maintain a constant watchfulness and to resort to secret means to defeat them. An insurance corporation, however, holds a position of peculiar advantage in opposing any legislative measure which really antagonizes the interests of policyholders. A very large proportion of the voters of the State hold policies of life insurance. It is easy for the company to apprise them of hostile legislative measures, and in addition a department of the State government exists for their protection, whose recommendations have rarely failed to receive proper consideration in the Legislature. It is not a difficult matter to direct public attention to an objectionable bill affecting life insurance corporations or to have opposing argument and criticism effectively presented. Again, if, in spite of argument fairly and publicly presented, the Legislature insists upon passing a law inimical to the true interests of the companies, it is not the officers, but the policyholders, who must bear the loss, and the consequences which can readily be pointed out are almost certain to bring about an early repeal of the obnoxious legislation. The employment of agents to disburse large sums, and of clandestine methods to defeat legislation is wholly inexcusable."

Various States have enacted lobbying legislation. Legislation of this character has been adopted in the following States: Alabama, Alaska, Connecticut, Georgia, Idaho, Indiana, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Mississippi, Montana, Nebraska, New Hampshire, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Virginia, Vermont, and Wisconsin.

assistant counsel of the association following the 1935 session of the Florida State Legislature. This memorandum, part of which follows below, succinctly states the procedure adopted for handling legislative matters in that State: [24]

PROCEDURE

As soon as a study of the pending insurance measures had been completed and some thought given to anticipated introductions, it was decided in view of the administration control of both houses, that it was imperative some effort should be made to overcome the antagonistic attitude of the Governor, otherwise effective contacts with the membership of either House would be ineffective. To accomplish this end, it was decided the approach to the Governor should be through purely political contacts. Work was begun immediately along this line and was prosecuted incessantly throughout the entire session. Further, since proposed insurance taxation was only a part of the Governor's program and was the portion capable of mustering strenuous opposition, the Governor through its defeat might suffer a loss of prestige. Consequently these political contacts urged upon the Governor that a further increase in insurance taxes was wrong on principle and then from the purely political viewpoint the measure might be defeated on its merits, thus affecting administration prestige.

These efforts were stressed while at the same time direct legislative contacts were also developed by the insurance groups.

COOPERATION WITH FLORIDA LIFE UNDERWRITERS

1. The agency directors' and managers' conference at Jacksonville is the best organized group of life underwriters in the State. These men were advised of the threatening nature of the legislative situation and requested to furnish a list of the names and addresses of their Florida agents. Card index was then made for this information.

2. Contacts were immediately established with the individual agents to ascertain their sphere of influence with members of the house and senate. Each agent was furnished with the name of the members of the house and senate from his particular locality and asked to advise us at once as to acquaintanceship. Where the particular agent was close to some member, suggestions were made to ascertain the attitude of the particular member toward insurance. Many other items of a personal nature were also made the subject of inquiry.

3. After the agency contacts had been established, the check of the house and senate membership was made to ascertain the names of those with whom any such agency contacts had been directly established. For example, in many instances members came from some towns where there were no life agents. To meet this problem those members from various small communities with no resident life agents were listed and assigned to a larger city for contact. Notably the Jacksonville agents assumed the responsibility for contacts with some members from the north and the northeast sections of the State, Tampa for the south-central portion, and so on.

LEGISLATIVE CONTACTS

In order to obtain the most effective contacts with members of the senate and house, the following course was followed:

1. The geographical location of each member was indicated upon a large map of the State by using red tacks for house and blue tacks for senate members.

[24] Pt. 10, exhibit No. 698. The author of this memorandum, Mr. Robert L. Hogg, discussed it at length in the course of his testimony. See pt. 10, R. 4375–4396, inclusive.

Attached to each tack was the name and post-office address of a particular member. The map was on a large scale and clearly discernible for ready reference.

2. An individual card index [25] was made for members of the house of representatives and a similar index for members of the senate. Each carried the post-office address and personal data of the particular member. Notation was made in some instances as to the best method of approach. For example, if a particular life-insurance agent was personally acquainted with a member, a notation was made to that effect. It was not considered wise, however, to place much personal information on these cards. This was carried on a separate memoranda. To indicate a member's attitude toward insurance, or the names of the particular agents with whom he was on intimate terms, might be subsequently the cause of some embarrassment to both the member and ourselves in the event that the cards should come to the attention of unauthorized persons. Consequently records as to attitude of members or each plan of contact were in most cases omitted from the card record, although preserved by independent means.

3. Every adverse measure was examined from the standpoint of its sponsor. For example, another set of cards was prepared showing the authors of all adverse measures. Whenever we found that the same member had introduced several adverse measures or was cointroducer of several adverse measures, we concluded his general attitude toward insurance was unfavorable. This theory was certainly borne out by subsequent check.

4. After determining the identity of our opposition, we then established its geographical distribution upon the map. This course was followed in order to find out the activities behind our opposition. In other words, we wanted to know whether the attitude of the particular member was his own personal conclusion or whether it reflected the sentiment of some particular section of the State. In pursuing this theory, it developed that most of our opposition centered around the less densely settled sections of the State—primarily in the north and north central counties.

NATURE OF CONTACTS

The actual contacts with individual members rested primarily with local people. The following methods of approach are—listed in the order of their effectiveness,

(*a*) Personal interview by some life representative on intimate terms with the member;

(*b*) Contact by telephone, telegraph, or letter from the same party where personal interview was not practical;

(*c*) Interviews by telephone, telegraph, and letters from representative citizens and especially life insurance policyholders;

(*d*) Telegrams and letters from the public generally.

The use of these different methods of approach, of course, depended upon the nature of legislation under consideration.

Having used such strategy, the association at the conclusion of the 1935 Florida legislative session was able to assume that "although many adverse measures were introduced and pressed for passage, none was enacted." [26]

Further insight into the association's lobbying methods can be obtained from a review of the activities of the legislative correspond-

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[25] Concerning this card index, Mr. Hogg testified (pt. 10, R. 4384):

"The CHAIRMAN. I do take it that in the compilation of this card index and in the assembling of the information with respect to each of the various members of the house and the senate you overlooked nothing that could possibly be regarded as helpful in swaying the vote of that member.

"Mr. HOGG. Absolutely not. In conformity with facts."

[26] Pt. 10, exhibit No. 702.

ents or "voluntary workers." One such correspondent, Mr. Robert L. Cooney, for the last 15 years the association's representative in Georgia, was subpenaed and testified with respect to his legislative activities in that State.[27] The association selected its representative well. Mr. Cooney has important insurance contacts in Georgia. In addition to representing the association he is inspector of agencies for the New York Life Insurance Co., chairman of the legislative committee of the Georgia Life Underwriters Association and chairman of the legislative committee of the Atlanta Association of Life Underwriters.[28] The New York Life, as well as the Underwriters Association, financed Mr. Cooney in his work and it is apparent that he was in a key position to mobilize insurance pressure and direct it where it could be most effective.[29]

Mr. Cooney's work has not been done in the open where all can hear and all can challenge. His legislative activities have been directed primarily toward "killing" bills before they come out of committee and, if possible, even before they are introduced. In a letter written during the 1937 legislative session, he and two associates explained their methods to the association. The letter stated: [30]

> It has been our practice for years:
>
> 1. To try to persuade the author of a bill, either before its introduction or after introduction and reference to a committee, to withdraw same. This has worked out oftener than might be thought.
>
> 2. We make effort in advance, as described to you, to have friends on the committee and to have meetings at the proper time and under favorable environment. This has frequently worked out.
>
> 3. If we do not succeed in getting a bill adversed, we try to introduce another bill, hoping that the whole thing will wind up in a row, to be plain about it. This has worked at this session, and I will add in passing that we have one man, that if any bill comes out on the floor, to get up and say that he does not believe in taxing life insurance premiums at all and create a diversion in that way.
>
> 4. If a bill passes either house and goes to the other house, we try to repeat the above tactics * * *.

These obstructionist tactics have been successful; only one bill adverse to the insurance interests has gotten onto the floor of the House of Representatives of the State of Georgia in the last several years.[31]

Mr. Cooney's methods are simple and effective. In furtherance of his lobby activities, he has interested himself in the election or defeat of certain candidates for the legislature and has made "quite a number" of campaign contributions.[32] Mr. Cooney described his

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[27] Pt. 10, R. 4396, 4397.

[28] Pt. 10, R. 4396, 4397.

[29] Pt. 10, R. 4397, 4398. In recent years Mr. Cooney's salary from the New York Life has ranged from $9,600 to $11,000 plus commissions. Despite his continued legislative activity which admittedly takes substantial portions of his time, particularly while the Georgia Legislature is in session, the New York Life has never included in schedule K of the convention form annual statement any portion of his salary as an allocation to legislative expenses. The caption on schedule K indicates that the schedule is designed to reflect "All expenditures in connection with matters before legislative bodies, officers, or departments of government during the year" (pt. 10, R. 4417, 4418).

[30] Pt. 10, exhibit No. 703.

[31] Pt. 10, R. 4405.

[32] Pt. 10, R. 4402, 4403. At one time Mr. Cooney approached a group of 20 prominent policyholders who were residents of Rome, Ga., and received their promise that if he indicated to them legislators interested in increasing premium taxes they would do the best they could "to keep them from going to the legislature again." Pt. 10, R. 4407–4409, exhibit No. 709.

technique in this regard in a letter to an officer of the New York Life as follows: [33]

* * * I am going to say in passing that (admitting, of course, that we have been rather successful in heading off legislation) the method is to interest ourselves in key men before they are elected, help them to get elected, and then they owe us something instead of our owing them. That is the whole secret.

Not only did the Georgia insurance men assist in the election of State representatives, but they also arranged to have an agent of the

[33] Pt. 10, exhibit No. 705. It is not unusual for life insurance companies to make political contributions or to participate actively in campaigns. For example, it appeared that the Federal Reserve Life Insurance Co., of Kansas City, Kans., through the Federal Agency Investment Co., campaigned regularly for Mr. William R. Baker, insurance commissioner, during the period from 1922-28 (pt. 13, R. 6615-6617).

Mr. W. H. Gregory, president of the Federal Reserve, wrote Mr. Baker on August 5, 1926, as follows (pt. 13, exhibit No. 1348-1):

"DEAR MAJOR BAKER: It is my pleasure to make these suggestions; you may, or may not, think well of them.

"First. During the campaign some bad news was collected; it will be sent to you in due course. Don't worry about it, because people who do things surely will be criticized.

"No bad news was sent you during the campaign, as you seemed to be somewhat worried and it was my wish to relieve you as much as possible; and it will only be sent now in order to keep you posted.

"Second. It seems to me that one of the most important things now is for you to write the people here in Wyandotte County a letter of appreciation—thank them for their good work.

"For instance: When a judge on the bench lays aside judicial matters and goes out to work for you, that should be acknowledged in a letter that shows feeling.

"If you are too busy to do this, send us your stationery and we will have the proper letters written for each and every one; send them back and you can sign them, or you can make such changes as you like. Rest assured that they will be written in the proper spirit and they will be written to fit the case.

"Third. We do not know what you ambition is—no one has told us—but a great secret has been discovered by me. If you should like to continue as superintendent of insurance for the fourth, fifth, sixth, or seventh term, and so on, this secret will enable you to do it. It is not necessary to talk about it now, but in a short time plans should be laid. However, the work would be done so unobtrusively that no one would realize your ambition, or the point at which you were driving until the proper time.

"Think the matter over and, if at any time in the future you are in a receptive mood, we could discuss my plan.

"In this campaign something was learned by me about politics; it seems that there are four essentials: (*a*) Some money, (*b*) some brains, (*c*) hard work, and (*d*) friends.

"It requires some money to acquire ammunition and guns and then to plant them in the right spot; it requires brains to know what to do, how to do it and to know what your opponent is doing and then to outgeneral him; it requires hard work, because nothing worthwhile can be accomplished without hard work; it requires friends—friends with whom one can trade and with whom one may work—friends who can turn the trick for one.

"Perhaps we did not do everything exactly and precisely as you ordered, because we were enthusiastic and determined to win; we used our judgment, but, in looking back over the ground over which we traveled no errors can be seen by us.

"We spent money—it was necessary to do it—but you will never know what we spent; in fact, we do not know ourselves, and that is the way it will rest if anything comes up in the future. But, in my opinion, nothing will come up in the future, because there would be too much to investigate.

"It is our impression that more money was spent in this campaign than probably any other campaign in Kansas; it rolled as freely as water running down stream.

"Sometime, if you wish me to do so, it will be a pleasure to write you something of the intricacies of this last campaign and you would acknowledge that we played the game to win.

"My ambition in life is to win every time, the goal always is in sight, with a steady tramp to that goal—never allowing myself to be deflected from a path that leads directly to the goal.

"It seems to me that you are in position now to get anything you wish along political lines, although it is our impression that some fight will be made on you at the next session of the legislature; but we can find out in advance what they wish to do and Senator Vincent, if you will pardon a slang expression, will have the 'low down' on it.

"You must take off your hat to him when it comes to politics. He knows a great deal about the game. And he will place the cards on the table in a manner that everything will move along satisfactorily to all concerned; he will smooth the rough edges.

"Senator Vincent has been in politics for a quarter of a century and 6 years and he loves to smile at the other fellow. He has an attractive smile that sinks deeply into the heart of his opponent.

"Congratulations and very best wishes."

Mr. J. D. DeBuchananne, a reinsurance promoter, gave political assistance to insurance commissioners or members of their party in return for tips or inside information which he received concerning the financial condition to promote his reinsurance activities. Mr. DeBuchananne testified (pt. 13, R. 6673):

New York Life Insurance Co. appointed chairman of the insurance committee of the House.[34] It further appeared that Mr. Cooney had adopted the practice of distributing the legal business of the New York Life Insurance Co. among "smart lawyers" in the legislature to assure their goodwill and legislative assistance.[35]

In order to make sure that he would be fully advised of all current legislative developments, and having in mind that it was far easier to deal with a single legislator than with a committee or with the legislature as a whole. Mr. Cooney arranged for the association to

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"Mr. DeBuchananne. * * * We always try to work with the people who are in office; politics, and so on, down the line.

"Mr. Gesell. Oh, you politic with these insurance departments?

"Mr. DeBuchananne. Yes; you have to do a little of it occasionally. There are always fellows running for office and if we can help out a little bit when the time comes, we do, you know.

"Mr. Gesell. I don't know that; no; and I am interested in it. Tell me a little more about it. How would you politic for the insurance department officials?

"Mr. DeBuchananne. Well, we know who the different organizations hope to reelect in different parts of the State, and we assist them in whatever way we can with our agency, with the agency force.

"Mr. Gesell. You mean you turn your agents into ward heelers for the time being, is that it?

"Mr. DeBuchananne. We get them busy. We would usually favor some officers, but we would get them to work.

"Mr. Gesell. What would you get them to do, drive cars, and that——

"Mr. DeBuchananne (interposing). Well, talk to the people in the town, and electioneer in a general way.

"Mr. Gesell. Would you sometimes send out notices with your premium receipts in favor of particular candidates?

"Mr. DeBuchananne. Well, we did have circulars once or twice, but we did not make a practice of that. * * *"

He admitted that it was his practice to pay campaign contributions from the funds of insurance companies in which he was interested. These contributions were disbursed in a manner which concealed their nature, the customary practice being to employ individuals as attorneys or appraisers with the understanding that they would do nothing to earn the fee disbursed to them. In one case, for example, at the request of Mr. Huskinson, Insurance Commissioner of Illinois, Mr. DeBuchananne caused the Mississippi Valley Life Insurance Co. to pay an attorney in Springfield, Ill., a retainer of $500 which was used to raise campaign funds and for which the attorney never performed any services. Pt. 13, R. 6676, 6377.

[34] Pt. 10, R. 4415. The chairman of this committee was Mr. Harold Dobbins, an agent for the New York Life. The evidence disclosed that on December 1, 1934, Mr. Lewis A. Irons, deputy insurance commissioner of Georgia, wrote Mr. Cooney as follows (pt. 10, exhibit No. 713):

"A few days ago I had a call from Mr. Harold Dobbins, who seems to have an agency contract with you and who is very much concerned about the payment of his occupational tax, although it had been my previous understanding that the company takes care of such matters for its agents. In any event, Mr. Dobbins gave me the impression that he was called on to pay this tax and that by reason of his inability so far to close some business, although he said he had some under way which he expected to close if he could hang on, he found himself unable at this time to pay the tax levied against him, and asked whether or not it could be allowed to run along for a little while unpaid.

"I did not take up the above matter with Miss Nagle, although she is in direct charge of, and has supervision in, the matter of occupation tax collection and license fees. My plan was rather to take it up with you, in the thought that under all of the circumstances you might feel that it would be a good 'investment' for the company to meet this expense, at least for the time being, in view of the fact that Mr. Dobbins is again scheduled, I understand, for the chairmanship of the insurance committee and his goodwill might be worth keeping.

"Think it over, and destroy this letter when you have its contents in mind."

Mr. Cooney paid the $10 tax for Dobbins (pt. 10, R. 4415).

[35] Pt. 10, R. 4410. With respect to employing, as lawyers, legislators who were sympathetic to the insurance point of view, Mr. Cooney testified (pt. 10, R. 4410):

"When we found a smart lawyer in the legislature and we were unable to show him that our particular proposition was correct and he indicated that he believed it, I have told our general counsel to take that man into any local litigation that we might have. I repeat that, and am going to keep on doing it."

Concerning one lawyer and legislator, Judge E. M. Davis of Camilla, Ga., Mr. Cooney wrote to a vice president of the New York Life as follows (pt. 10, exhibit No. 7[illegible]):

"Judge Davis, I make the statement unreservedly, has the reputation in the legislature of knowing more general constitutional law than all the rest. He is one of the two men to whom the legislature listens with the greatest respect and has been on the law committee at every session that he has attended. We are going to need him in the legislature to cover the constitutionality of an act depriving municipalities of the right to levy taxes, and that is the principal reason why I would like to see him in this *Lannie Thompson case*. * * *"

employ newspapermen who had the privilege of the floor in order that he might be supplied with up-to-date information. In a letter to the association, Mr. Cooney described services which could be expected from one such newspaper as follows: [36]

For $100 this man will keep his eyes open, not only for the introduction of bills, but for the talk that goes on before a bill is introduced, and this service has proven very valuable to us and has enabled us to abort on occasion the proposed tax measures.[37]

With the same end in view, Mr. Cooney and his associates spent money in entertaining legislators. He testified that it was far easier to influence legislation by communicating with legislators in this manner. Thus he wrote to the association that [38]—

* * * we believe in killing a bill before it gets on the floor, or before a committee, if possible. It is much easier to handle one man or two men alone than it is to argue with a whole committee, and it is impossible to argue with the whole house. This money has been spent in invitations to those of whom we wished to make friends, and seeing that their wives and daughters were looked after properly and courteously, and a large portion of it in giving a dinner after the session was over to all of those who were good enough to favor us. We have been told that one reason we are kindly received is that we do not forget favors after we get them.[39]

Where entertainment, the distribution of legal patronage, or giving assistance in campaigns for office failed, more coercive methods were used to influence legislators. Two specific cases may serve to illustrate. Mr. Cooney induced one legislator to withdraw his bill by having the latter's financial backer, the First National Bank of Valdosta, Ga., wire him stating that the bill was "detrimental to business interest of Georgia." [40] In another instance, a legislator named Dr. Daves withdrew a bill following a "salty interview" with Mr. Cooney, in the course of which Mr. Cooney indicated that the doctor would no longer receive medical examination fees from insurance companies if he continued to sponsor the bill.[41]

When all efforts to force withdrawal of a bill or to smother it in committee fail, the association encourages policyholders and agents of member companies to communicate personally with their repre-

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[36] Pt. 10, exhibit No. 706.

[37] Mr. Cooney testified (pt. 10, R. 4404):

"* * * as a matter of fact, we had 1 man who is a reporter for a newspaper who had the privilege of the floor and he hears talk all over the floor about bills to be introduced and then reports it to me, so we can get hold of the men individually instead of having to wait to argue the question in detail before a large body of men."

Mr. Cooney stated in further correspondence (pt. 10, exhibit No. 707):

"* * * I am a marked man. I have the privilege of the floor, and I have been down to the legislature several times, possibly a dozen or more. The speaker of the house has made one public statement that he does not wish any member to accept any invitation given by any person who has any interest in legislation before the house. I will try to deal with this later."

[38] Pt. 10, exhibit No. 704.

[39] 3 specific instances of cases where legislators had withdrawn legislation following entertainment were revealed by a letter of Mr. Cooney's which, in reference to 1 such instance reads (pt. 10, exhibit No. 704):

"The Honorable J. W. Culpepper (previously our friend and our friend again now), previously chairman and now on the ways and means committee, gave notice that he would introduce a 3-percent tax bill. One of our committee had supper with this gentleman, and a long interview afterward. This bill never made its appearance."

[40] Pt. 10, exhibit No. 712.

[41] "Mr. GESELL. Did you indicate to him in this salty interview that if he didn't withdraw and amend the bill you would attempt to see that he didn't get any more examination?

"Mr. COONEY. Yes; I told him that very thing" (pt. 10, R. 4417). (See also pt. 10, R. 4416.)

sentatives and senators to voice protests against the enactment of the particular bill being opposed by the association. Memoranda from the association's files indicate that this procedure is used frequently in last minute attempts to influence legislative action. One such memorandum from the association's California representative written in 1935 is informative: [42]

We are using as our field forces the California Association of Life Insurance Agents, the State organization of life underwriters, and the various local underwriters' associations throughout the State who are working under our direction. Among other things, they have by this time, through friendly agents, contacted practically every member of the senate and assembly in the State. In addition to that, we are securing a certain amount of publicity through the metropolitan and rural papers against the increase in insurance taxes.

While we have only allowed a comparatively small number of policyholders to be contacted, we have succeeded in creating the impression that over 2,000,000 policyholders in this State are up in arms against any increase in insurance taxes, and the writer is competently advised that Governor Merriam's administration is weakening in its purpose to increase the insurance taxes.

It appears that in some instances the association has even paid for the telegrams and letters sent under such circumstances. During the 1935 session of the Florida Legislature, for example, Mr. Hogg, the association's representative in that State, wrote to the representative of the Mutual Life Insurance Co. in Florida, stating: [43]

It is thought wise that there should be as many telegrams and telephone calls as possible to reach these members from their respective home communities. This, of course, is a matter with which you are thoroughly familiar. Furthermore, it is advisable to have as many communications as possible from policyholders. These, of course, are details concerning which you will use your own judgment.

In response to this letter, Mr. Hogg was advised that all members were writing their agents "to immediately solicit 10 letters each from policyholders." [44] Quick action was promised, and in 2 days' time a series of letters addressed to senators and representatives had been obtained. The expenses incurred in preparing these letters were paid by the association.[45]

Thus it can be concluded that the Association of Life Insurance Presidents is a powerful lobby able to combat successfully legislation intended to regulate or affect life insurance companies. Its influence extends from the initial election of State representatives to the building up of propaganda through the artificial stimulation of policyholders.

It is clear that the association has departed from its fourth stated object, namely: [46]

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[42] Pt. 10, R. 4366.

[43] Pt. 10, exhibit No. 699.

[44] Pt. 10, exhibit No. 700.

[45] Pt. 10, R. 4385–4387, exhibit No. 701. For other illustrations of this procedure, see pt. 10, R. 4406, 4427, exhibits Nos. 733, 734. The use of form telegrams by underwriters' associations in efforts to defeat savings bank life insurance in New York are described infra, p. 313. In connection with this, Mr. Whitsitt testified (pt. 10, R. 4367):

"Our general policy has been not to contact policyholders on a wholesale basis. There have been instances as I mentioned a moment ago, where a number of general agents or agents will wish to contact a certain limited number of their own policyholders, men whom they have insured, and enlist their assistance in opposing certain legislation, but our policy has not been, so far as I have been with the association, to send out a wholesale circularization or wholesale request to policyholders to enlist them."

[46] Pt. 10, exhibit No. 690.

To consider carefully measures that may be introduced from time to time in legislative bodies, with a view to ascertaining and *publicly* [47] presenting the grounds which may exist for opposing or advocating the proposed legislation, according as the welfare of the companies and their policyholders shall point to the one course or the other.

A "clandestine" lobby still exists.[48] While present-day practices are not as crude as those scored by the Armstrong committee in 1906, the life insurance lobby has become more polished and its effectiveness has been increased through concentration of funds and initiative in the hands of a single unit. No justification exists for a lobby carried on without adequate disclosure and financed with the funds of policyholders whose interests more properly should be guarded by the free judgments of their elected representatives.

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[47] Emphasis supplied.

[48] One striking example of recent legislative activity on the part of life insurance companies was disclosed when correspondence written by Mr. C. B. Robbins, manager and general counsel of the American Life Convention, to the member companies of that association was made public by the chairman of the Temporary National Economic Committee. It appeared that under date of December 1, 1939, the American Life Convention had sent to each member company a form letter which stated:

"A resolution was passed at the last annual meeting of the American Life Convention, directing the executive committee to prepare a vigorous and effective campaign of education for the purpose of advising Members of Congress of a possible purpose behind the present investigation by the Temporary National Economic Committee in Washington. It was thought advisable to warn them of the desire of some members of the Temporary National Economic Committee for Federal supervision of all life insurance, together with the taking over by the Government of industrial insurance and merging it with the social-security system. During the course of the investigation savings bank life insurance has been held up as a model institution in view of the fact that no agents' commissions are paid, and the agency system of selling life insurance has been severly criticized.

"Pursuant to this resolution, the enclosed pamphlet has been prepared, and approved by the executive committee, with the thought that each State vice president of the convention would contact, through personal interviews, the Members of Congress from his State and give them a copy of the pamphlet for their information. He could also ascertain the attitude of the Members of Congress toward the objectives of those members of the T. N. E. C. who desire Federal supervision and absorption by the Government of industrial insurance. I am sending you under separate cover 25 copies of the pamphlet. Should you desire any more from time to time please advise us and they will be forwarded to you promptly. Inserted in the pamphlet you will find a mimeographed copy of a recent address by Hon. James M. McCormack, commissioner of insurance and banking for the State of Tennessee.

"The ---------- companies in ---------- are likewise members of the convention. I am sure that they will cooperate with you in this matter, and if you will contact them, asking that they see the Congressmen nearest their home offices, the work of interviewing all the Members of Congress from your State will be distributed so that your task will be considerably lessened. I am sending each company a copy of this letter so that they may be advised as to what is being done.

"May I have your assurance that you will see to it that every Member of Congress and both Senators from your State are interviewed by you or by one of the executives of the member companies in your State.

"We do not believe congressional members of the T. N. E. C. are in sympathy with the critical attitude of the departmental members in the investigation—criticism seems to come largely from the Securities and Exchange Commission and other departmental members of the committee.

"It will also be interesting to you to know that, at the present time, we are informed that the S. E. C. has 64 investigators among the companies, obtaining minute information as to conduct of the offices of the companies, examining files, etc. You are probably familiar with the questionnaire which was recently sent to all State insurance commissioners, inquiring closely into the conduct of the various State departments. It is our understanding that this questionnaire will be considered at the commissioners' meeting in Biloxi, Miss., December 6–9, inclusive.

"Copies of the pamphlet are being sent to nonmember as well as member companies, and if you know some executives of nonmember companies in your State, I am sure they will assist in the work of contacting Members of Congress.

"I enclose a list of the Congressmen and Senators from your State. Will you please advise me from time to time, as you have interviewed them, what the results of your efforts have been?

"If you desire further information, or if we can be of any assistance to you, please write me and I will be delighted to give you anything which the convention has on this matter."

This letter enclosed a pamphlet entitled "Life Insurance Should Be Supervised, Regulated, and Governed by Law in the States." The American Life Convention letter and pamphlet contained misstatements of fact. See letter of Chairman Joseph C. O'Mahoney, of the Temporary National Economic Committee, dated January 22, 1940, to Hon. Edward T. Taylor, pt. 28, supplemental data.

SECTION XIII

Classes and Types of Life Insurance Sold

The business done by life insurance companies falls into three broad categories—life insurance, accident and health insurance, and annuities.[1] One or more of these forms of business may be written by a single company. They require no particular discussion at this time, since their very names are sufficient to define their general characteristics. It is with only one of these categories, namely, life insurance, that this sestion of the report is primarily concerned.

The classes of life insurance sold are ordinary, industrial, and group.[2] While in many respects similar, and often offered for sale by the same company and sometimes even held by a single individual, these three classes of insurance differ considerably in their form and operation.[3] In the case of group insurance,[4] a group of persons, customarily em-

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[1] Of these, life insurance, which is essentially the insuring of persons, individually or in groups, against the financial hazards of death is by far the most important. Accident and health insurance, as written by the life insurance companies, is in most cases a side line offered for the purpose of rounding out an individual's insurance program by providing protection against injury or ill health. There was only passing reference to this type of business in the course of the hearings. (See pt. 10A, R. 68–71.) Annuities, however, are of greater importance. An annuity has been defined as (MacLean, Life Insurance, fifth ed., p. 56):

"A periodical payment to continue during a given status. The 'status' may be, and usually is, the duration of a single life, in which case the annuity is called a life annuity or, more correctly, a single life annuity."

The principal forms of annuities are immediate annuities and deferred annuities. An immediate annuity contract is one which provides that the benefits to the annuitant shall begin to accrue at once. Immediate annuities are generally paid for in 1 premium payment. A deferred annuity contract provides that the payments shall commence after a stated period of years has elapsed. Deferred annuities may be purchased either by single premiums or by periodic premiums payable during the deferred period. In many companies the sale of annuities in the last few years has accounted for substantial portions of their business. A full discussion of annuities will be found in the section on operating results, which follows, pp. 328 to 336, infra.

[2] Pt. 4, exhibit No. 216. Industrial insurance was made the subject of a special study and is discussed in detail, pp. 248 to 305, infra.

[3] The study of 1,666 insured families, reported in Families and Their Life Insurance, disclosed at p. — the following distribution of types of insurance within the insured families:

	Families
Industrial life insurance only	701
Industrial and ordinary only	370
Industrial, group, and fraternal only	198
Industrial, ordinary, group and fraternal only	194
Subtotal	1,463
Ordinary only	104
Ordinary, group, and fraternal only	36
Group and fraternal only	63
Total	1,666

Group insurance has been defined by the National Convention of Insurance Commissioners (Pt. 4, R. 1168):

"Group life insurance is that form of life insurance covering not fewer than 50 employees with or without medical examination, written under a policy issued to the employer, the premium on which is to be paid by the employer or by the employer and the employees jointly, and insuring all of his employees or all of any class or classes thereof, determined by conditions pertaining to the employment for amounts of insurance based upon some plan which will preclude individual selection, for the benefit of persons other than the employer; provided, however, that when the premium is to be paid by the employer and the employee jointly, and the benefits of the policy are offered to all eligible employees, not less than 75 percent of such employees may be so insured."

ployees of a single employer, are insured under a master policy which provides benefits for each person who participates in the program.[5] This form of insurance is usually issued without medical examination and is written on a yearly term basis, the master policy being renewed each year. Ordinary and industrial insurance policies, on the other hand, are issued on an individual contract basis, and are usually so arranged that they are continuing contracts and need not be renewed annually. The ordinary insurance policy is customarily written in units for a face amount of $1,000 or more, and premiums are payable annually, semiannually, or quarterly and sometimes monthly. The industrial policy, which is primarily sold to persons in the lower income brackets, is for smaller amounts and is paid for in weekly or monthly premiums which are collected by house-to-house canvassers who call at the homes of the policyholders. In general, industrial policies are issued without medical examination, while ordinary policies usually, though not always, require such an examination. The relative importance as of December 31, 1938, of these three classes of life insurance business,[6] for the 26 largest companies, is indicated below:[7]

	Number of policies	Amount of insurance in force
Ordinary insurance	27, 728, 000	$63, 241, 613, 000
Industrial insurance	70, 309, 667	17, 453, 863, 690
Group insurance	[1] 17, 350	11, 555, 487, 273

[1] In the case of group insurance, only master policies are indicated

The principal types of insurance sold in both the ordinary and industrial departments of the business are whole life, endowment, and term.[8] Though American companies issue a great variety of policy plans numbering as high as 136 in the case of the Prudential,[9] these plans are but combinations or variations of the 3 principal types indicated above. The modifications and variations of these types reflect the efforts of the companies to design plans to suit the many different needs and family situations that insurance is expected to meet.

The relative importance of whole life, endowment, and term insurance in force in companies reporting to Spectator as of December 31, 1938, is shown in the following table:[10]

	Number of policies	Amount of insurance in force
Whole life [1]	73, 981, 529	$79, 779, 470, 559
Endowment	42, 350, 220	23, 370, 672, 889
Term and other [2]	8, 146, 439	6, 744, 820, 408

[1] Includes group insurance.

[2] Excludes group insurance and dividend additions.

[5] Benefits allowed under group insurance sometimes include health and accident benefits, hospitalization benefits, accidental death and dismemberment benefits, or retirement annuity benefits.

[6] Life insurance may be classified in yet another way, as participating and nonparticipating insurance. This difference has been described in sec. III. (See p. 13, supra.)

[7] Pt. 10A, R. 18, 19, 25, 26, 45, 46. (See also pt. 4, exhibit No. 216.)

[8] Amounts of industrial originally written on a term plan are negligible.

[9] Pt. 28, exhibit No. 2325. For information as to number of life-insurance plans issued in 1939 by principal companies see Id.

[10] Compiled from Spectator Insurance Year Book, 1939.

These three types of insurance require the same basic actuarial assumptions. It is necessary to pass for a moment to a description of the net level-premium plan in order to understand the essential differences.

The basic theory of life insurance [11] in its simplest aspect presupposes the existence of a large group of persons banded together in order to assure each one of the group that he will leave an estate of a certain size whenever he shall die. For illustrative purposes, it is customary to assume a group of 100,000 persons of the same age. Let us suppose that each of a group of 100,000 persons is exactly 35 years old, of comparable health, and that each person wishes to be assured that his estate will have $1,000 if he should die during the year. For this purpose the group may elect a few of their number to manage the enterprise. The company obtains a table of mortality, such as the American Experience Table of Mortality.[12] which has been compiled from actual experience to show the mortality which may be expected within such a representative group at various age levels. The company examines this table of mortality to ascertain the number of the group which will probably die before the end of the next year. According to this table this number is found to be 8.95 persons per thousand at age 35. Therefore the company will expect 895 of its 100,000 members to die by the end of their thirty-fifth year. In order to pay a thousand dollars to the estate of each deceased, the company must collect a total of $895,000 from the group of 100,000. This means a payment or premium of $8.95 (excluding any interest assumption on the amount collected) from each member of the group. This amount is called the net annual cost of insurance (no margin for expense is included) for a 1-year term.

At the beginning of the second year, assuming actual experience follows that indicated by the table, there will remain 99,105 persons of the original group who were 35 years old when the company began doing business. If these 99,105 wish to continue their insurance for the second year, each one must pay another premium to the company. An examination of the mortality tables shows that the mortality rate is slightly higher between the ages of 36 and 37 than between the ages of 35 and 36. The mortality table indicates that out of the 99,105 there are 901 who will probably die before the end of the second year. Nine hundred and one thousand dollars is then the amount needed this second year to pay $1,000 to the estate of each of the 901 persons expected to die. A contribution of $9.09 from each will be required.

It should be observed that this represents an increase the second year over the premium of the first year. This same process can be continued during each succeeding year until all the members of the group have died. However, it can readily be seen that the premium would have to increase every year because of the rising rate of mortality as the group gets older. By the time the individuals have reached the age of 69, for instance, when approximately half of the group that started would be dead, the net annual premium on $1,000 insurance would have to be about $57. From this age on the premiums increase so rapidly as to become almost prohibitive. In order to obviate the difficulty presented by this continually increasing cost of annual 1-year term insurance, there was devised what is known as

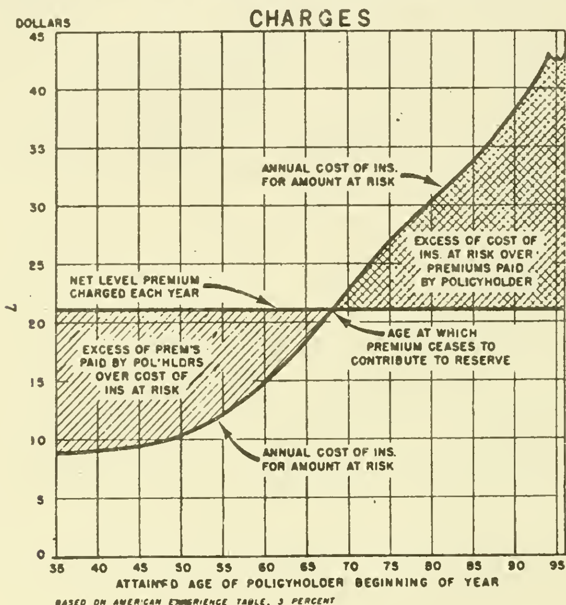
[11] See MacLean, Life Insurance (5th ed.), ch. 1.

[12] Pt. 10, exhibit No. 681.

level-premium life insurance. This calls for an annual premium which remains the same throughout the lifetime of the insured.

Reference to the accompanying chart and table will assist in understanding the significance of the level premium plan.[13] The illustration is worked out for a whole-life policy for $1,000 taken out at age 35.[14] At this age the net level premium each year is $21.08. This net level premium is based on the American Experience Table of Mortality and assumes that the company will be able to earn from its investments interest at the rate of 3 percent.

WHOLE LIFE POLICY ($1,000) AGE 35



Whole-life policy ($1,000) age 35

Attained age at beginning of year	Annual net level premium for $1,000	Annual cost of insurance for $1,000	Tabular cost of insurance for amount at risk	Reserve at end of year	Amount at risk	Sum of reserve and amount at risk
35	$21.08	$8.95	$8.84	$12.88	$987.12	$1,000
39	21.08	9.59	8.94	68.16	931.84	1,000
44	21.08	10.83	9.25	146.01	853.99	1,000
49	21.08	13.11	10.05	233.28	766.72	1,000
54	21.08	17.40	11.70	327.58	672.42	1,000
59	21.08	24.72	14.20	425.49	574.51	1,000
64	21.08	36.87	17.59	522.92	477.08	1,000
69	21.08	56.76	21.85	615.14	384.86	1,000
74	21.08	87.03	26.27	698.21	301.79	1,000
79	21.08	131.73	29.73	774.29	225.71	1,000
84	21.08	211.36	32.97	844.01	155.99	1,000
89	21.08	395.86	37.37	905.59	94.41	1,000
94	21.08	857.14	43.04	949.79	50.21	1,000

[13] See pt. 10, exhibit Nos. 681, 682.

[14] This is a regular life insurance policy payable at death and requiring regular premium payments until death.

The level premium is computed in such a way that the interest earnings augmented by the annual premiums will provide the company with sufficient funds to meet all claims. To maintain $1,000 of life insurance in force throughout his lifetime, a person who takes out this insurance at age 35 must pay a net level premium of $21.08 each year plus his share of the expenses. In the early years of his life, this net level premium is in excess of what it would cost to buy one-year Term insurance; in the latter years it is less.

This excess charge, which represents an amount above that required to cover his participation during the year, constitutes the policyholder's savings and is accumulated by the company for him at compound interest and with benefit of survivorship, by the company. When the insured has attained an age where the mortality rates are so high that the annual cost of insurance would be greater than this level premium, the company begins to draw on the interest earned by the accumulated savings or "reserve" of the policyholder.

Reference to the table upon which the chart is based will indicate how the savings element in the net level premium accumulates for an individual policy. Ten years after the policy is taken out, the savings or "reserve" will amount to $146.01.

When the policy has been in force 20 years the "reserve" will amount to $327.58. Under the table being used by the time the policyholder is 96 years old the "reserve" will have reached the face value of the policy, $1,000. The company holds the "reserve" for the benefit of the policyholder. Subject to certain restrictions the policyholder may obtain it in cash by surrendering his policy. On the other hand, he may borrow almost all of his "reserve" from the company, at interest.

There are two elements, therefore, insurance and savings, that make up the amount that is paid upon the death of the insured. These parts vary in importance depending upon the number of years the policy has been in force. In the early years the insurance element, the amount at risk, is predominant. In the later years the "reserve," or the policyholder's accumulations of savings, overshadows the insurance.

To return to the discussion of the three principal types of insurance sold it may be seen that in term insurance the insurance element is predominant. Term insurance is so designated because it insures for only a term of years, after which the policy expires. Term policies may be paid for by almost any number of premium payments as long as the payments fall within the designated term of years. The "face amount" or "principal sum" of a term policy is payable only upon the death of the insured. The savings element in term insurance is relatively insignificant, as is reflected in the fact that it seldom offers cash and loan values, and it is generally offered at much lower rates than other forms of insurance.[15] Most term contracts written today provide that a policy may be converted, subject to certain conditions, into a more permanent form of insurance during or at the expiration of the term period.

Whole life policies are generally purchased by persons who desire insurance for an indefinite period at low cost. The savings element

[15] Term policies for periods longer than 10 years occasionally have cash and loan values, paid up and extended insurance values, depending on the provisions of the State law. These values, when given, are very small. Of course, a term policy, written to expire at age 96, would be exactly the same as a straight life policy, which in turn is merely an endowment maturing at age 96.

is far more important in whole life insurance than in term, as is evidenced by the fact that whole life policies usually include substantial cash and other surrender values.

The face amount of a whole-life policy is payable only on the death of the insured and the policy may be paid for either throughout the life of the insured or for a limited number of years. A policy which requires the payment of premiums continuously throughout the life of the insured is known as a straight life policy.[16]

When the premium payments are for a limited number of years the policy is known as a limited-payment policy, such as 20-payment life, a designation which means simply that the policyholder pays for his insurance over a period 20 years, but that the face amount is paid to his beneficiaries if his death occurs during or after the premium-paying period.

Endowment insurance is a combination of a savings plan with term insurance. It is purchased by those who wish insurance for a definite period as well as a definite sum of money at the end of this definite period. The face amount of the policy is payable to the insured if he lives to the end of the endowment period or to his beneficiaries in the event that he dies before the endowment period has elapsed. Like term policies and whole life policies, endowment policies may be paid for in any number of payments within the endowment period.

Whole life, endowment, and some term policy contracts offered by American life insurance companies at the present time contain certain basic standard policy provisions. Some of these provisions may be mentioned briefly in order to describe in general terms, at least, the principal clauses in a life insurance policy.[17] Two of the most important provisions of a life insurance policy are those establishing its cash, i. e., (surrender, and loan) values.

The cash value of a policy represents that amount of cash which the company will pay the policyholder if he surrenders his policy. This value has been defined by law in terms of the policy reserve described in connection with the discussion of the net level premium. The amount of money available to the policyholder under the cash-surrender provision of his contract is usually less than the reserve and the difference has come to be known as a surrender charge. The loan value, on the other hand, represents that amount of cash which the company will lend the policyholder against his policy as security. This amount is almost always equal to the cash value of the policy. The policies of a few companies provide that the cash or loan value will equal the reserve by the end of the second year of the life of the policy; in the vast majority of companies the cash or loan value equals the reserve only after the policy has been in force from 10 to 20 years and, in a few companies, those values are never equal to the reserve. The loan against a policy bears interest at an interest rate fixed by the company within the limitations of State laws. Both principal and interest of the loan are secured by the value of the policy and both the loan and the policy, if premiums are regularly paid, remain in effect as long as the cash value of the policy is sufficient to guarantee the repayment to the company of the loan, both as to principal and interest. There is no obligation upon the borrowing policyholder to

[16] As has been explained above, the American Experience Mortality Table ends at age 96; the face amount of any whole life policy based on this table is payable at that attained age.

[17] For a detailed discussion of industrial policy provisions see pt. 12, R. 5768–5782.

repay the loan within a given period of time and frequently the loan remains outstanding until the policy is terminated.

Another basic provision establishes certain options known as nonforfeiture values, which the policyholder may utilize in the event of default on his premium payments (usually available only after three full annual premiums have been paid) instead of obtaining his equity in the policy either by borrowing on it or surrendering. The three principal nonforfeiture values are paid-up insurance, extended insurance, and automatic premium loan. The paid-up insurance value and extended insurance value are measured not in terms of cash, but in terms of the insurance which the cash value will purchase. The paid-up insurance value of any life insurance policy is the amount of paid-up insurance which the cash value of that policy will buy. Extended insurance value is measured by the length of the period of term insurance, in an amount equal to the face amount of the policy, which the cash value applied as a single premium will buy. The automatic premium loan value provides that if the policyholder has not remitted the premium required under the policy contract the company will automatically charge the amount of the premium due against the cash value of the policy as a loan and continue the policy in force—provided, of course, that the cash value is sufficient.

Another provision creates a grace period of approximately 30 days during which time the policy remains in force in spite of the fact that a premium has fallen due and has not been paid. This provision frequently permits the insurance company to deduct the unpaid premium with interest in the event a claim matures during the grace period. Policies also frequently contain a statement that after the policy has been in force for a period of 2 years it shall be incontestable except for nonpayment of premiums or for violation of policy conditions relating to military or naval service or other similar exceptions. It is customarily provided that the provisions of the policy shall constitute the entire contract between the parties, that the policyholder may participate in the surplus of the company if the policy be participating and arrangement is made for a readjustment of the proceeds of the policy in the event the age of the insured has been misstated. The policy also permits the policyholder to reinstate his policy within a definite period from the date of default if the cash value has not been paid or the period during which extended insurance is in effect has not expired, subject of course to a provision that the policyholder shall be an insurable risk at the time and that he pays all overdue premiums or other indebtedness against his policy, with interest, which is usually computed at the rate of 6 percent. There is still one final provision which deserves mention; namely, that which permits the policyholder to arrange for the payment of the proceeds of his policy either in installments to his designated beneficiaries or in the same fashion as if the proceeds had been used to purchase an annuity. There are many complicated arrangements made pursuant to this general policy provision. These are frequently referred to as settlement options.[18]

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[18] For a more complete discussion of standard policy provisions, see MacLean, Life Insurance (5th ed.), pp 221–224.

SECTION XIV

Policy Terminations

As has been indicated there are three principal types of life insurance policies sold in either the ordinary or industrial departments of the business; namely, whole life, endowment, and term. Policies of these types in the normal course of events would be expected to terminate with the death of the insured, the maturity of the endowment, or the expiration of the term. It is a striking phenomenon of the life-insurance business that only a small percentage of policies remain in force until these modes of termination result.[1] The great bulk of terminations are the result of lapse or surrender, both essentially wasteful modes of termination which, in the case of most policyholders involved, represent at least some loss.[2]

During the 10-year period, January 1928 to January 1937, insurance in force (excluding group insurance) in the United States increased from approximately $80,592,000,000 to $96,662,000,000, an increase of $16,070,000,000. To attain this increase American companies sold $146,656,000,000 of new insurance, an amount over nine times as great as the increase achieved. Thus during this same period $126,675,000,000 of insurance was terminated, an amount nearly eight times as

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[1] For testimony relating to policy terminations, see pt. 10, R. 4281 et seq.

[2] There are several ways in which a contract of life insurance may be terminated. The most important of these are death, disability, maturity, expiry, decrease, surrender, and lapse. The cessation of all enforceable legal relations under an insurance policy between the company and the policyholder or insured constitutes a termination. In case of a "decrease" the amount by which the policy is decreased constitutes a termination pro tanto. Termination of the policy through the death of the insured or through the attainment of the date specified in the policy as the maturity date constitutes an involuntary termination. In every case in which a disability payment is identified as a termination of the policy, in whole or in part, that termination is deemed involuntary. The phrase "voluntary terminations" includes all terminations which the policyholder might have avoided had he conformed to the provisions of the original policy contract in respect to payment of premiums. The various categories of voluntary terminations are:

Death.—When a policyholder dies, his policy is said to terminate by death.

Disability.—Some policies carry provisions by which premium payments cease and benefits are paid to the insured by the company if the insured suffers total and permanent disability. When this occurs the policy has terminated by disability.

Maturity.—Policy contracts, such as endowments, written to mature within a stated period of time, at the end of which the benefits are paid to the insured, terminate by maturity when the stated period arrives.

Expiry.—A term policy, or a policy which has been transferred to extended term insurance by the operation of a nonforfeiture provision, may be terminated through expiry, which means that the period of years designated as the "term" has totally elapsed. The termination through expiry of a policy originally written as term insurance is an involuntary termination, while the termination through expiry of a policy which has been transferred to "extended term insurance" by the operation of a nonforfeiture provision is voluntary termination. Therefore, in respect to ordinary insurance, expiry may be regarded as either a voluntary or an involuntary mode of termination, depending on the particular circumstances. In respect to industrial insurance, all expiries are deemed voluntary, since practically no industrial term policies are written.

Decrease.—The amount by which the face amount of the original policy is reduced during any of its life is deemed terminated by decrease.

Surrender.—Termination of a policy except through death, maturity, disability, or expiry, after a cash-surrender value is available to the policyholder, is deemed a termination by surrender.

Lapse.—Termination of a policy, other than by death, disability, or expiry, before a cash-surrender value is available to the policyholder, is deemed a termination by lapse.

great as the increase in insurance in force for the 10 years. The importance of life insurance terminations is thus self-evident.[3]

The extent to which the above terminations may be regarded as successful depends on the extent to which the terminations represent the accomplishment of the purposes for which the insurance was originally purchased. Obviously, a policy that terminates through death, maturity, or disability (and to some extent through expiry) [4] can be said to have terminated through the eventuation of the contingencies against which the policyholder wished to insure. On the other hand, if the policy terminates through decrease, surrender, or lapse, it has not served the purpose for which it was purchased and in most cases it may be said that its owner has experienced some degree of frustration in his insurance program.

Of the $126,675,000,000 of insurance terminating during the indicated 10-year period, only 21.59 percent terminated by death, maturity, disability, decrease, or expiry; while 78.41 percent terminated by lapse or surrender. The relative importance of the modes of termination is indicated below.[5]

	1928–37	
	Amount of insurance terminating	Percentage of total terminations for period
Lapse	$65,388,000,000	51.62
Surrender	33,932,000,000	26.79
Expiry	12,246,000,000	9.67
Death	8,353,000,000	6.59
Decrease	5,407,000,000	4.27
Maturity	1,255,000,000	.99
Disability	94,000,000	.07
Total	126,675,000,000	100.00

The significance of lapse and surrender cannot be overemphasized since at least 78.41 percent of the insurance terminating during this 10-year period terminated in a manner which did not fulfill the principal purposes for which it was intended.

It will be recalled from a discussion of the net level premium plan [6] that policyholders purchasing whole life and endowment insurance pay considerably more than the cost of their protection during the

[3] Pt. 10, R. 4294–4301, exhibit No. 684. A fairly comparable situation was found for the period 1918–27. (Id.) These figures are based upon Spectator Life Insurance Year Books and since the number of companies reporting to this publication over the years covered varies considerably the figures are not completely reconcilable. (See pt. 10, exhibit No. 684, footnote 3.) During the period there were revivals amounting to $11,314,000,000. (Id.) The figure for amount of new business also includes revivals and reinsurance of business in bulk. The termination experience of industrial policies will not be considered separately in this section, but may be found at pp. 278 to 282, infra.

[4] When a term policy terminates through expiry it has clearly fulfilled the purpose for which it was purchased. Terminations by expiry include, however, the expiry of extended term insurance. Extended term insurance is one of the nonforfeiture values available to a policyholder who is unable to continue payment of his premiums and, to this extent, terminations by expiry may be regarded as representing the frustration of the policyholder's original purpose.

[5] Pt. 10, exhibit No. 684.

[6] Pp. 179 to 182, supra.

early years a policy is in force in order to reduce premiums which would otherwise increase precipitously in later years. In the case of most companies an ordinary policy must have been in force 3 years before the policyholder may draw out any portion of his savings through surrender or policy loan. If premiums are discontinued during the period—i. e., if the policy lapses—the policyholder's savings are forfeited to the company and can never be retrieved. Thus with over $65,000,000,000 of insurance lapsing in the 10-year period [7] the tremendous waste which exists in the insuring machinery is readily apparent. In the case of surrender a similar, though somewhat less serious, situation is to be found. It must be recognized that when a policy is surrendered the policyholder is not always able to recover the full reserve which has been accumulated against his policy. Frequently a surrender charge is made at the time of surrender which is deducted from the reserve. In the case of a policy which lapses, the surrender charge is in effect 100 percent of the reserve. After 3 years have elapsed from the time the policy was taken out, however, companies commence to release at least a portion of the reserve to the surrendering policyholder.

The following schedule[8] shows for present issues of different companies the first policy year in which the full amount of the policyholder's reserve is returned in the event of the surrender of his policy:

Company:	*Year in which full reserve is first paid on surrender of policy*
Mutual Benefit	Third policy year.
New England Mutual	Do.
Guardian Life	Eighth policy year.
Connecticut Mutual	Tenth policy year.
John Hancock	Do.
Massachusetts Mutual	Do.
National Life	Do.
Northwestern Mutual	Do.
Penn Mutual	Do.
Provident Mutual	Do.
State Mutual	Do.
Union Central	Do.
Bankers Life	Fifteenth policy year.
Equitable (Iowa)	Do.
Lincoln National	Nineteenth policy year.
Aetna	Twentieth policy year.
Connecticut General	Do.
Equitable	Do.
Metropolitan	Do.
Mutual (New York)	Do.
New York Life	Do.
Pacific Mutual	Do.
Phoenix Mutual	Do.
Travelers	Do.
Western and Southern	Do.
Prudential	Surrender charge always made.

[7] Pt. 10, exhibit No. 684.

[8] Little Gem Life Chart, 1939.

Thus many policyholders whose policies terminate by surrender receive, in accordance with their policy contracts, a refund of only a portion of their reserve and suffer a loss to the extent of the surrender charge assessed. This charge is substantial, amounting to as high as $25 per thousand dollars of insurance in force in certain large New York companies.

There is yet another way to demonstrate the extent of termination by lapse which from the point of view of the policyholder is certainly the most undesirable. The figures presented above undertake merely to show the relationship between the amounts of insurance terminated by lapse and total terminations; they do not reflect the amounts of insurance which terminated through lapse in relation to the amount of insurance exposed to lapse. This latter relationship is known as a lapse rate. There is no lapse rate available for the industry in its entirety. Lapse rates for its member companies are prepared on a confidential basis by the Life Insurance Sales Research Bureau.[9] These rates show that in the year 1938, 21 percent of all insurance in force with all the Bureau's member companies which was exposed to all the various modes of termination, terminated by lapse. The lapse rate for some of the member companies was as high as 65 percent; the lowest lapse rate in the group was 11 percent. Lapse rates as calculated by the Life Insurance Sales Research Bureau for individual companies are set forth below.[10]

	1929 Percent	*1934* Percent	*1938* Percent
Acacia	--	--	24
Aetna	16	18	15
Atlantic	37	39	32
Bankers (Iowa)	--	--	26
Bankers of Nebraska	25	42	37
California-West States	36	38	35
Canada	17	17	21
Connecticut General	17	20	19
Connecticut Mutual	17	19	17
Continental American	--	--	28
Farmers & Bankers	45	55	53
Fidelity Mutual	24	24	19
Franklin	--	--	42
Great Southern	46	52	42
Great-West	26	27	24
Guarantee Mutual	--	--	43
Guardian	19	25	20
Home of New York	19	22	16
Jefferson Standard	33	38	31
Lamar	39	50	38
Lincoln National	37	35	30
Manufacturers	32	25	20
Massachusetts Mutual	9	18	15
Midland Mutual	24	[1] 29	23
Midwest	44	53	65
Minnesota Mutual	--	--	35

[1] Estimated.

[9] Pt. 10, R. 4319-4325.
[10] Pt. 10, exhibit No. 689.

	1929 Percent	1934 Percent	1938 Percent
Monarch (Massachusetts)	31	35	42
Mutual Benefit	9	20	13
Mutual Life	11	17	12
Mutual Trust	31	33	30
National Guardian	17	32	24
National Life & Accident	--	61	50
National of Vermont	17	24	19
New England Mutual	9	13	11
Northwestern Mutual	10	16	12
Northwestern National	35	30	30
Occidental of California	46	72	34
Oregon Mutual	31	50	31
Pacific Mutual	23	26	22
Pan-American	--		37
Penn Mutual	15	23	18
Philadelphia	35	39	29
Pilot	41	49	41
Phoenix Mutual	12	11	16
Provident Mutual	12	18	16
Southland	37	50	46
Standard of Pennsylvania	32	48	26
State Mutual	13	22	14
Sun	19	28	21
Union Mutual	--	--	30
United Benefit	--	52	60
United Life & Accident	--	--	26
Volunteer State	38	46	36
West Coast	51	52	48
Western	--		49

There are no figures available from any source which reflect the amount lost to policyholders through lapse and surrender. Unquestionably this amount would reach staggering proportions if it were known. The convention form annual statement casts little light on the subject. In one schedule companies are asked to state the net gain from lapses and surrenders. In every year since 1918 the American companies in the aggregate have reported a gain from these two sources. The total "gain from lapses and surrenders" to companies during the period 1918 to 1937 amounted to $1,328,443,189 or an average of $66,000,000 a year. The results by 5-year periods since 1918 are shown below.[11]

1918–22	$128, 254, 209
1923–27	257, 156, 216
1928–32	532, 178, 653
1933–37	410, 854, 111
Total	1, 328, 443, 189

These figures may represent a fairly accurate measure of policyholders' losses. They overstate company profits, from lapses and surrenders. The difficulty in obtaining figures on this highly significant

[11] Pt. 10, exhibit No. 687.

question, namely, What are the losses and profits to policyholders and companies from lapses and surrenders—arises from basic deficiencies in life insurance accounting. When a life insurance company sells a policy it incurs certain initial expenses or acquisition costs. These, when added to the amount which the company is required to set aside as a legal reserve against the policy may total more than the first premium received. It is necessary, therefore, for the company to draw upon its surplus to make ends meet, and it is not until the policy has been in force for a given period, varying in the case of each company, that the income from the policy repays the surplus account for the drain resulting from acquisition.

If the release of the reserve, which results from and is made possible by the termination of the policy contract by lapse, is insufficient to reimburse the company for the amount of its surplus expended to acquire that policy, then the lapse results in a loss to the company pro tanto. If, however, the reserve is true, the company may break even or may realize a profit from the lapse. Similarly in the case of a policyholder who surrenders his policy; though the policyholder always recovers a portion of his reserve, the company may gain from a surrender if the difference between the money released to the policyholder and the reserve itself (surrender charge) is more than sufficient to reimburse the company for the cost of acquiring that policy and maintaining it in force. Since the figures given on gains from lapses and surrenders are net it is impossible to determine to what extent a gain for a given year constitutes simply a return of the amount originally withdrawn from surplus and to what extent it represents additions to surplus from profits realized through the lapse and surrender of the policies in question.

The problem of lapse and surrender has confronted the life insurance business almost since its inception. Repeatedly critics have called for correction, pointing to social evils resulting therefrom. Company officials have replied that they are conscious of the problem and working toward its solution. When their failure to make substantial progress toward this end, however, is mentioned, and pointed reference is made to the serious deficiencies in their accounting methods which prevent any true estimate of the gains or losses experienced as a result of lapse and surrender, most companies offer excuses, arguing that lapse and surrender are to a certain extent inevitable because they are the result of the natural human tendency to discontinue a program of thrift and savings and other factors beyond the control of the insuring company.[12]

The Commission's sales questionnaire requested companies to state the results of any studies or statistics which they might have indicating the causes for lapse, surrender, decrease, or transfer to extended term insurance. An effort was thus made to determine what were in the opinion of the companies the principal causes for voluntary terminations. Many companies indicated by their answer that they did not have any definite information on the subject.[13]

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[12] Pt. 10, R. 4315, 4316, 4323, 4324, 4325; pt. 12, R. 5962, 5963, 5970, 5971, 5972, 6020.

[13] The answer of the Mutual Benefit, for example, stated, Reply to Commission's sales questionnaire, item 73:

"The principal causes which in the declarant's opinion affect termination of insurance by lapse, surrender, or transfer to extended term insurance are the inability or unwillingness of the insured to keep the insurance in force. Declarant has no means of knowing or ascertaining such causes at the time the insurance is written. Declarant has not made any study with respect thereto."

Among the principal causes mentioned by companies were the following: A change in the financial condition of the insured resulting from loss of job or other change in economic status, the operations of twisters, accumulation of indebtedness against the policy, instability of the insured, loss of contact or dissatisfaction with the particular agent responsible for the sale and the discontinuance of the need for which the policy was taken.[14]

There were very few companies however which indicated they had made any special studies to determine causes for voluntary terminations. The only comprehensive study which was presented in reply to the questionnaire was a study by the Northwestern National based upon information assembled over a period of 10 years. These studies indicated that the principal cause of lapse was simply the "normal human failure to carry out projected plans."[15] Education, social standing, type of policy, and a great variety of other factors were shown to have some effect upon the persistency of business. For example, business women, business executives, teachers, nurses, bookkeepers, Government employees, and railroad workers were found to have particularly high persistency, whereas nonskilled laborers and farm laborers, for example, were found to have a low persistency. In setting forth the results of the study, the Northwestern National stated:[16]

If we approach the question from the standpoint of the man who sells the business rather than from the standpoint of large classes of buyers sold by the agents, we find that the variation in performance tends to be far more extreme indicating that the influence of the agent has a far more vital influence than any other.

In substantiation of this statement the company presented figures comparing the records of two agents and disclosing that regardless of the size of the policy, the amount of insurance sold, the income level of the purchaser, his age, sex, or occupational standing, one agent was found to consistently write insurance with a lower persistency record than the other. The Northwestern National's concluding findings are:[17]

* * * the major factors affecting lapse are these:

1. How exactly does the original sale fit the existing needs or desires of the buyer and how thoroughly is it sold as a solution to a vital problem of the buyer?
2. How frequently and thoroughly is the policy serviced and resold?
3. Is the agent's compensation and are his incentives so set up that these two essentials to persistency are emphasized and encouraged in his work and his potential earnings dependent on them?

This study indicates that lapse and other voluntary terminations are partially the result of selling practices. This view was substantiated by several companies which indicated that the activities of the agency force were in at least some measure responsible.[18] The strong-

[14] Replies to Commission's sales questionnaire.

[15] Northwestern National reply to sales questionnaire No. 73. See also pt. 28, exhibit No. 2332, showing study made by Connecticut Mutual.

[16] Id.

[17] Id.

[18] Central Life, Life Insurance Co. of Virginia, Ohio National, Penn Mutual, Volunteer State, replies to Commission's sales questionnaire, item 73.

est statement in this regard was made by the Southwestern Life Insurance Co. which listed the following six causes as the chief causes of lapse:[19]

1. Change in financial status of the insured.
2. Improper selection of agents.
3. Lack of training of agents.
4. Inadequate compensation of agents.
5. Overemphasis on production on the part of the company and agency supervisors, especially in the use of sales contests.
6. Policies were originally purchased to cover a temporary need. This reason for termination of insurance is sometimes ascertainable at the time the insurance is written.

In the absence of more complete company studies or the testimony of the many policyholders involved it is impossible to weigh the exact significance of each factor contributing to lapse and other modes of voluntary termination. So important a phenomenon cannot be explained or justified by simple reference to "the human frailties." Upon analysis a substantial portion of the blame will be found to rest primarily upon certain management policies, particularly those policies relating to the sale of insurance and the servicing of insurance after it is sold. In the sections on agency practices and industrial insurance which follow, it will be demonstrated that insufficient training of agents, high turn-over in sales personnel, poorly designed methods of compensation of agents and managers, high-pressure selling and other related matters contribute materially to lapse and surrender and the losses to policyholders incident thereto.

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[19] Reply to Commission's sales questionnaire, item 73.

SECTION XV

Agency Practices [1]

It has been traditional in the life insurance business that policies be sold by agents. During the years when the companies were yet to be established in the public's confidence and the benefits of life insurance were not known to large sections of the population, the life insurance agent pioneered in making people insurance conscious and in so doing unquestionably performed an important service. Although it is now recognized and quite generally admitted that agents of many companies were goaded into overzealous actions by managements interested only in increasing volume and that high-pressure tactics frequently prevailed during the period,[2] these excesses may be partially overlooked in the light of good accomplished.

Today, however, problems of serious economic and social consequence confront the agency system. During recent years, weaknesses in the traditional method of distributing life insurance have become increasingly apparent. Though the country is security-conscious to such an extent that life insurance will be found an accepted part of the family budget, the agency machinery has been maintained on essentially the same basis as when life insurance was a novelty and unfortunately has not been adapted to the changing conditions. In brief it is evident that the number of agents is too great, that many agents are unfit and untrained and that average agency compensation is very low. Furthermore, due to their continued emphasis upon the production of a volume of new business the companies have failed to develop adequate methods for servicing the needs of their existing policyholders, and, in perpetuating sales practices no longer suited to the market, have encouraged a condition which fosters maldistribution of policies and results in unnecessary losses to many policyholders.

The agency system, itself, is not at fault. When properly managed, it provides the backbone of the entire business and its continuation is essential. Through the ignorance or carelessness of management, however, it has been permitted to deteriorate until it no longer fills the needs of the insurance buyer.

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[1] This section is confined to a discussion of agency practices of companies selling ordinary insurance. Agency practices of industrial companies are considered at p. 258, *et seq.*

[2] In discussing the historical development of life insurance during the post-war period 1919–29, Mr. Joseph B. Maclean, associate actuary of the Mutual Life, states (Life Insurance, 5th ed., p. 544):

"Undoubtedly some of the growth of this period was forced and unhealthy. There was a good deal of high-pressure salesmanship and over-insurance and, in fact, of over-purchasing of insurance by those whose purchases were being financed temporarily by the easy gains of the stock market."

See also annual meetings of the Association of Life Agency Officers and Life Insurance Sales Research Bureau; 1938 at pp. 7 and 223; 1937 at p. 113 and 1935 at p. 23.

That department of a life-insurance company concerned with sales and agency affairs [3] is generally headed by an executive at the home office who in many cases works in close cooperation with a sales or agency committee of the company's board of directors. The home office executive and his assistants are usually compensated on a salary basis and are responsible for exercising general supervision over sales activities in the field. Most of the records concerning the performance of agents are maintained at the main offices of the company and matters of policy are initiated and put into effect by the staff of its agency department.

It is only in rare instances that agents are directly responsible to the home office. Usually an agent will work under the direct supervision of a general agent or branch manager. The general-agency system was the first system used by life-insurance companies to supervise selling activities in the field and it is still the most important. Under this arrangement, the company appoints an individual as general agent and assigns him a specified area over which he is given control and sole jurisdiction. It is his job to hire and fire agents in the territory he has been assigned and he must himself stand financial responsibility for the principal expenses incident to the conduct of the agency. The general agent receives a commission usually equal to a percentage of from 55 to 65 percent of first-year premiums on whole life policies written by agents whom he employs on behalf of the company and renewal commissions on the same policies ranging in amount from 5 to 10 percent for a period of from 6 to 10 years from the date the policy was written. The general agent not only retains a portion of these first-year and renewal commissions but he also receives commissions on business which he, himself, writes directly.[4]

Under the branch-manager system the company appoints managers to administer field offices of the company set up in various key localities throughout the territory in which the company operates. The branch manager performs the same functions as the general agent, including the hiring and firing of agents. Agents' contracts are, however, made directly with the company. The branch manager is somewhat less independent than the general agent and may count on more financial assistance from his company. He usually receives a guaranteed salary which is often augmented by underwriting commissions on his own business and business written by agents under his jurisdiction.[5]

It is not unusual for a single company to utilize both the general-agency and branch-office systems simultaneously. Out of the 58 companies examined, 17 operated under both systems while 35 used the general-agency system exclusively. Of the total insurance in force,

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[3] This general information was obtained from company replies to the Commission's sales questionnaire. For a description of the operations of the agency department of the Equitable see pt. 13, R. 6508-6514.

[4] Replies to Commission's sales questionnaire, exhibit V.

[5] Id.

as of December 31, 1938, in these companies, almost twice as much insurance was carried with general agencies as with branch managers.[6]

The method of compensating life-insurance salesmen by first-year and renewal commissions has existed with little variation for many years. Regardless of whether he is responsible directly to the home office of his company or to a general agent or branch manager, he receives a first-year commission which is augmented by renewal commissions. The first-year commission is equivalent to a percentage of the premium paid on the policy during the first year it is in force and the renewal commission is based on a lower percentage of the annual premiums paid on the policy during a specified number of years following the first year. An agent usually receives from 45 to 75 percent as a first-year commission on whole-life policies written by him and a somewhat lower percentage of first-year premiums on other plans of insurance which he sells. The renewal commission paid

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[6] Replies to Commission's sales questionnaire, items 20 and 27.

Companies using the general-agency system urge that its chief advantages lie in the fact that it enables the company to attract men of experience, initiative, and financial resources who are willing to accept a general-agency appointment where they would not accept a branch-manager assignment because they have as general agents more of a stake in the enterprise and greater opportunity for profit if successful. Companies employing general agents feel that they can better control field expenses since the general agent is an independent contractor and cannot demand money from the home office in excess of that specified in his contract. These companies also believe that under a general-agency system they do not have to be concerned with as many supervisory problems. Those companies using the branch-manager system, on the other hand, argue that it gives a better supervisory control, a more flexible basis of operations, enabling a company to initiate modifications in agency programs more readily. The smaller companies almost uniformly use a general-agency system since it requires less original cash outlay. Many companies follow one system or the other primarily because that system was traditional to the company's operations. In only a few replies to the questionnaire did any company indicate a positive conviction that one form of field management was the only form conducive to good agency organization. (From companies' replies to Commission's sales questionnaire, item 28.) Mr. Parkinson, president of Equitable, whose company employs both systems, distinguished the general agent from the branch manager in the following manner (pt. 13, R. 6512):

"The general agent, speaking generally, derives very little of profit for himself from the first year's commission; he makes his compensation principally from the renewal commissions, and his renewal commissions run always for 9 years, and under our contracts usually for 5 succeeding years; and the agency manager, on the contrary, has only a limited interest in renewal commission, deriving his compensation largely from his guaranty and from his performance of the various functions assigned to him; but we have in recent years varied our agency-manager contract to increase his interest in the renewal commissions and thereby have tended to remove the distinctions between the agency-manager contract and the general-agent contract."

Out of 58 companies replying to the Commission's sales questionnaire there were 28,788 agents working under branch managers and 61,216 working under general agents. Replies to Commission's sales questionnaire, item 20.

ranges from 2½ to 5 percent of the annual premium and customarily is received by the agent for a period of 9 years.[7]

A. THE DRIVE FOR NEW BUSINESS

It will be observed that the above method of agents' compensation depends largely upon the production of new business. It effectively implements the desire for growth which has been one of the principal preoccupations of company management. This attitude of management toward growth was apparent from the testimony of several company officials. Mr. William Montgomery, president of the Acacia Mutual Life Insurance Co., for example, testified that in his opinion some companies were:[8]

> * * * pushing agents too hard to get a volume of business that will make the company good window dressing.

[7] The following list of representative companies pays whole-time agents the indicated first-year commissions for whole life, 20-payment-life and 20-year-endowment policies:

	Whole life	20-payment life	20-year endowment
Prudential	50 percent	45 percent	35 percent.
Occidental Life	60 percent	50 percent	40 percent.
John Hancock	45 or 50 percent, depending on age of policyholders.	45 percent	30 percent.
Northwestern National.	do	55 percent	45 percent.
Travelers	25 to 55 percent, depending on age of policyholder and size of policy.	25 to 47½ percent, depending on age of policyholder.	25 to 35 percent, depending on age of policyholder.
Southwestern	75 percent	75 percent	75 percent.
Central Life	55 percent	50 percent	35 percent.
Kansas City Life	70 percent	70 percent	65 percent.
Guarantee Mutual	30 or 50 percent, depending on age of policyholder.	50 percent	35 percent.

In almost all cases the companies pay a 5 percent renewal commission for a period of 9 years. In the case of Prudential, renewals may continue for 10 years while in the case of the Occidental Life renewals are paid as long as the agent remains in the company and the policy continues in force. In the case of the Kansas City Life, the agent's contract provides that the renewals may be fixed by the company and no specific percentage is stated. The Central Life, Guarantee Mutual, and Southwestern have renewal systems which pay the agent longer renewals if the amount of his new business written is in excess of a specified figure. The Southwestern for example will pay renewals up to the end of the sixth year if the new insurance written is between $50,000 and $75,000, up to the end of the eighth year if it is between $75,000 and $100,000 and if the agents writing are $100,000 or over it will pay renewals of 10 percent in the second year and of 5 percent for from 3 to 10 years thereafter (from current agent's contracts submitted by companies in reply to Commission's sales questionnaire).

[8] Pt. 13, R. 4340. Most companies replying to the Commission's sales questionnaire indicated that growth was one of their objectives. Statements of company objectives in respect to growth and the writing of new business are illuminating. The Union Central, for example, has as its objectives the writing of $100,000,000 of new business in 1939, the continual increase of business in force and the writing of an amount of new business equal to 1½ percent of the total new business in the industry. The Penn Mutual set as its objective in this regard the writing of new business each year equal to about 2 to 3 percent of the total ordinary new business written in the United States. The Atlantic Life Insurance Co. stated that it wished to write about $10,000,000 new business each year and show a gain of about $1,000,000 a year. The Aetna stated that it wished to write an amount of new business equivalent to 10 percent of its business in force with a view to effecting a net increase of about 2 percent. Replies to Commission's sales questionnaire, item 7.

Mr. Frederick H. Ecker, chairman of the board of the Metropolitan, acknowledged that his company definitely encouraged the writing of new business and considered growth inherent in the business. In response to a question as to whether his company had come to a conclusion that it "should stop growing" he stated:[9]

It never has * * *, that would result in our going out of business. You can't stand still. You either go forward or you go backward. You have an organization in the field who are depending for a livelihood upon their writing of life insurance. If you tell them to stop writing they will go to a company where they will get paid, and that whole organization will disintegrate.

Mr. Thomas I. Parkinson, president of the Equitable, testified to the same effect. After discussion of the sales objectives of his institution he said it was possible that if the Equitable was successful from the point of view of its present management policies its assets might grow in size to 5 or even 10 billion dollars in time and that he felt there must be growth for the life insurance companies to have the most vigorous and sound policy.[10]

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[9] Pt. 4, R. 1252.

[10] Pt. 13, R. 6539, 6560. The attitude that unlimited and continued growth is either necessary or beneficial was not shared by all company executives who testified. Mr. Charles F. Williams, president of the Western & Southern, testified, for example, that if his company grew to have more than $1,000,000,000 insurance in force, it would be bound to lose contact with the problems of the agency force and the policyholder (pt. 12, R. 5935). Approximately this same position was taken by Mr. Arthur Coburn, vice president of the Southwestern Life, who testified (pt. 13, R. 6593, 6594):

"Mr. GESELL. Then you think that the writing of policies on a high-pressure basis, and the consequent lapse and continual turn-over of policies, creates ill will among the people?

"Mr. COBURN. Oh, definitely so.

"Mr. GESELL. And from a strictly operating, realistic approach to the conduct of the business on a profit-and-loss basis, it is desirable to keep policyholders contented and not to trick them out of too much money.

"Mr. COBURN. I think that is correct.

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"Mr. GESELL. Have you ever given any consideration to going outside of the State of Texas and doing business in the surrounding States?

"Mr. COBURN. We have.

"Mr. GESELL. Why have you decided not to do so?

"Mr. COBURN. Because we were writing so much business in Texas.

"Mr. GESELL. Well, I take it you could write more if you went outside.

"Mr. COBURN. We think it would be unwise to write more business than we are now writing.

"Mr. GESELL. I take it, then, that you do feel that there is some advantage to a company which keeps its operations from growing too extensive.

"Mr. COBURN. It is more profitable not to grow too fast. You make more money.

"Mr. GESELL. What about it from the point of view of the policyholder?

"Mr. COBURN. I don't feel that we are under any obligation to the citizens of Oklahoma. We have never undertaken to render them any service. I don't think that Oklahoma is in any way jeopardized by the fact that we have not entered Oklahoma.

"Mr. GESELL. Do you feel that you can better service a smaller group of policyholders than you can a large group of policyholders?

"Mr. COBURN. I believe you secure maximum efficiency in the life-insurance business with a regular company that has $500,000,000 of life insurance in force. I believe any growth, any substantial growth, orderly growth up to $500,000,000 is definitely advantageous from an operating point of view.

"Mr. GESELL. Beyond that, you have serious doubts?

"Mr. COBURN. Beyond a billion dollars of life insurance in force, to maintain the same efficiency becomes a problem. It has been done, but nevertheless it is a problem to be solved. You have in this country one notable example of a company that has solved it."

See also testimony of Mr. John A. Stevenson, president Penn Mutual, who stated that it was not necessary for a company to grow in order to maintain the integrity of policies now in effect (pt. 28, testimony on Feb. 13, 1940; testimony of Mr. George S. Van Schaick, vice president New York Life; pt. 28, testimony on Feb. 20, 1940; and testimony of Mr. Alfred M. Best, president Alfred M. Best & Co., pt. 28, testimony on Feb. 29, 1940).

This desire for growth is perhaps nowhere more apparent than in the cold statistics which present the actual results accomplished in recent years. As has already been indicated, in less than 60 years insurance in force has increased 2,500 percent or at a rate 25 times as fast as population, and in the last 28 years alone it has grown from 16 billion dollars to 111 billion dollars in force.[11] There is a frequent saying that life insurance is sold, not bought. The tremendous growth which has been experienced, though partially attributable to many causes, is to a considerable extent the product of a push for sales. In this respect activities of company managements in sponsoring sales contests and in distributing high pressure sales literature to their agents and managers are revealing.

Of the 62 companies replying to the Commission's sales questionnaire 55 companies held company-sponsored sales contests during 1938.[12] These sales contests take many forms but the only criterion of success in practically all of them is the volume of new business written. The persistency of insurance written during the contests is seldom a consideration.[13]

The character of the sales contests may be judged by typical examples chosen from a wide group of contests described by witnesses before the committee or reported to the Commission in reply to its sales questionnaire. Almost any excuse is used to justify a contest: the breaking of ground for a new office building, the birthday or anniversary of some executive officer, the anniversary of the company, the retirement or promotion of an executive officer or well-known salesman, Thanksgiving Day, Christmas, the opening of the baseball or football season, the September lag, the opening up of a new territory or the achievement of a high mark in insurance in force. No matter what the excuse, the contest is presented to the agent in dramatic and glowing terms, the effort being made to stimulate him

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11 P. 9, supra.

12 Replies to Commission's sales questionnaire, item 17.

13 Some company officials have stated that the lapse rates of contest business are much higher than the lapse rates of business obtained at other times. The testimony of Mr. Arthur Coburn, vice president of the Southwestern Life, is interesting in this connection (pt. 13, R. 6591):

"Mr. GESELL. Do you believe in the usual type of high pressure contests such as we considered yesterday?

"Mr. COBURN. I am absolutely unalterably opposed to high-pressure selling.

"Mr. GESELL. Do you believe that sales contests generally promote that kind of selling?

"Mr. COBURN. Highly detrimental * * *.

"Mr. GESELL. It is your experience, I take it, that any efforts to emotionalize the salesmen or artificially stimulate them into production results in writing a poor form of business * * *.

"Mr. COBURN. It does."

See also p. 258 infra at note 59.

In its reply to the Commission's sales questionnaire, item 17, the Central Life Assurance Society stated.

"The persistency of business written during these contests cannot, of course, be determined as a year has not elapsed and we cannot ascertain how much of the business written will renew. Previous experience indicates that the persistency of this business will be less than the company average primarily because there is business written which is oversold to some extent and also a certain amount of high pressure selling is involved. In addition a certain amount of poor business is submitted to enable agents to qualify for prizes primarily. These are disadvantages involved in and a natural result of any sales contest when an attempt is made to develop enthusiasm and maximum effort from salesmen. Our point system and minimum renewal requirement were adapted to correct this as far as possible."

to greater productive activity.[14] The Continental Assurance Co., of Chicago, Ill., for example, held a contest known as the Second Sellebration. A 2-weeks' vacation was promised the winner, a cash prize of $300 for the man who reached second place and several third place prizes were offered to men who produced a minimum volume of $25,000 of new business. Literature distributed by the company in connection with this contest carried pictures of prizes and warm sunlight vacation spots to which the winner might resort.[15] The contest literature read in part as follows:[16]

How would you like to give your wife a Christmas present she will remember for the balance of her life * * * a present so big, so generous, so unusual that she will be envied by all of her friends, relatives and acquaintances?

Better yet, how would you like to make that gift a joint present * * * something she can share with you * * * something fascinating, romantic, exciting * * * something you both can enjoy and look back on in later years with memories so vivid you can't forget them?

You'd like that? Okay. You can arrange right now to play Santa Claus on a magnificent scale next Christmas Eve. And best of all * * * it * * * won't * * * cost * * * you a cent. No sir; not one red cent. Continental will buy this gift for you * * * a present to your wife and you

[14] Replies to Commission's sales questionnaire, item 17 and exhibit F. The Continental American Life Insurance Co. distributed literature during 1938 in connection with founders month reading as follows (reply to Commission's sales questionnaire):

"Will you be on the roll of charter members of the founders club which will be put on display in the home office next month? Will you wear the gold key, and hang in your office the membership certificate? Will your agency display the new type bronze and silver plaque?

"Founders month is just half over, and there is still plenty of time for you to be among the select '31.' Don't think the same old fellows are going to be among the top 31 at the end of October, either. Several dark horses are piling up applications and making new records. You will have to get a few extra ones to keep your position. Will you exert that little bit of extra effort as your personal tribute to those who founded Continental American and the ideals behind the company?

"In our first 3 regular bulletins we reminded you of the priceless contributions of Philip Burnet, of the original directors, and of the 'old timers' in the home office. In this, bulletin No. 4, we call your attention to the original old guard of Continental American, and ask you as an evidence of your appreciation of the work of these men, to send us every possible piece of business you can during the rest of October, the company's anniversary month."

* * * * * * *

"There is still time:

"The end of founders month is in sight. When you read this bulletin, 3 working days will remain in October. Yet, when you stop to think of it, 3 days is 10 percent of the month—and a lot of constructive work can be done in 10 percent of any month.

"Our applied-for business is well ahead of October 1937—and so is the issued. All of you are heartily congratulated for this showing. We know it has meant a lot of hard work. But the weak link in the chain is the paid-for business, and we can't let that defeat us. We are too near to beating the biggest October in the company's history—October of 1937. That is why we want to ask you, today, this personal question: What can you individually do to put every possible policy in force before Monday night, October 31? Which policies need a little extra effort to secure payment?

"There is still time to pay for your outstanding policies.

"There is still time to get one more application to boost founders month for yourself, and the best way to insure getting it in this month is to get cash with the app.

"There is still time to nose out some of those near the top of the list and become a charter member of the founders club. The upsets on today's list of potential club members proves that.

"If you are near the top, we salute you. But we warn you not to stop working yet. Others are fighting for your place.

"If you are further down on the list, turn on the steam. It's not too late to be 1 of the 31 who will wear the gold key. The battle is only nine-tenths over.

"And if you are not on the list at all: We earnestly request you to get on it. All of us in the company want to see the name of every last Continental American representative on the founders month list. Whether you can win a membership or not, get 1 application and be on the list."

[15] Reply to Commission's sales questionnaire, item 17 and exhibit F.

[16] Id.

* * * in return for just one thing—namely, production. Consistent, day-by-day production that will take you out in front of the producers in your group and keep you in front until after the close of this "Sell'bration."

As a reward for that effort, Continental will present you with two railroad and Pullman tickets to New York City, reservations aboard a palatial ocean liner sailing to Bermuda, hotel accommodations and meals during your stay on this lovely tropical island. In addition, before you sail, you'll be given a check for $100 for incidental expenses and spending money.

That's a real Christmas present. A 2-weeks' winter vacation * * * the finest, most luxurious accommodations, fit for a millionaire * * * old-world charm * * * exotic sights and scenery * * * fun, fellowship, an eventful, ever-exciting, ever-changing journey. Man, you can't possibly give your wife * * * or yourself * * * a finer, more lasting gift.

But * * * before you can enjoy this gift * * * you'll have to earn it. You'll have to set yourself a daily quota, make more calls, start earlier and stop later, sell more forcefully * * * get out in front of the men in your group and stay in front until you've won your reward. You'll have to make every day count. Every day a sale * * * every sale a step closer to your vacation reward. You can do it * * * if you start, go * * * and keep going.

Remember, showmanship on your part is what will put over this contest. Decorate the agency office with pennants, banners, football equipment if possible. Also, provide a gridiron, either on your blackboard or on cardboard to keep a running account of the yardage gained by each team. Enthusiasm and showmanship are the thing. Let's use "em."

Emphasis upon persistency and sound underwriting would seem impossible in such an atmosphere.

A good example of a contest run as a game was found in the "Pigskin Classic of 1939" contest sponsored by the California-Western States Life Insurance Co.[17] Under the rules of this contest the agents in each branch office were divided into two groups and a "football game" was played by setting up charts representing gridirons in the office. Each team scored in accordance with the amount of insurance sold and a series of prizes were arranged for the winning team. Company executives gave branch managers detailed instructions designed to work up enthusiasm. Some of these instructions were as follows: [18]

Bedeck yourselves in coaches garb ((*a*) cap; (*b*) sweat shirt; (*c*) whistle) at every meeting during the contest.

Provide a water bucket with bottled "cokes," or sumpin', for a half-time break in the meetings.

Use the whistle to call your meetings to order or halt a speaker.

You may want to pass the football to the team captains, and those called on to speak at meetings.

A contest run by the Equitable in connection with its opening of new territory in the State of Texas during 1939 was an outstanding example of pressure tactics used to bring in production at all costs. The contest was in charge of Mr. W. W. Klingman, the Texas general manager of the company, who staged what he called a "double barrelled effort" for production during June. In the midst of this drive, arrangements were made to bring in one half a million dollars of new business on a single day. This day was set for June 20, 1939, and was

[17] Id.

[18] Id.

designated as "the perfect day." Beginning 10 days in advance literature went out to prepare the agents toward the big drive that day. Thus on June 10, Mr. Klingman wrote he was planning to have "the perfect day." He described that program as—

A day perfect from the standpoint of a tremendous day's work well done—a day perfect from the standpoint of complete cooperation on the part of each one in fighting to attain the goal which we have set for that day, which is one-half million of new written business at the end of a perfect day—Tuesday, June 20—may we have so far exceeded our goal of "one-half million" in a single day that all the world will know that we are building the greatest life insurancy agency in the world right here in Texas.

In subsequent literature to his agents Mr. Klingman urged that this was to be "a red letter day"; a "supreme 1-day effort" requiring the "never say die spirit" and that the company was to make—

* * * a path of blazing glory to heights never yet achieved in the history in the State of Texas in a single day's business.

As the big moment approached, special telegraph apparatus was installed in Mr. Klingman's private office. Every Texas agent of the Equitable was to be handed five form telegrams addressed to Mr. Klingman's office at Dallas, Tex. Each telegram marked "a perfect day" was intended to indicate the agent had written an application. The telegrams read: [19]

Got my first for $------- Still going.
Here is my second $------- Going strong.
Here is my third $------- Fighting through.
Here is my fourth $------- It is a dandy.
Here is my fifth $------- The end of a perfect day.

Contests are however but a phase of the drive for production. Though in some companies they occur with a frequency which almost makes them a normal condition,[20] they are intended not only to get volume but to be the exciting moments which break up the steady day-to-day emphasis upon new business.[21] The instructions given agents on how to sell insurance and the various sales tricks which all agents are taught demonstrate even more clearly the underlying tempo of the sales efforts of most life insurance companies. In the next few pages this material will be presented on the basis of excerpts taken from typical instruction books and literature given the agents from time to time in the course of their duties. It will be seen that

[19] Pt. 13, exhibit No. 1342.

[20] For example, one agency of the Equitable had had 14 contests during the period June 1, 1937, to June 1, 1939. These contests were identified as a national educational conference, a turkey campaign, a scrimmage campaign, a loyalty day campaign, an eightieth anniversary campaign, an Ott eighth anniversary campaign traffic court, life insurance week, another turkey, world series, a scrimmage, another loyalty day, a 5-and-10 club, and a ninth anniversary of the Ott agency campaign (pt. 13, R. 6545).

[21] The companies justify sales contests on many grounds. The following statement by the Continental American Life Insurance Co. in reply to the Commission's sales questionnaire, item 17, is typical:

"While, of course, the immediate reason for these or any other similar contests or 'drives' is to increase, through the arousement of greater activity and interest of the sales force, the volume of new sales, yet there are also other reasons equally important—or, indeed, even more important since their purpose is to improve the morale and well-being of the sales force. Some of these other reasons are to relieve the tedium of day-after-day solicitation by injecting the spirit of fun resulting from the salesmen vieing with one another; the improvement in the bank account of the salesmen resulting from the stimulation of effort due to the contest; the building up of enthusiasm and confidence of the successful participants that results from having been successful; increased loyalty and ambition that is engendered by recognition and acclaim of earnest effort—not merely for the production of a large volume, for our contests are so planned as to give recognition for meritorious accomplishment rather than only for totals, by taking into consideration in making awards the difference in opportunity for large volume, as, for instance, between rural and urban agents."

in order to accomplish the ideal of more and more sales the agent is given detailed instructions on how to break down sales resistance. All the legerdemain of sales psychology is placed at his disposal. "Canned" sales talks and other set speeches to meet objections and to force the final signing of the application are made the agent's stock in trade. He is even told how to modulate his voice and when to smile. Little and frequently no emphasis, on the other hand, is given to standards which will enable the salesmen to suit a particular insurance program to the needs and income of his prospect.

Most companies have worked out a detailed plan of sales procedure for their agents. An agent is told there are four steps to a life insurance sales presentation: (1) Preapproach, (2) approach, (3) presentation, and (4) close.[22]

The "preapproach," which is the locating of potential purchasers of life insurance, is generally known among agents as prospecting. Many companies teach their agent three methods of prospecting: The personal-contact method, the center-of-influence method, and the endless-chain method. The use of the first, personal contact, depends principally on the making of as many friends as possible and the recognition of each of them as a prospect. The center-of-influence method of prospecting requires that the agent make use of some individual who has a wide circle of friends with whose problems he is familiar and who will have a serious respect for his opinion. From his "center" the agent tries to obtain introductions to friends as well as tips on their interests and their needs. The endless-chain method of prospecting consists simply in making every interview lead to another one. When an application is signed or a policy delivered, the agent asks the recent prospect for the name of one person to whom the insurance plan he has just purchased might apply.[23]

With the "approach" the actual job of selling begins. One device recommended in starting the selling interview is for the agent to tell the prospect that the purpose of the interview is not to sell insurance. Thus the Bankers Life Co. of Iowa suggests:[24]

> Assure the prospect that you have not come to sell him life insurance today. Take that barrier and deftly lay it aside, by agreement. It's hard work to outargue him. It is an easy job to agree with him. If he knows that you aren't going to try to sell him today, he is far more willing to grant you an interview today.

Many companies furnish their agents with a series of "opening lines." Among those recommended by the Kansas City Life is the following:[25]

> Bill, I have just made a connection with a financial concern that seems to have more money than it knows what to do with and I want to distribute some of it among my friends.

[22] See, e. g., Life Insurance, What It Is and How to Sell It—Midland Mutual; Single Need Selling—distributed by John Hancock and others; Applying Life Insurance to Human Needs, vol. 3—distributed by Bankers Life (Iowa); Sales Course, sec. 8—distributed by West Coast Life; and Sales Results, Skill in Selling—distributed by Connecticut Mutual, all submitted in reply to Commission's sales questionnaire.

[23] See, e. g., Prospecting, Whom to See—distributed by Connecticut Mutual; Profitable Prospecting—distributed by Berkshire; and the Market for Life Insurance—distributed by Fidelity Mutual, all submitted in reply to Commission's sales questionnaire.

[24] Applying Life Insurance to Human Needs, vol. 3, p. 24, submitted in reply to Commission's sales questionnaire.

[25] From Calling the Life Underwriter (Walter Cluff) distributed by the Kansas City Life, submitted in reply to Commission's sales questionnaire.

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The Mutual Benefit suggests: [26]

Mr. Prospect, I've come to talk to you about having one of these (hand him an unsigned check made out to Mrs. Prospect) come to your wife every month.

The agent is taught to use a prepared or "canned" sales talk in his initial "presentation." [27] In fact many companies give great emphasis to this feature of the "canvass" and have dozens of sales talks and stock stories to meet the salesman's every requirement, a different sales talk for every policy, and a different story for every type of prospect. These sales talks may be written for the salesman to memorize or they may be more general in character.

Of this latter type is the graphic advice on "How to Apply Sales Pressure" given agents of the Columbus Mutual.[28]

In imagination picture yourself living in your later years the way you would like with a life income guaranteed. You'll become enthusiastic about it. When in the prospect's presence draw him out and imagine a similar picture for him—living as he tells you he would like to live later—perhaps in the South or in California or abroad, with a life income guaranteed. In a word picture describe with enthusiasm a future for him—one that will please. Stir his imagination.

The pressure that will put over the sale hoped for is the pressure of the want which you uncover for a specific kind of ease and comforts later on. The word picture assists you in making that want keen enough to exert pressure. Your enthusiasm will be a tremendous factor.

When a pleasing picture of the future fails to get action, a scare picture may be hinted at to move the prospect; he can be pictured living later as a dependent—perhaps in ill-health.

Word pictures and moving stories are great factors in appeals to emotions and feelings, wherein lie the mainsprings of thoughts and actions.

Such appeals may be greatly strengthened by making definite the problem embraced in the want so that the prospect squarely faces it and by putting on paper some figures—not many—for the prospect to see. His money may be doubled or trebled, live or die.

As part of his sales presentation the life insurance agent is frequently taught how to create a fear of death which will frighten the prospect into taking out a policy. This is made clear by excerpts from litera-

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[26] Your Sales Talk, p. 4, Mutual Benefit Study Leaflets, submitted in reply to Commission's sales questionnaire.

[27] A pamphlet called Single-Need Selling distributed by several companies including John Hancock and Mutual Trust Life, and submitted in reply to Commission's sales questionnaire, states at p. 9:

"* * * it is important that you master one proven sales talk right at the very beginning. You will want to master others from time to time with some regularity until soon you have a good talk for each of the primary needs.

"Every life insurance man uses what we call an 'organized talk' whether he realizes it or not. It would be impossible to improvise a different talk for each person on whom you call.

"From month to month the good salesman discovers that certain phrases 'click'; he excludes those which do not. Other salesmen try the same phrases. They work. They try the entire talk. It works. Then if it is good enough the company may pass it on to the new man in order that he may save himself months of effort and experimentation.

"There are other advantages in using an organized sales talk.

"It provides a sales track for you. The prospect cannot switch you on to a dead-end line, nor wreck you on the bridge of objections. All of the necessary ideas are included and in logical sequence, while superfluous ideas are excluded.

"This means that organized sales talks are a time-saver for you and for your prospect. You are enabled to see more people, and as you have a good talk, to make more sales.

"A sales talk which you learn will sound entirely natural as soon as you have made it your very own. You will do this by rehearsing it time after time until you can give it any way you please—slow or fast, soft or loud—but particularly in a conversational manner so that the modulation of your voice becomes the result of your feeling, not of your memory."

[28] Supplement to sec. 2, Sales Course, at p. 6, submitted in reply to Commission's sales questionnaire.

ture distributed to agents containing advice regarding the effective use of fear in selling insurance. The Columbus Mutual suggests three specific methods for arousing this fear in the mind of the prospective insurance purchaser.[29]

(1) Suggestion that the prospect or his dependent may suffer serious hardships and privations if action is not taken;

(2) Suggestion that the prospect may not be able to qualify tomorrow—if death does not intervene he may become uninsurable;

(3) Suggestion that if action is postponed the prospect may not be able to obtain a contract as advantageous as the one he may obtain today.

This company then goes on to say: [30]

"Back the hearse up to the door" in such a way that the prospect will not suspect or resent it, put before him a word picture of the future that thrills—an attractive picture—then follow up with a suggestion of a displeasing picture—the kind of future which the prospect does not want but which may become a reality if action is not taken today. Such a contrast is effective.

The Travelers describes this same technique in the instruction book for its agents.

Fear is an instinct that all men possess to a greater or lesser extent. In it is found an impelling clause for action when others fail. We do not recommend scaring a man into the buying of insurance but we can conscientiously advocate an emphasis being placed on the freedom from worry afforded only through the possession of adequate insurance protection. Even so it is better to scare a man into the purchase of insurance that he needs than to leave him uninsured.

Still another company instructs its agents as follows: [32]

Ask disturbing questions. For example: "If you knew you had only 24 hours to live, would buying this insurance be one of the things you would try to do?"

This emphasis upon fear is but part of a general appeal to the emotions which the agent is urged to employ. The Travelers lists love of kin, curiosity, vanity, rivalry, play, sociability, and self-preservation among the gamut of emotions which its representatives should use in attempting to sell their wares.[33] The agent is told that people do not buy on logic but because their emotions have been aroused. Based on this one company advises: [34]

It is seldom necessary to make a full and complete explanation of the policy. In fact, the contrary is true, present merely the highlight, as it were, in a few sweeping but carefully selected remarks. Too much detail as we have given in the explanation of the policy, if given all at once, is too confusing.

The thing to bear in mind is that definite details of a policy contract do not sell insurance; that few prospects are interested in the technicalities in the contract. A wise rule perhaps to follow is this, explain just as little as possible.

This "wise rule" of "explain just as little as possible" is expressed by another company in a slightly different fashion. [35]

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[29] Columbus Mutual log—October 1938, submitted in reply to Commission's sales questionnaire.

[30] Id.

[31] Agents' Handbook III, H5, submitted in reply to Commission's sales questionnaire.

[32] Leaflet distributed by California-Western States Life, submitted in reply to Commission's sales questionnaire.

[33] Agents' Handbook III, H.4, 5, 6, submitted in reply to Commission's sales questionnaire.

[34] Calling the Life Underwriter (Walter Cluff), distributed by the Kansas City Life, submitted in reply to Commission's sales questionnaire.

[35] Selling and Success, distributed by Guardian Life, submitted in reply to Commission's sales questionnaire.

Where you are dealing with a prospect strictly in the mental field you are always more or less in doubt because there is such wide difference in mental concepts. It is much easier to win a man's heart than to win his mind. Emotions are better understood because they are a common factor in all men.

Logic which would carry deep meaning and significance to one man might go entirely over the head of another; there may be no common ground between their minds or intellects. There is, however, a common ground for emotions. These same men who could not understand each other in the mental sphere would experience exactly the same feeling if both were hungry, thirsty, or in pain—perhaps in different degrees but still the feeling would be the same; it would be a common understandable factor.

Similarly the Mutual Benefit Life Insurance Co. in instructing its agents on how to make sales talks says:[36]

Make your talk simple. Omit technicalities about the mechanics of life insurance. Your prospect wants to know what a Mutual Benefit policy will do for him or his family.[37]

Agents are instructed to use every effort to make a prospect buy at once before he has time to think the proposition over. To allow him to think is to lose the effect of the emotional appeal. The companies give their agents full instruction in methods of forcing an immediate decision regardless of what the prospect may say. For example, if the prospect says [38]—

I wish you would write that out so I can mull it over at my convenience—

one company instructs its agent to answer.

I know exactly what you want. You want to see it in black and white. Can you see the doctor at 2:15 today? We will see if the company will offer this contract to you and then you can mull it over as much as you like. Anything I could write might be very different from the company's offer and would be of no value as a basis for your consideration. Is 2:15 all right?

If the prospect says "Give me a sample of that policy," the agent of one company is instructed to answer:[39]

Not I. A man was killed and his widow called me in to adjust his life insurance affairs. We found five $10,000 sample policies in his desk from five different companies, and not a dollar of insurance in force. I am not going to run the risk

[36] Your Sales Talk. Mutual Benefit Study Leaflets, submitted in reply to Commission's sales questionnaire.

[37] But after the policy has been sold, the agent is permitted to tell the policyholder what he has bought. The instructions continue (Id.):

"When you are selling life insurance you talk about what your prospect wants to accomplish in life for himself, his family, or his business. You discuss the place of life insurance in his plans. You talk about what life insurance will do for him, and you refrain as far as possible from technical explanations of a life insurance policy.

"When your sale has been completed and you go back to deliver the issued policy to the new policyholder your interview is on an entirely different basis. You are not persuading the prospect to make a purchase, you are showing him the advantages of a purchase which he has already made, encouraging him in his feeling of pride and satisfaction because of it. The policy you refer to now is his policy. It has his name on it. His wife's name is written in as the beneficiary. It promises definitely to do something for him, and for his wife, in event of certain contingencies. You are now in a position to explain a contract which is to him not merely another policy, but his own possession. Praise of the contract is now a compliment to him and his good judgment.

"For these reasons the delivery interview is considered by most salesmen the most effective time for a detailed discussion of all the policy features."

[38] How to Solicit (p. 131), distributed by Guarantee Mutual Life, submitted in reply to Commission's sales questionnaire.

[39] Id.

of your widow's finding one of my sample policies in your desk. What you need is some life insurance in force, so as to carry out your ideals, and I want to start you on a plan of doing just that. I'll use your phone to see if the doctor will see us right now.

If the prospect indicates a desire to delay in order "to talk it over" with his wife, the agent is equipped with answers designed to prevent him from doing so. One company tells the agent to explain to the prospect that his wife's judgment is perhaps not to be relied upon, especially regarding a proposition with which she is entirely unfamiliar, but that if he wishes the opinion of a woman, he had better consult a widow to whom life insurance money has been paid. She is the one who can give him proper advice.[40]

The prospect will, of course, seldom sit through the whole sales talk without interruption. But if he objects, the agent has been told just what to do to meet the many different objections which may be presented.[41]

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[40] From Calling the Life Underwriter (Walter Cluff) distributed by the Kansas City Life at p. 160; submitted in reply to Commission's sales questionnaire.

[41] One company sets out these objections which a prospect might raise (Basic Training Plan, Business Men's Life Insurance Co.; submitted in reply to Commission's sales questionnaire):

"I want to talk it over with my wife. I want to think it over, and would like to have you call back later. Leave me a sample contract and I will look it over."

For any of these objections, an omnibus answer is suggested:

"I would be glad to comply with your request but it just happens that my company has designed a plan, which practically does the same thing, and still gives you more advantages than would ordinarily be the case. As you perhaps already realize, the deposits and consequently the commissions are so small that this proposition should be presented in a concise manner with sufficient time granted the applicant to confirm his decision in the event he should apply. This is taken care of in the application blank, by granting you the privilege of returning the policy within 3 days if it is not satisfactory. If you are eligible and I can secure the contract for you, it will take about 7 days to get it; you will then have 3 more days in which to examine it, and accept, or return it. This is done not only to be fair with the applicant but also because it is consistent with the company's method of doing business. You perhaps realize that a company doing business in the ordinary manner could not give you such an attractive proposition at so low a cost. We could not, either, if we followed the ordinary method of doing business through brokers and maintaining collectors. We are dealing with a select class of risks upon the assumption that they would prefer to make their subsequent payments by mail and save the collection cost in increased protection, than to have collectors call for the payments. This system, however, would not work out unless we took special care to have our people who apply absolutely satisfied with the deal, because they would lapse at the end of the first period. That is why we take your application today, and still leave you absolutely free to accept or reject the contract when it is received. In fact (assuming a deposit is made now), we will actually give you accident protection from today if you are eligible, which will be effective during the time you are deciding, even though you should return the contract. You make your check payable to the company, not me—it is sent in with your application, and the money will be returned to you if for any reason the contract is not satisfactory—you to be the sole judge. Let's complete the information."

The West Coast Life Insurance Co. lists "The 17 most common objections" as follows (Sales Course, sec. 9, submitted in reply to Commission's sales questionnaire):

1. "Not interested."
2. "Can't afford it."
3. "Don't need it."
4. "My wife objects."
5. "I want to talk it over with my wife."
6. "I must pay off my debts first."
7. "I'll think it over."
8. "I invest my money—it pays better."
9. "I'm not ready yet; see me later."
10. "I don't believe in life insurance."
11. "I prefer assessment insurance."
12. "My wife is well provided for; so am I."
13. "I am worth more dead than alive, now."
14. "I can get better return on my money in a savings bank."
15. "I have a friend in the business."
16. "I don't want to leave a lot of money for some other man to spend."
17. "I have ample property to leave my family."

The Bankers Life of Iowa, for example, tells its agents: [42]

* * * *don't take objections too seriously.* A good many objections which the prospect fires at the salesman are nothing more than his customary method of treating all salesmen. * * * They feel that he is fair bait for a great deal of biting wit and unpleasant sarcasm, and that * * * the proper attitude to assume toward a salesman is to put him on the spot and give him an uncomfortable half-hour.

Life insurance agents are customarily told that there are four effective methods of meeting objections.[43] These are usually listed as follows: [44]

1. The direct return (the "Boomerang" method).
2. The indirect return (the "Admission—But" method).
3. The emphatic denial (the "Head-on" method).
4. The "passing up" method (self-explanatory).

The West Coast Life Insurance Co. defines these various methods thus: [45]

1. *The direct return.*—This is called the "Boomerang" method because the objection of the prospect is hurled back in the form of a selling argument. * * *

2. *The indirect return.*—With the "Admission—But" method the agent appears to agree with the prospect, but qualifies his admission by statements that destroy the force of the prospect's objection. * * *

3. *The emphatic denial.*—This method should only be used when a prospect, through ignorance or misinformation, makes statements that are obviously false or without foundation. The most effective way of meeting such objections is to flatly deny them, taking care, if possible, not to offend the prospect in so doing. Your robust defense of life insurance or your company will win the prospect's respect and you can swing into your sales talk again. * * *

4. *The "passing-up" method.*—A prospect will sometimes advance many trivial objections in quick succession for the express purpose of confusing the agent. He does not expect them to be answered, indeed he does not give the agent an opportunity to answer them. The best way to handle such a case too, is to pass up the objections if you can do so without giving the prospect the impression that you are evading the issue. If he insists on replies, assure him that you will handle them later. By the time your sales talk is concluded the majority of them will have passed from his mind. Some agents make a rule never to answer an objection until it has been raised twice.

For each objection, or each group of objections, prepared answers are furnished. For example, if the prospect demurs on the ground of religious scruples, the agent is instructed to quote Scripture to him. The New York Life furnishes this answer to the religious objection: [46]

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[42] Applying Life Insurance to Human Needs, vol. 3, p. 75, submitted in reply to Commission's sales questionnaire.

[43] The Mutual Life classifies all objections in 5 groups: (The Fundamentals of Selling, vol 2, p. 46, submitted in reply to Commission's sales questionnaire).

1. *"Adequate" objections.*—The prospect is not opposed to life insurance, but he believes that he has sufficient life insurance or other investments and that, therefore, adequate provision has been made.
2. *"Investment" objections.*—The prospect prefers other plans of saving and of investing.
3. *"Spending" objections.*—The prospect recognizes his need for life insurance, but prefers to put his surplus money into luxuries and current pleasures.
4. *"Principles" objections.*—The prospect is opposed to the principles of life insurance.
5. *"No Money" objections.*—The prospect feels that he is financially unable to purchase additional life insurance.

[44] Sec. 9, Sales Course; submitted by West Coast Life in reply to Commission's sales questionnaire. (See also pt. 13, R. 6524.)

[45] Sales Course, sec. 9, Op. cit. Note 44.

[46] Objections Answered, submitted in reply to Commission's sales questionnaire.

In ch. 41, of Genesis, Joseph tells of what was probably the first insurance project: "Now, therefore, let Pharaoh appoint officers over the land, and take up the fifth part of the land of Egypt in the seven plenteous years * * * and let them gather all the food of those good years * * * and that food shall be for store, to the land against the seven years of famine * * *."

The Bible says, First Timothy, ch. 5, verse 8: "But if any provide not for his own and especially for those in his own house, he hath denied the faith and is worse than an infidel."

If the prospect says he can't afford the insurance offered, the Businessmen's Assurance Co. suggests this answer: [47]

The fact that you feel you cannot afford it is the very reason why you need it. If it is difficult for you to pay current expenses now, while you are receiving your full income, your family would have great difficulty when you are disabled or gone.

This company also gives certain universal answers, to be used for any objection. By keeping a few of these universal answers handy, the agent need never be caught without anything to say. Some of these all-purpose answers are: [48]

That's a good point, Mr. Prospect. We'll cover that in just a moment. [Then proceed with interview.]

* * * * * * *

I was at fault in not developing that point in detail a moment ago.

* * * * * * *

Well, if you were going to buy additional insurance today, what form of contract would you prefer? [Or, how would you want to pay the annual deposits?] [Or, what amount would you apply for?]

* * * * * * *

Yes, Mr. Prospect, that is very true but I wonder if you have considered, etc.

* * * * * * *

I will get to that point in just a moment.

* * * * * * *

Mr. Prospect, I'm afraid I can't answer that objection [regardless of what the objection may be], because it is not your real reason for not buying life [accident, and health] insurance. Your real reason for not buying is that you don't think that you are going to die [be disabled]. Now you are perfectly justified in thinking so, because that thought has a perfectly sound psychological basis. Any fear to which you are subject, Mr. Prospect, can make you forget that fear of death [disability]. Picture your wife on the sidewalk seeing your child fall in front of an approaching automobile, and what does she do? She rushes to save the child. You can understand that picture, Mr. Prospect, but can you understand this one? In place of your wife and child substitute yourself and your new straw hat, and exactly the same thing will happen. The fear of losing the hat is going to make you forget the fear of death [of being hurt]. We were made that way; we may just as well face it. Now the fear of giving up the things that you will have to give up in order to pay your premiums is strong enough to make you forget your fear of death [disability]. And so, Mr. Prospect, you will never decide to buy life [accident and health] insurance through thinking of what might happen to your family if you die [become disabled]. But you will buy life [accident and health] insurance if you will just think for a minute of some of the things that might have happened to your family had you died [been totally disabled] in the past few years.

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[47] Daily Reference Course, sec. F, submitted in reply to Commission's sales questionnaire.
[48] Id.

The final step in the life-insurance agent's presentation is the "close." In making the attempt to secure an application the agent is instructed to push the prospect along by getting minor decisions. The Southland Life Insurance Co. says:[49]

It is fatal to say to the prospect, "Will you buy this policy?" Such a decision is too big a one to ask him to make. But it is not fatal to use the law of implied consent and ask him to make a little decision. Each little decision brings him a bit closer to the signature of the application.

This company suggests that the request for the little decision be on the alternative basis, not upon a direct "yes" or "no" basis. Some suggested questions are:[50]

Would you rather see the doctor here at your office or drop in this noon at his office while you are downtown?

Would you want the premium notices sent to your home or to your office?

Shall the payments in the event of the death of your wife go direct to your son or to your trust company?

Another device frequently recommended to secure action is suggesting to the prospect that he may not be able to qualify for the insurance offered. The Business Men's Assurance Co. tells its agents:[51]

Try to raise a question in the prospect's mind all the way through and quite often in the sales interview, telling him what the plan will do "if you can qualify". These four little words, "if you can qualify," promote action. When you are ready for his signature, write your own name on the blank and then hand him the pencil or pen, suggesting "Please write your name here above where I have recommended you, just like you want it on your income checks, and we will see if you can qualify for this special plan."

The Western and Southern Life Insurance Co. advises its agents in these homely terms concerning the close:[52]

Try to close early in the interview. Remember when your mother was baking how she used to test the cake with a straw? It it came out sticky she put the cake back in the oven and applied more heat.

Do not hesitate to test your prospect early in the interview. If he begins to ask questions during your presentation try him out: "You would like to have this contract, wouldn't you?"

When the response to such a feeler indicates your prospect is not yet ready, turn on some more heat.

As the climax of the sales canvass approaches and the frequent urgings to decide the "little points" have had their expected effect it comes time for the prospect to sign his name to an application. Here again psychology and special sales technique are brought into play. Thus under the heading, "Getting Action from the Prospect," the Equitable agent is given this explicit direction in the use of "psychology":[53]

The weighing part of the brain, the brain cells that perform the act of deciding, are not the cells that need to be actuated now. The motor part of the brain

[49] Sales Process of Life Underwriting, p. 143; submitted in reply to Commission's sales questionnaire.

[50] *Id.*

[51] From an address by Robert Sanders distributed by Business Men's Assurance Co., submitted in reply to Commission's sales questionnaire.

[52] Pt. 12, R. 5947.

[53] Pt. 13, R. 6523.

must be set to work and these cells will perform the act of signing on the dotted line much more quickly if some sort of action is previously requested of the prospect in order to rouse them into activity. It is for this reason that many salesmen hand the prospect a pen and ask him to do some figuring or write some data before asking him to sign his name. When you ask for the signature, a good way to make the request is to say, "Write your name here as I have written it above." You note in this statement we have put two ideas forward, writing a name and writing it as written above. Since you give the prospect two ideas to think about, he doesn't give all his attention to the question of signing his name."[54]

If these techniques are not enough to bring the prospect to a decision the agent is urged to use sterner methods. The Bankers Life suggests its agents make this vigorous statement to a recalcitrant prospect: [55]

Mr. Prospect, here is the application blank to the Bankers Life I had planned for you to sign today. Put it in your desk, and when you get ready to sign it, let me know. But I don't think I would keep it in my desk if I were you. If something should happen to you, your wife will come down and look over your desk. Who is coming with her? Your children? Your father-in-law? Your brother-in-law? Do you want them to find this unsigned application in your desk? Don't give it back to me, because I can't afford to walk the streets with your wife's bread and butter and your children's education in my pocket. Either tear it up or sign it. It's your blank now, not mine."

Another company, the Equitable, suggests this final ruse if the agent has not accomplished the results he originally desired.[56]

If a prospect says, "I will take $5,000" and you are trying to sell him $25,000, stop right there and write the application for $5,000 * * * Close him for 5,000 and order out 20,000, and try to deliver it when you deliver the 5,000.

This attitude toward sales which places the production of new business above all else is not conducive to good agency organization.

The basic objectives to be achieved by a satisfactory sales organization are fairly apparent. Insurance should be sold at the lowest possible cost commensurate with safety. In addition to receiving their insurance at a fair price, policyholders are entitled to receive adequate professional advice on their insurance needs at all times. The agents who come in contact with such policyholders must be

[54] The Midland Mutual tells its agents (Life Insurance, What it is and How to Sell it, p. 79, submitted in reply to Commission's sales questionnaire):

"Closing is urging him (the prospect) to accept the insurance offer. In the close is where you use pressure, if need be, and there usually is need of it. No anxiety must be shown in your urge, but only sincere desire to benefit him and his. Your close is composed of both suggestion and argument. The following is a good urge argument for closing purposes: 'Mr. Jones, after you have started this purchase going you will do one of four things: Either you will continue to live, or you will die, or you will lose your earning power, through injury or disease, or you will sell your policy back to the company. Now, if you live, you will save more money; if you die, you will leave to your people more money; if you permanently lose your earning power, the company pays the premiums in your stead; and if you withdraw from the company, you will receive an equitable and fair settlement for your policy.' You are using a suggestion each time you repeat the urge, 'Let's fix it up right now.' 'Now's the time, as delays are dangerous.' 'You're alive today and in health; tomorrow may be too late.' While using closing arguments and suggestions, frequently offer him your fountain pen, with the injunction, 'Write your name on that line.' Never ask him to 'sign' his name. Use the word 'write' instead."

[55] Applying Life Insurance to Human Needs, vol. 3, p. 150, submitted in reply to Commission's sales questionnaire.

[56] Pt. 13, R. 6523. The Guarantee Mutual suggests this colloquy to its agents: "Prospect. All right, I'll take $1,000. Answer. Fine, $1,000 for the undertaker. Now how much for wife and children." Reply to Commission's sales questionnaire. "How to Solicit" by J. B. Duryea, submitted in reply to Commission's sales questionnaire.

adequately compensated on a basis which is not conducive to over-forced sales or other types of malpractice and which will enable them to provide conscientiously for the continuing service which policyholders require. Finally an agency organization should maintain and increase insurance in force only if this can be done through the acquisition of business of good quality and persistency and without abandoning at any time for the sake of growth, practices which contribute to the achievement of the other indicated objectives.

The three principal factors upon which good or bad agency management rests are the selection, the training and the compensation of agents. A well-selected agent, carefully trained and adequately compensated, should produce a satisfactory volume of more persistent business at a lower cost. An agent chosen without regard for his capacity to do the job, who is permitted to set out to sell without sufficient training and subject to the compulsion that he must produce new business at all costs to earn commission sufficient to feed himself and his family,[57] brings only harm to the company he represents and to the policyholders with whom he comes in contact. The policies he writes will usually have a high lapse rate and a bad mortality experience and he, himself, will soon drift away from the business or to another company. New agents may be brought in to take his place under the same conditions and thus the process will be repeated over and over again with the result that there is a continual churning of policies and turnover of agents and, as a consequence of all these factors, a great waste decidedly to the disadvantage of the policyholders.

A carefully selected, properly trained, and well compensated agent on the other hand, grows in experience and efficiency and because of his success is more likely to stay with his company and accomplish the purpose for which he was hired.

The four objectives identified above can never be attained by a company which places primary emphasis upon the acquisition of new business and is preoccupied with growth for growth's sake. A drive for volume inevitably leads to the indiscriminate employment of many agents who can produce the amount of new business desired. Wholesale employment of agents goes hand in hand with poor selection; inadequate or hasty training methods are then adopted in order that the agents may be turned out to seek new prospects. Impelled by a constant emphasis upon new business, the agent seeks to induce his prospect to sign his name on an application rather than to purchase insurance which meets his needs and as a result there is an uneconomic distribution of policies and high lapse. When new business becomes hard to find, the agent, having no backlog of continual renewal commissions on persisting business, cannot feed and clothe himself. Finally as deficiencies in his basic training become apparent and his circle of ready prospects becomes exhausted, the agent becomes discouraged by a lack of compensation and resigns from his company which then hires another agent to take his place who must in turn face the same experience. Those agents who stand

[57] In this connection a statement by the Northwestern National in reply to Commission's sales questionnaire, item 7, is of interest. This company stated:

"But we do believe that where the agent's compensation leads there the agent is likely to follow; and conversely, we believe it takes 10 times the effort to lead an agent in the direction we want him to go if, by chance, his compensation leads in the opposite direction."

the gaff and are able to continue in the business are frequently forced to adopt a course of action which prevents them from achieving the position in their community which the word "life underwriter" should rightfully imply.

From the point of view of the policyholder, the situation described above is important. Inexperienced agents, harried into constant search for new policies, obviously cannot give adequate service. In addition, it is clear that turn-over of agents, nonpersistent business, and generally inefficient sales operation increase the net cost of insurance and have a direct effect on the policyholder's pocketbook.

A summary of the companies' principal methods for training and selecting agents and the results achieved in compensating such agents will demonstrate the degree to which the emphasis upon growth has prevented the companies from adapting their agency organizations to the changing needs of their policyholders.

B. TRAINING AND SELECTION OF NEW AGENTS

In approaching the question of training it must be recognized that as soon as the new agent begins his job he is subject to an economic compulsion to write new business. He has no renewal commissions upon which the older and successful agent can sometimes depend for continuity of income. In almost all cases his livelihood is entirely dependent upon commissions he receives from the sale of new policies or loans from his general agent or manager which he must soon repay with such commissions.[58] It is obvious that an agent entering the employ of a life insurance company should be taught to underwrite in a professional manner and to offset the natural inclination to produce new business recklessly by exercising a conscientious regard for the policyholders' best interests.

The Commission's sales questionnaire forwarded to the larger legal reserve companies requested detailed information concerning the training courses given new agents. An analysis of the replies disclosed a basic inadequacy in the training methods employed by the great majority of the companies. There were 57 companies which furnished sufficient information on the subject of training to permit analysis. Of this number all but 6 companies offered some type of training course for their new agents. It appeared however, that in the case of as many as 30 companies the courses offered were not mandatory, with the result that it can be said that 63 percent of the total companies had no definite training requirements of any type. Furthermore, it appeared that 11 of these companies which had no required course confined their permissive training activities to correspondence courses which were optional with the agent. In a few instances these correspondence courses were supplemented by some sort of field training but this was found to be the exception rather than the rule. The remaining companies within this group of 30 were content to send literature to their managers or general agents,

[58] The general agents of many companies, and some companies directly, occasionally make cash advances to new agents. These advances, however, do not provide an adequate solution to the problem, because they are usually made at irregular intervals, and because they depend on future commissions for repayment. Since they are secured by future commissions there is a natural reluctance to finance any but the most promising agents, whose possibilities of success justify the risk. Those who are financed are under pressure for early production in order to earn the commissions necessary to make the repayment. Some companies are now experimenting with minimum guaranteed salaries for new agents. (See pp. 225 to 227, infra.)

leaving to their complete discretion both the manner in which the training, if any, was to be conducted and the scope and content of the courses given. In 4 cases this literature was not made available unless it was purchased by the agents or for them by their general agent or manager. It also appeared that of the 27 companies which had some mandatory training course, 10 companies had no provision requiring any basic or so-called preliminary training prior to permitting the new agent to solicit prospects for business. Thus only 29 percent of the companies required that their agents receive some preliminary training prior to solicitation.[59]

For the most part the training courses offered are of a short duration. By far the larger number of companies have no definite period for the completion of their courses—the length of training being left either to the agent himself or the discretion of his general agent or manager. The following schedule indicates the duration of training courses of companies which submitted adequate information in response to the Commission's sales questionnaire: [60]

Minimum period of training course:	*Number of companies*
No definite period	24
1 week	2
2 weeks	5
3 weeks	2
4 weeks	2
5 weeks	1
6 weeks	2
2 months	3
10 weeks	1
3 months	6
6 months	1
32 weeks	1
1 year	1

In view of the fact that, as has been indicated, many of the companies left training procedure to the discretion of their general agents or managers and consequently had little knowledge of the extent or true

[59] Replies to Commission's sales questionnaire, items 41, 42, and 43.

[60] Id. Many companies do not have information on the cost of training new agents. The following schedule on the cost of selecting and training agents [a] gives such information in this regard as is available (pt. 28, exhibit No. 2325):

Name of company	Total cost during 1937	Cost per agent appointed during 1937	
		Based on all agents appointed	Based only on those who remained under contract throughout 1938
Acacia	$45,110.00	$254.86	$867.52
Business Men's Assurance	10,203.48	47.68	179.01
Central Life	[b] 27,215.87	70.89	200.12
Equitable Iowa	10,654.24	21.88	57.02
Great Southern		139.05	1,081.70
Guarantee Mutual (Nebraska)	4,173.33	11.89	40.11
Lincoln National	386,613.74	131.75	252.62
Mutual (New York)	592,096.00	313.00	596.00
Penn Mutual	250,405.77	388.82	1,526.86
Southwestern	78,325.90	842.21	2,175.44

[a] Does not include general agents, branch-office managers, supervisors or other sales-promotion assistants. This schedule does not include agents soliciting industrial business.

[b] Estimated cost to company only.

character of the courses given, it is difficult to generalize concerning their nature. A considerable portion of the literature quoted in previous pages of this section as indicating the desire for growth and pressure for new business was taken from company training courses, and in many courses a disproportionate emphasis was placed in this direction. The general company attitude appears to have been well expressed by the Aetna in the introduction to the training course where it is stated: [61]

We all agree that the purposes of training are three-fold; to get the agent into production more quickly, to increase his production, and to keep him in production.

A group of companies, definitely in the minority, appear to give their agents adequate training. Many of these companies, however, emphasize but one portion of the training problem and there are less than a dozen companies which may be said to give a well-rounded course. Many companies give special courses for advanced agents.

This group includes 17 which encourage and sometimes assist their agents in obtaining the designation of "chartered life underwriter" [62] and which run regional or home office schools for the advance training of qualified agents.

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[61] From Trainer's Guide Book, Aetna Training Course in Planned Salesmanship, submitted in reply to Commission's sales questionnaire.

[62] In January 1927 the board of trustees of the National Association of Life Underwriters approved the creation of the American College of Life Underwriters. This is a nonprofit organization designed to further the following objectives in the manner described (The American College of Life Underwriters Announcement and Directory, 1939–40):

"(1) To establish an educational standard for the profession of life underwriting which will comprise (*a*) all the general fields of knowledge with which an underwriter should be acquainted in order to understand life insurance as a functioning institution in a world filled with economic, social, and political problems which it can help to solve, and (*b*) all the specific fields of knowledge essential to the rendering of expert advice and service to the insuring public.

"(2) To encourage and foster the training of students in educational institutions for the career of professional life underwriter. To this end the college stands prepared to cooperate in every way possible with universities and colleges which are contemplating the introduction of a complete insurance course. The college does not conduct educational courses itself, believing that the work of instruction can best be given by the institutions already in existence, just as has been the case in the field of accounting.

"(3) To cooperate with universities and colleges in general life-insurance education for laymen, since the subject is regarded as fundamentally important and well worthy of incorporation into a business school's curriculum.

"(4) To award to properly qualified life underwriters a professional recognition."

For completion of the designated course of study and a satisfactory examination the college grants to candidates the designation of chartered life underwriter. By June 1939 this designation had been granted to 1,530 candidates. The course of study covered by the examinations includes the following (id.):

I. Life insurance fundamentals:
  (a) Economics of life insurance.
  (b) Principles and practices.
II. Life insurance salesmanship:
  (a) Principles of salesmanship.
  (b) Psychology of life insurance salesmanship.
III. General education (including English):
  (a) Economic problems.
  (b) Government.
  (c) Sociology.
IV. Law, trusts, and taxes:
  (a) General commercial law, including law of life insurance.
  (b) Wills, trusts, and estates.
  (c) Taxation and business insurance.
V. Finance:
  (a) Corporation finance.
  (b) Banking and credit.
  (c) Investments.

There are 7 companies which give fairly complete training courses and are definitely the most advanced in this respect. These companies are the Acacia Mutual, Aetna, Bankers Life (Iowa), the Connecticut Mutual, Northwestern National, Penn Mutual, and Southwestern Life. The Acacia, for example, offers a formal study course and field training work conducted under the supervision of its branch managers. Though it has no requirements for training prior to solicitation, it does require that all or at least part of the preliminary portion of the training course be completed and weekly progress reports on the training are made to the home office. The course takes about 6 weeks. In addition, the company encourages continued study through coaching, meetings, and outside training courses particularly directed toward the attainment of the chartered life underwriter degree. New agents are compensated at the rate of $33 a month for servicing old policies during their training period. The training course of another of these companies, the Southwestern Life, provides for field training and a formal school for experienced agents. All agents are required to complete 2 weeks of study or 12 units of the training course prior to solicitation and thereafter all agents are required to complete a training program which covers approximately 1 year's time. New agents are brought in as junior salesmen for a 6 months' training period which is followed by 3 days' special classroom work. Qualified experienced agents attend home office schools on advanced subjects. In many cases, the new agents receive a basic minimum salary during the period of training.[63]

In some respects it may be said that training commences with the method used to select new agents. Here also the controls set up by company managements are frequently not conducive to the best results. In almost every case the selection of new agents is left in the hands of the general agent or branch manager who may receive some general instructions from his home office. Few companies, however, have any educational requirements and seldom is any effort made to limit selection to agents whose finances will permit them to support themselves for the period of adjustment and training. Recently experiments have been made, particularly by the Life Insurance Sales Research Bureau, in an effort to develop aptitude tests as aids to selection. These or similar tests are now being widely used by managers and general agents.[64]

In reviewing selection procedure, the effect of State laws must also be recognized. Though laws governing the licensing of life insurance

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[63] Note 59 at p. 212, supra.

[64] Compiled from company replies to item 41, sales questionnaire. See note 59, supra. The Life Insurance Sales Research Bureau was organized January 1, 1922, with a stated object according to article 2 of its constitution:

"* * * to investigate through its own activities or otherwise the selling conditions in life insurance and to act as a medium for the exchange of ideas between members."

The Bureau has members who are representatives of legal reserve life insurance companies in United States, Canada, and Newfoundland. Members pay dues on a formula based upon the amount of insurance in force, and these dues finance the research work of the Bureau. As of December 1, 1938, there were 146 members (taken from Membership Roster of the Bureau). Some indication of the work of the Bureau may be obtained from the following list of some of its publications: Aptitude Index, Recruiting, How to Train the New Man, Selling Yourself, Programming, Planning for Profit, How to Improve the Quality of Business, Measuring Agency Profit, General Agencies and Branch Offices, Monthly Survey of Life Insurance Sales, Handbook of Agency Management, Selection of Agents, Compensation of General Agents, Compensation of Branch Managers, Not Taken Business, Written Business, etc. (See generally pt. 10, R. 4317–4338.)

agents may be found on the statute books of every State, they are of little aid to the companies in eliminating the unfit agents. In many instances these licensing laws are designed primarily for the purpose of supplying machinery for collecting property and franchise taxes from the companies or to facilitate the collection of premium taxes and commissions received. It is clear that the licensing statutes are insufficient to guard the policyholders of a State against unqualified or unfit agents. An analysis of these statutes discloses that 4 States have no statement of minimum character or training requirements with which the applicant for an agent's license must comply. Furthermore, there are but 6 States which require such applicants to take an examination, and only 2 additional States which permit the insurance commissioner to examine applicants at his discretion. In as many as 23 States, the applicant is simply required to file a statement which contains a general indication of minimum qualifications. In these States legal requirements are satisfied if it be found that the applicant is "a suitable person" or that "the facts warrant" the issuance of a license. In a few instances there must be a specific negative finding to the effect that the applicant has not been guilty of bad practices in the past. In the remaining States the statutes provide one or more additional safeguards, but these are frequently of doubtful value. In most States, for example, the applicant must file one or more vouchers with his application certifying to his character and fitness and in a few instances it is necessary that there be a statement to the effect that the applicant has had previous experience or that he will receive immediate training.[65]

The improper direction and inadequacy of training methods employed by many companies is made further apparent by a recognition that the agents' job involves much more than mere sales ability and success in getting prospects' signatures on the dotted lines. The agent's duties are numerous and varied, and his job when conscientiously performed is indeed a complicated one.[66] Not only should he be thoroughly conversant with a great variety of policy forms issued by his company and by his company's competitors but he should be equipped to sell insurance intelligently and to fit insurance to the needs of the prospective policyholder. It is not unusual for the agent to be required to give preliminary advice on matters involving tax questions and business insurance problems or to assist in drawing up complicated settlement option arrangements which the insured wishes followed in distributing the proceeds of his policy. The agent is called upon to give advice concerning the methods of premium payments and to assist in the payment of claims, taking the necessary papers to the beneficiary and attending physician, procuring affidavits from the undertaker, and doing whatever else is necessary to see that the claim is properly and promptly paid. The policyholder may wish to secure a loan on his policy, change the beneficiary, alter the income agreement on his policy or even the plan of insurance, and to add features to the policy, such as family income, waiver of premium, or double indemnity. On all these matters the agent should be able to give expert advice. When policies lapse the agent is called upon to advise on questions of cash recovery or the desirability of taking paid-up or

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[65] For summary of State laws concerning licensing of life insurance agents see pt. 10, R. 4929.

[66] The duties of the life insurance agent were discussed in detail by Mr. Charles J. Zimmerman, president, National Association of Life Underwriters (pt. 28, testimony on February 28, 1940).

extended insurance.[67] With the constant development of new policy forms, the agent should be ever alert to changes in the business in order that he may adequately serve the needs of his policyholders and analyze correctly the insurance requirements of his prospects. His responsibility to his policyholders is a continuing one, as many of the above duties indicate. In recent years, the emphasis upon programming in the sale of insurance has meant in effect that the agent commences an insurance program with a policyholder and, as circumstances permit, assists him in working out a protection, educational, and retirement program, which in effect follow the policyholder almost from the cradle until his death. The development of endowment and retirement fund policies, mortgage policies, educational policies, policies to pay inheritance taxes, business insurance policies, and annuities are but a few of the more recently developed policy forms which an agent now has to offer. Life insurance has long since ceased to exist purely for the purpose of meeting contingencies arising out of premature death. The investment and security features of the policies are being emphasized more and more, and the idea of pure protection is receiving a correspondingly secondary emphasis. These developments and the increased benefits [68] which life insurance now offers have

[67] In addition, he is usually assigned the responsibility of caring for a number of "orphaned policyholders"; that is to say, policyholders who were sold by an agent no longer in the employ of the company. Thus his service responsibilities are broadened beyond the necessity of caring for his own policyholders (pt. 28, testimony of Charles J. Zimmerman, February 28, 1940).

[68] Some appreciation for the many benefits offered through life insurance policies may be found in the following description of the uses for life insurance taken from the Travelers Insurance Co. Agent's Handbook III, H 3 B-P-BH, submitted in reply to Commission's sales questionnaire:

"The uses to which life insurance can be applied are many and varied. In general, they pertain first to the personal and family needs of the individual; and second, to his business interest. It is not feasible to list all the known uses of life insurance. Business life insurance will not be discussed here. The following personal uses are given to prompt you to uncover wants in your community. The most common uses follow:

"The husband insured for the benefit of his wife to provide:

"1. Money to pay the current monthly bills, final sickness, and funeral expenses, etc.

"2. Money to pay off mortgages, loans, and other outstanding obligations.

"3. Money to cover inheritance and estate taxes.

"4. Money to tide over the interval prior to the settlement of large estates (1 to 2 years required to probate).

"5. An income large enough to keep the family together and educate the children at least through high school.

"6. A life income thereafter for the wife.

"The wife insures for the benefit of her children or husband to provide:

"1. Money to replace the economic loss incident to her death.

"2. To perpetuate her name and tender thoughtfulness for her family—her memorial.

"A father or mother may be insured for the benefit of children to provide:

"1. Money for their education.

"2. A life income for the daughter to maintain her financial independence.

"3. A lump sum of money to start the son in business.

"4. Special gifts at Christmas and birthdays.

"A son may be insured for the benefit of his father or mother:

"1. To protect the financial investment already made in him.

"2. To cover the amount spent for college education.

"3. To cover a loan made for a college education.

"4. To provide for them when they are aged.

"A daughter may be insured for the benefit of her father or mother:

"1. To cover the financial investment made in her.

"2. To cover the money spent for a college education.

"3. To provide money for aged or possibly dependent parents later in event of her prior death.

"The individual insures himself to provide:

"1. A guaranteed monthly income for himself for life in later years without worry of investment or reinvestment.

"2. A fund to start in business later on.

"3. A fund to carry out some ambition in later life.

"4. Bequests to beloved educational or charitable institutions."

greatly increased the responsibilities of the agent and the services he is expected to render to his policyholder.[69]

That many life-insurance executives have not taken a realistic position in the matter of training and selection of new agents is demonstrated by their continued willingness to employ part-time agents. A part-time agent is one who does not spend his entire time in the sale of life insurance and who in fact has other business responsibilities which he carries on in conjunction with his work as an insurance salesman. Part-time agents are employed by most companies at the present time, there being approximately 18,000 part-time agents in the employ of 44 companies furnishing information in this regard in reply to the sales questionnaire.[70] Generally speaking, part-time agents are to be found in the smaller communities, although it is true that even in the large metropolitan areas they are fairly numerous in the case of some companies. Originally the need for part-time agents arose from the fact that in some communities the number of possible insurance buyers was not sufficiently large to justify the establishment of a regular insurance agency or even the employment of a single person on a full-time basis. In the drive for new business, however, many companies were anxious to have as many field representatives as possible and made arrangements with persons in strategic jobs, such as bank cashiers, employees of credit unions, personnel officers, clubmen, politicians, and others who might, through their many contacts and as a sideline to their principal occupations, encourage the writing of insurance and obtain new business.

The evils of the part-time agency system are apparent. A part-time agent receives less training and has less interest in his job. As a consequence he is apt to be unfit and is more likely to utilize improper selling methods. As one agent stated:[71]

Except in towns of less than 5,000 population, I am against the part-time agent. The part-time agent has a part to play, and a lot of families would have gone

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[69] It is not clear whether the renewal commission which the agent receives is simply a delayed first year commission or whether it represents an amount paid the agent for servicing the policy after it is written. In the light of the agent's varied duties and responsibilities toward the policyholder which have been considered above and in view of the many services he performs on the policyholder's behalf after the execution of the policy contract, it would appear that the renewal commission should properly be considered as in the nature of a service fee paid the agent for his work in this connection. Mr. Zimmerman stated he thought the sounder concept was that the renewal commission was a service commission. He testified (pt. 28, testimony on February 28, 1940):

"Mr. GESELL. What would you think about paying an agent a little lower first year commission and stretching his renewal commissions out over a longer period?

"Mr. ZIMMERMAN. Well, personally I think that would be a good idea again. There would be some opposition to it, naturally, but I think there might very well be a reduction, let's say, of 10 percent in first-year commissions, with the renewal commission or service commission paid as long as the policy is a premium-paying policy.

"To me, there is no logic in the fact that when I get to the tenth year, my service commission stops, because quite often I have do do as much service in the twelfth or thirteenth years as I do in the sixth or seventh." (See also pt. 28, exhibit Nos. 2588-2604.)

[70] The number of part-time agents sems to be gradually decreasing; 26 companies reported a total of 31,540 part-time agents in 1930, 39 companies reported 26,527 in 1934, while 44 companies reported 17,641 in 1938. All except one of the companies reporting for both 1930 and 1938 reported less full-time agents in 1938 than in 1930. Replies to commission's sales questionnaire, item 20.

[71] Pt. 28, exhibit No. 2595. Statements of agents appearing hereafter in this section are frequently taken from letters received in reply to a questionnaire letter of the Commission and introduced in evidence as exhibits Nos. 2587-2604 after having been selected by a special subcommittee as typical of numerous replies received (pt. 28, copy of form letter to agents, May 13, 1940).

unprotected had it not been for the part-time agent and it's impossible for a full-time man to work in these smaller towns and make a living. The companies are too eager for new business, and they allow their managers and general agents in the field to appoint entirely too many part-time agents. They appoint these part-time agents without serious investigation, and in many cases they are simply contracts placed in order to write business on the members of their own firm.

Recently in a town of approximately 5,000 population, an owner of a chain store was in the market for approximately $200,000 of life insurance on himself and other executives. He began to shop around. One of the agents writing for a New York company told him that he would get him a contract with his company and give him a part of the commission. An agent with a company not operating in the State of New York said that he could have his company give the man a part-time contract and give him a lot more commission. A third agent who is, I am told, related to the prospect and is with still another company, got the man a contract with his company so that he could get all the commission. The company accepted the contract and the business. I have seen numerous instances where this has been done and the companies O. K. these contracts.

Part-time contracts have been placed in banks, manufacturing plants, department stores, general merchandise stores, and the agents appointed therein have their fingers on local gossip so that they know every time anyone buys life insurance and they thereby cut full-time men out of business. This part of our business is wrong.

In recent years, through the adoption of the so-called agency practices agreement,[72] companies have attempted to eliminate the part-time agent in communities of over 50,000 population. These efforts have been only partly successful; several companies, including the Equitable of New York, have refused to adhere to the agreement.[73]

It is notable that life insurance agents who communicated with the Commission in response to its questionnaire letter almost uniformly objected to the part-time agent and stated that the elimination of such agents would greatly benefit the business of life insurance and the public generally.[74] Indeed, it seems difficult to justify the employment of part-time agents, since there is a great need for intensive training of life insurance agents which cannot be given the part-time man.

In the final analysis, the efficacy of the training and selection methods employed by legal reserve life insurance companies may be judged by the fitness of the agents and the extent to which the number of qualified agents is adjusted to the market for life insurance. There was an almost universal recognition among company representatives that there are too many unfit and poorly trained life insurance agents selling life insurance in the United States today. Mr. Charles J. Zimmerman, who in the past year had traveled from coast to coast, interviewing agents and addressing them at their meetings, testified unequivocally that, while he did not think there were enough good

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[72] Pt. 13, exhibits Nos. 1337, 1338; pt. 28, testimony of Charles J. Zimmerman, February 28, 1940.

[73] Pt. 13, R. 6562, exhibit No. 1339.

[74] Pt. 28, exhibits Nos. 2588, 2589, 2590, 2591, 2592, 2593, 2594, 2595, 2596, 2597, 2600, 2601, 2602, 2604. One agent stated (pt. 28, exhibit No. 2592):

"In my opinion, there is no place in the field of life underwriting for part-time agents. Twisting, rebating, misrepresentation, incomplete and unfair comparisons, and all of the other evils incidental to this business flourish where the ill-trained, uneducated, ill-financed part-time agent abides. In my 16 years in the business, I have yet to meet the first part-time agent who ever became even a good class 'B' underwriter, and it is my conviction that the very few exceptions to this rule are those exceptions which prove the rule."

agents in the country he was certain there were too many unqualified and unfit agents in the business.[75]

Similarly, Mr. Arthur Coburn, vice president of the Southwestern, of Dallas, Tex., stated that in Texas there were 139 companies who employed 8,000 life insurance agents excluding companies which sold burial and industrial insurance. He testified:[76]

Mr. GESELL. Now, do you believe that these 8,000 agents are a large enough group to service the interests of the policyholder?

Mr. COBURN. Oh, they are far too large.

Mr. GESELL. They are far too large. Why do you say that?

Mr. COBURN. Because 7,000 of them are utterly incompetent.

Mr. GESELL. You mean untrained?

Mr. COBURN. Unqualified and untrained, incapable of rendering a satisfactory public service.

Mr. GESELL. Then, I take it, your feeling would be that it would be desirable in the interests of life insurance and the public for there to be fewer and better trained agents.

Mr. COBURN. I believe the best interests of Texas would be served if Texas had 3,000 carefully selected, thoroughly trained salesmen. They could get the job done, too.

Mr. GESELL. Well, I suppose Texas is not any different in that respect from the country at large.

Mr. COBURN. I am more familiar with the conditions in Texas, but I assume the conditions in other States are somewhat comparable.

Statements from individual agents located in various parts of the country were to the same effect. One agent stated:[77]

* * * I believe the number of agents attempting to sell insurance is altogether beyond the number necessary, and I believe the business could be much more efficiently handled and maintained by a smaller corps of more able underwriters.

Another stated:[78]

It is my conviction that a definite lack of balance exists between the size of the life insurance market and the number of agents attempting to sell therein. As you probably know, 80 percent of the business is now being written by 20 percent of the life underwriters (probably the better-trained and better-equipped group). If we could have another 30 percent of the life underwriters trained to do as good a job as the top 20 percent and eliminate the lower 50 percent, a situation would undoubtedly result much more satisfactory to the public and the companies.

Another who had been for 24 years in the life insurance business stated:[79]

I do believe, however, that there are too many unqualified men in the life insurance business, inadequate in knowledge to render proper service, who are burning up territory and creating adverse centers of influence.

And finally the question was summed up by another agent in these vivid terms:[80]

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[75] Pt. 28, testimony of Charles J. Zimmerman, February 28, 1940.

[76] Pt. 13, R. 6594, 6595.

[77] Pt. 28, exhibit No. 2590.

[78] Pt. 28, exhibit No. 2592.

[79] Pt. 28, exhibit No. 2588.

[80] Pt. 28, exhibit No. 2594. (See also exhibits Nos. 2589, 2593, 2600, 2602, 2604.)

It is a matter of common knowledge that life companies contract men indiscriminately in the hope that they will at least write a few of their friends and relatives, and that they might develop into producing agents even though the percentage who come through is pitifully small. * * * This practice results in a lower income to those agents who are capable, a low standard of service to the policyholders of the temporary agent, and a large percentage of poor underwriting by men who know little or nothing about covering a risk with the right type of contract.

The existence of unfit agents is attributable to the bad training and selection methods employed by the life companies. Their failure to take more forthright steps in this connection is attributable in turn to their emphasis on the production of new business. The situation was well summarized by Mr. William Montgomery, president of the Acacia Mutual Insurance Co., who testified: [81]

Mr. MONTGOMERY. * * * If an agent isn't trained, if he doesn't understand what he is selling, is picked off the street, given a rate book, and told to go out and sell life insurance, how can he intelligently sell any man a policy?

Mr. GESELL. Is it your experience in the business, Mr. Montgomery, that frequently that is what is done?

Mr. MONTGOMERY. It seems so, sir.

Mr. GESELL. Would you feel managements which do engage in that practice are perhaps motivated by the desire for volume in getting business on the books at any cost without regard to the training of their personnel in connection therewith?

Mr. MONTGOMERY. Well, if that isn't their motive, why should they do it?

C. TURN-OVER OF AGENTS

It is only natural that the press for the production of new business when coupled with inadequate selection and training, should result in the contracting of a large number of unqualified agents whose connection with their company is brief, whose average compensation is very low, and whose business is improperly sold. The situation was summarized by Mr. Arthur Coburn speaking before the American Life Convention in Chicago in 1935, where he said: [82]

Because of the interest of management in the volume of new business, the path of the disreputable life insurance agent has been made easy. In other lines of endeavor a disreputable salesman fired by one concern finds it difficult to secure employment with another concern. That, however, is not the rule in the life insurance business. * * * Little thought is given to the public point of view that life insurance cannot be sold if we hire disreputable agents fired by other companies. * * * Because of the emphasis that has been placed on the quantity of new business sold by life insurance companies managers have appointed in recent years a very large number of new life insurance agents. It is estimated at the present time that there are 200,000 licensed life insurance agents in this country, of which 15 percent are making a decent living.

The New York Life Insurance Co. observed to the same effect in a pamphlet issued to its agents in 1926: [83]

An inspection of the books of any company will reveal an astonishing condition as to the length of service of the average agent. It is not an exaggeration to

[81] Pt. 10, R. 4341.

[82] Proceedings American Life Convention, 1935, Thirtieth Annual Meeting, Chicago, Ill., "Sales Side of Life Insurance," Arthur Coburn, pp. 51-55.

[83] From pamphlet entitled "NYLIC," No. 3, at p. 6, submitted in reply to Commission's sales questionnaire.

say that too many agents are migratory, shifting, and uncertain in their company connections.

Figures combining the experience of 45 representative companies disclose that during the year 1938 these companies terminated the contracts of 16,297 whole time agents out of a total force which numbered at the end of the year 43,452. A review of the experience of these companies over the preceding 4 years disclosed a comparable though somewhat higher turn-over ranging as high as 22,178 in 1934, at the end of which year 48,775 agents were employed in these companies.

From 1934 to 1938 these 45 companies hired 85,899 new agents.[84] The experience of individual companies reflecting a particularly high turn-over for the year 1938 is indicated below:[85]

Name of company	Number of of agents employed, Dec. 3, 1937	Number of of agents appointed during 1938	Number of of agents terminated during 1938	Number of of agents employed, Dec. 31, 1938
Alliance	85	55	52	86
American United	514	522	369	671
Bankers Life (Nebraska)	139	88	94	133
California-Western States Life	325	179	224	277
Franklin Life	484	386	416	453
Great Southern Life	651	280	428	503
Jefferson Standard	392	415	478	329
Minnesota Mutual	318	270	250	351
Mutual Life of New York	2, 983	1, 292	1, 410	3, 035
Ohio National	673	538	531	680
Prudential	848	529	504	861
Reliance Life	797	586	522	830
Volunteer State	40	60	38	62

[84] Pt. 28, exhibit Nos. 2324, 2324A. As might be expected turn-over of general agents and managers is much less than turn-over of soliciting agents. The following schedule shows for a group of 7 companies chosen alphabetically from the list of companies replying to the sales questionnaire turn-over experience during 1938 for branch managers and general agents, respectively:

BRANCH MANAGERS

Company	Number at beginning of year	Appointed	Terminated	Number at end of year
Acacia	52	9	12	49
Bankers Life (Iowa)	37	6	5	38
Business Mens	16	2	1	15
Conn. General	27	3	2	28
Continental American	11	1	2	10
Continental Assurance	6	1	1	6
Equitable (Iowa)	11	1	6	6

GENERAL AGENTS

Company	Number at beginning of year	Appointed	Terminated	Number at end of year
Aetna	75	3	3	75
Alliance	52	12	23	41
American United	174	109	68	215
Atlantic Life	17	3	6	14
Bankers Life (Iowa)	20	0	2	18
Bankers Life (Nebraska)	48	5	14	39
Berkshire	27	1	0	28

[85] Replies to Commission's sales questionnaire, table 1.

Statements by various life insurance agents left no doubt that turn-over is a pressing problem with the men in the field and that its causes are basically attributable to bad agency management. One agent who had been in the life insurance business for 18 years and who received an average annual income in commissions in excess of $16,000 stated: [86]

There is a large turn-over of agents not only in my office but in every office in my locality, and from what I am told, in the whole country. The main factor responsible for this is that general agents are anxious to make a showing and, therefore, take every available man who is unemployed and give him a contract to sell life insurance. A great many of these men are not equipped to sell insurance and sell their friends and relatives and then drop out of the business, with the result that the business does not stay on the books. I think that the crux of the whole matter is in picking salesmen who, first, have character, second, selling ability, and, third, an aptitude for the life insurance business. The life insurance business takes no capital and so if a man is out of a job, he turns to this business to make some money. I believe that the continual entrance of new agents in my office and in other offices hinders the sale of life insurance not only in my territory but in all territories.

Another agent called particular attention to the effect of the emphasis upon production on agency turn-over: [87]

My office has had about the same experience in agent turn-over as the rest because in the desire to build a sizable agency force we have naturally placed under contract people that did not fit in, and only trial and error could determine this because sometimes the least likely to succeed are the ones who, in some cases, turn out to be good producers and vice versa. In this connection, it is my opinion that there are too many men in the life insurance business due to the fact that the companies' home-office organizations, in order to justify their salary and positions, are constantly urging more production; and the only answer to that is to put on new men, with the result that under home-office pressure new men are constantly being recruited into the business, but very few of them are worth having, and in a short while they fade from the picture, leaving the company the gainer by whatever business they have written.

Still another agent discussed the situation in more detail but to the same effect. He said: [88]

Despite my 7 years' insurance experience, my failure in the life venture was assured due largely to inadequate and improper training plus pressure for production. In less than 6 months I witnessed a complete turn-over of personnel, and as I look back over this period I can't help but conclude that a system of recruiting which demanded immediate production from the novice encouraged failures on a large scale. In fact it almost appears as if the companies deliberately operated on the theory of wholesale recruits to maintain production, figuring each recruit was good for at least $25,000 among his friends and relatives. Each new recruit is asked immediately for a list of his friends and relatives for the purpose of solicitation in the company of the agency's high-pressure supervisor. You are expected to begin practice on your friends and briefly your sales argument is as follows: "Bill, I've become a special agent for ——— life company. I need

[86] Pt. 28, exhibit No. 2590.

[87] Pt. 28, exhibit No. 2593.

[88] Pt. 28, exhibit No. 2599. See also pt. 28, exhibit Nos. 2588, 2589, 2591, 2592, 2595, 2596, 2597, 2600, 2601, 2602, 2604.

your application as a demonstration of confidence in me. Frankly, I don't know much about life insurance as yet, but I do know that you cannot go wrong in buying more life insurance." And poor friend who is put on the spot usually comes across with a $2,500 "testimonial" application and a year or two later when you leave the field the policy is lapsed. An effort is made to revive this contract but this effort consists of a "training" call by some new recruit, who has been sold on the idea that it may become the source of new business some day. Needless to say, the recruit receives no compensation for his efforts even though successful in reinstating the policy. By this time, from other sources, you have learned that an agent renders many a free service in connection with old policies.

There are many causes for agency turn-over. Among those given by the majority of companies are insufficient earnings, lack of production, transfer of employment to another company, personal differences with the general agent, illness or death, deficiencies in accounts, poor persistency of business written, resignation or promotions, company's withdrawal from a territory, failure of agent to receive renewal of bond, and the nonadaption of the agent to his work.[89]

Of these causes, lack of production, or as it is sometimes stated, insufficient earnings, was almost uniformly listed among the chief causes for agency terminations. It represents the following percentage of total terminations in the case of the companies listed below: [90]

Company:	*Percentage of total terminations due to insufficient earnings*	Company—Continued.	*Percentage of total terminations due to insufficient earnings*
Bankers Life (Iowa)	51. 0	Home Life	50. 0
Berkshire Life	94. 1	Life Insurance Co. of Virginia	19. 0
Businessmen's Assurance Co	6. 1	Midland Mutual	68. 5
Central Life	91. 1	New York Life	79. 1
Connecticut General	56. 7	Northwestern National	70. 0
Continental Assurance	100. 0	Northwestern Mutual	35. 8
Equitable of Iowa	58. 4	Pan-American Life	75. 2
Franklin Life	92. 6	Penn Mutual	70. 5
General American	56. 0	Union Central	46. 5
Great Southern	82. 0	Prudential	57. 7
Guarantee Mutual	89. 0	Reliance Life	65. 4
John Hancock	49. 4	Volunteer State	65. 1

Other companies not submitting information enabling a presentation of the exact percentage of terminations resulting from the causes indicated frequently stated that nonproduction or insufficient earnings were one of the chief causes for the terminations of agents.

D. COMPENSATION OF AGENTS

In addition to inadequate training, poor selection, and other causes contributing to turn-over as listed above, insufficient compensation must be recognized as one of the prime avoidable causes for turn-over. Even an agent naturally adapted to the work cannot be successful if he is poorly trained and will not remain on the job if he is underpaid.

[89] Replies to commission's sales questionnaire, item [illegible]0.

[90] Id.

Detailed studies were made to show the compensation of agents employed in a representative number of companies. On the basis of figures submitted by 27 companies which reflected the amount of compensation paid agents during the year 1938, it appeared that a total of 23,923 whole-time agents received during the year $20,216,935.16. Of this number 81.70 percent received only 29.72 percent of the indicated compensation. It appeared that 50 percent of the agents received during the year a sum of less than $250; that 74.14 percent received $999 or less; and that 90.36 percent received less than $2,500. It is, of course, true that these figures include agents not employed for the entire period of a year and exclude compensation paid agents by insurance companies other than those reporting. Some life insurance companies' agents received compensation from several companies and may in some instances represent casualty and fire companies as well as life insurance companies.[91] The figures are, however, indicative of the very low compensation received by life insurance agents.

The inadequacy of the compensation of the average agent was demonstrated by special figures on agents' remuneration received from 28 representative companies. These 28 companies paid their agents, on the average, amounts ranging from a high of $3,696.74 in the case of the Indianapolis Life to a low of $625.01 in the case of the General American.[92] These average compensations, though very low, partially conceal the serious situation which exists with respect to agents' compensation. It was found that even after eliminating all agents who had not been in the employ of these companies for more than 1 year, as many as 19 of the 28 companies paid 50 percent or more of their agents $1,500 or less, and that as many as 5 companies paid 50 percent or more of their agents $750 or less. The following schedule shows for these 28 companies the average earnings of the agents who have been with the company more than 1 year and the percentage of the total agents who receive amounts less than that indicated on the respective columns. In all cases agents not receiving any compensation during the year have been eliminated.[93]

Name of company	Average compensation of those receiving compensation	Percent of agents receiving under $750	Percent of agents receiving under $1,000	Percent of agents receiving under $1,500	Percent of agents receiving over $1,500
Acacia	$2,309.80	10.85	17.63	35.59	64.41
Bankers Life Co	1,403.26	41.38	49.31	65.17	34.83
Bankers Life Insurance Co	1,045.79	65.24	70.05	78.61	21.39
Berkshire Life	971.96	68.15	71.85	77.04	22.96
Business Men's	2,109.41	31.10	40.16	52.76	47.24
California Western States	2,382.48	33.04	37.44	49.78	50.22

[91] Pt. 28, exhibit Nos. 2326, 2327.

[92] Replies to Commission's sales questionnaire, table 6.

[93] Id. Southwestern does not make brokerage or surplus-line agents contracts but will accept such business from its regular agents under certain conditions. The amounts paid its agents as indicated above include commissions on these types of business and such commissions are presumably shared with the originating broker or agent. Reply to Commission's sales questionnaire, table 3. These 28 companies employed a total of 663 agents who, though licensed for the entire year 1938, received no compensation during the year. Of this number 286 were employed by Occidental (California), and 272 by Bankers Life Insurance Co. (id.). (See also pt. 28, exhibit Nos. 2326, 2327.)

Name of company	Average compensation of those receiving compensation	Percent of agents receiving under $750	Percent of agents receiving under $1,000	Percent of agents receiving under $1,500	Percent of agents receiving over $1,500
Central Life	684.35	69.15	76.06	86.70	13.30
Connecticut General	1,799.81	28.84	38.74	53.68	46.32
Connecticut Mutual	1,900.71	23.47	32.80	52.25	47.75
Continental American	2,117.78	26.73	34.65	45.54	54.46
Equitable, Iowa	1,453.17	41.03	48.88	62.33	37.67
General American	625.01	77.25	80.24	88.62	11.38
Great Southern	1,605.49	39.73	48.00	64.53	35.47
Guardian Life	1,903.11	26.30	36.67	54.44	45.56
Indianapolis Life	3,696.75	1.64	13.11	21.31	78.69
Jefferson Standard	1,955.65	10.19	21.36	47.09	52.91
Life Insurance Co. of Virginia	1,240.41	40.48	47.62	64.29	35.71
Lincoln National	1,514.97	42.46	50.99	67.46	32.54
Northwestern National	1,463.40	41.29	48.86	64.39	35.61
Occidental	768.95	73.21	77.26	84.64	15.36
Penn Mutual	2,066.44	27.62	35.19	50.75	49.25
Phoenix Mutual	1,961.16	19.59	28.45	45.77	54.23
Prudential	1,721.41	24.82	34.79	54.50	45.50
Reliance	2,151.43	28.22	36.31	51.04	48.96
Southland	2,637.12	20.83	29.86	49.31	50.69
Southwestern	3,435.84	2.46	7.02	16.84	83.16
Union Central	1,447.92	44.19	51.56	66.29	33.71
Volunteer State	1,315.15	45.00	50.00	70.00	30.00

In order to give additional information on the compensation of agents, schedules were introduced which reflected the highest commissions paid to the leading whole time agents of 35 different companies. From these figures it appeared that the greatest amount received by any life-insurance agent in any of the companies indicated was $36,463.70 in the case of the Southland Life. It appeared, however, that the highest paid agent in each of 10 companies received commissions of less than $10,000 and that there were but three instances where the highest paid full-time agents received over this amount.[94]

In the case of all companies presenting adequate information, it was found that those agents who remained with the company an average of from 3 to 4 or 5 years commenced to receive more substantial compensation. The principal problem as far as agents' compensation is concerned rests, therefore, in the development of adequate means of compensating the new agent during his period of training. A new agent who does not receive adequate compensation is forced either to leave the business or to engage in unethical selling practices. There are very few companies, however, which have developed adequate means of financing the new agent. Of all the companies replying to the Sales Questionnaire there were only 14 which were even experimenting in this field and in no case was any company found which

[94] Pt. 28, exhibit No. 2328.

had adopted an over-all program in this direction.[95] One of the most advanced companies in this respect is the Southwestern Life. This company started in June of 1935 to experiment with a salary basis for recruits and has met with such success that it plans to carry on all its recruiting on a salary basis beginning in 1941. At the present time about 40 percent of the new agents are receiving a guaranteed minimum salary of $100 a month. The agent who receives this salary is given an intensive training course and is permitted to receive commissions if those commissions on the basis of a regular agent's contract would exceed the amount of the minimum guaranteed salary. The Southwestern Life has found that agents employed on this basis are much less apt to leave the company, are more successful, adopt more satisfactory sales methods, and that from an over-all point of view the general agents and others associated with the selection of

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[95] Experiments with minimum salaries or guaranteed earnings are being conducted by Acacia, Berkshire Life, Connecticut General, Guardian Life, Home Life, Mutual Life, New York Life, Northwestern National, Penn Mutual, Phoenix, Union Central, Southland Life and Southwestern. (Replies to Commission's sales questionnaire, item 55). Comments by the Northwestern National are most illuminating. This company stated (reply to Commission's sales questionnaire, item 8):

"New agents: Declarant's objective is to provide some means by which declarant may compete for top-grade available men and provide for limited earnings from other than new sales sources for new agents during their early period of training and development.

"Over 2 years ago, declarant began experiments with employing new agents for a limited period of time on a salary basis. Objective of this experiment has not been to test the salary basis as a practical mode of payment for new agents, but it has been to determine what sort of performance and what particular activities might be developed for the new agent which would prepare the new agent for new business sales and at the same time pay the home office a return adequate to warrant some direct compensation to the agent. Declarant's aim has been to see what sort of activities might be compensated in such a way as to at least supplement commission earnings for the new salesman and assist him in financing his early months in the business. Agents employed for this experimental work have not been permitted to sell insurance to the public. Declarant has been experimenting with teaching these agents how to obtain data on prospects for the use of full-time active agents, how to analyze the insurance and the needs of prospective buyers, how to handle simple service activities, and other activities apart from direct new sales effort to determine the value of such activities when performed by new men and to determine the degree of preparation provided by such activities as a basis for selling on a commission. These new agents have been kept on a salary basis for 3 to 4 months.

While results of this experiment are as yet inconclusive, declarant is encouraged to believe that new agents can be given a better start, if, during their preliminary training, they are not made reliant on new business sales. Declarant also is of the opinion that preliminary training and field work aimed at teaching agents how to obtain information necessary for sound analysis of the policyholder's or prospective buyer's insurance needs and how to handle simple service requests are both the best means of grounding new agents in sales methods in keeping with the declarant's objectives and the best way to equip the agent for the type of activity for which the declarant can pay the agent at least a basic or supplementary income. If these conclusions prove to be well founded, declarant believes investment in the preliminary training of agents along such lines will be warranted on a larger scale. Moreover, if these conclusions prove to be sound, declarant, upon completion of new agents' preliminary training period, will assign to these agents business of inactive agents and orphaned business for service under close supervision. Such policies as are assigned to the new agent will be entered in his insurance in force record exactly as though he had produced the business as of the original date of issue. Thereafter he will be responsible for service, and the persistency of the business will affect his earnings exactly as it affects the earnings of the active, full-time agents. It is declarant's belief that training and inducting the new agent on the basis described above will be both the most effective kind of sales training that could be afforded the new agent and the best basic training for molding agents into the type of activities which support declarant's sales objectives. Renewal commissions under the declarant's current plan will, at the same time, provide a basic or supplemental source of earnings for the agent and relieve to some extent the problem of financing and the difficulties inherent in the present widely accepted practice of making agents in their first year or more wholly dependent on new business sales."

new agents are inclined, as a result of the program, to be more careful in their selection.[96]

That some system of salaries for the new agent is necessary was demonstrated by the testimony of Mr. Charles J. Zimmerman, president of the National Association of Life Underwriters. He stated: [97]

Mr. ZIMMERMAN. I believe—again my own personal belief—that a salary plan for perhaps 3 years to 5 years at a maximum on a decreasing scale, a minimum salary plus commission, to give the added incentive to go out and hit the ball, would be a desirable thing for the business, on the basis that it would help this man, take the pressure off of him in many instances to go out and do a job; the pressure would still be strong enough, the incentive for him to do the job because of the fact that he could earn additional commissions, and in the second place it would enable us to get better men into the business.

Mr. GESELL. Now we are beginning to get down to something, I think. If you pay a man something so he can live when he first comes into the business, you are going to be able to offer your job to a different clientele, aren't you? You are going to be able to get more college graduates, for example. You are going to get more people who want to look at it as a profession, as a career.

Mr. ZIMMERMAN. That is right.

Mr. GESELL. And as a result you are going to have over a period of time a better trained, more professional agency crowd; isn't that right?

Mr. ZIMMERMAN. I think that is true.

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[96] Pt. 13, R. 6586–6592. Mr. Coburn testified (pt. 13, R. 6587, 6588):

"Mr. COBURN. * * * In the calendar year 1937 we hired 74 recruits that we did not guarantee a salary to. Out of these 74 recruits, 16 of these men are now salesmen for the company; a little better than 20 percent have survived.

"In 1937 we hired 19 recruits on a salary. Thirteen of them are now successful life insurance salesmen, a little better than 60 percent survival. Our experience to date has been that we have done three times better with recruits that hired on salary.

"The VICE CHAIRMAN. And probably you had a superior type of man, as you have indicated, to begin with when you took men to whom you advanced a salary.

"Mr. COBURN. Definitely so, sir.

"Mr. GESELL. So that your solution of this problem of turn over, which is so troubling the insurance industry, is to give some kind of a guaranteed salary in the first year, carefully recruit your agents, and train them well.

"Mr. COBURN. Yes, sir.

"Mr. GESELL. Now, what effect from a strictly operating point of view has this new program of recruiting, training, and salary, had upon your business?

"Mr. COBURN. We have increased by $75,000 a year our expenditure in the selection and training of agents. We believe by virtue of that investment of $75,000 a year we have increased our cash earnings $300,000 a year."

[97] Pt. 28, Testimony of Charles J. Zimmerman, February 28, 1940. Statements by various life insurance agents were to the same effect. Pt. 28, exhibits Nos. 2591, 2592, 2593, 2595, 2596, 2601, 2602, and 2604. Portions of two letters from life insurance agents are quoted below:

"I believe that a guaranteed minimum salary for new agents is desirable. This would eliminate companies signing on 'policy peddlers' doomed from the beginning to failure, and would serve to develop competent life underwriters. I would not reduce the first-year commissions to increase renewal commissions" (pt. 28, exhibit No. 2601).

"I am of the opinion that the present method of compensation for life insurance agents is out of date and not at all practical. The present system dates many, many years back; and in spite of the change in every other line of selling, and the adoption of newer methods, the life insurance business has remained as it was.

"A guaranteed minimum salary for new agents is necessary either now or some time in the future if our present agency system is to survive. Many of the new agents going in now are going in on an advance or drawing account which in many ways is a salary; however, the agent has this disadvantage and mental hazard to overcome and that is he realizes that any deficit must be repaid if he does not make the grade.

"I know of no other selling organization that has such a handicap for a new man" (pt. 28, exhibit No. 2595).

See also exhibits Nos. 2588, 2589, 2597, and 2600; pt. 28, testimony of Thomas R. Crowley, February 28, 1940.

Mr. GESELL. In addition you are going to have men who are not going to be under the serious economic compulsion of going out and placing a policy for the sake of bringing home some food at night.

Mr. ZIMMERMAN. That is right. It will take the pressure off.

Mr. GESELL. And you feel very definitely that pressure is there on the new men, do you not?

Mr. ZIMMERMAN. It is on some of them, yes; it is on too many of them, let's say.

Mr. GESELL. We are talking, I understand, about the pressure that is inherent in the situation, not the pressure that comes from some guy pounding the table in front of the agent.

Mr. ZIMMERMAN. That is right.

Mr. GESELL. And you would feel that if this was a minimum, just as the word indicates, and a man might go above that if he were a successful agent and were placing insurance through some commission arrangement, that that would be desirable in that it would keep a man alert and interested in improving his status.

E. CONTRASTING METHODS OF AGENCY OPERATION

As was indicated earlier in this section, the factors of selection, training, and compensation are closely interrelated. A company which disregards any of the three will in all probability experience lapse and a heavy agency turn-over with the concomitant disadvantages to policyholders. In order to demonstrate the manner in which this situation develops in practical operations of a company a contrast of the agency management of two companies—the Equitable and Southwestern Life—was presented.[98]

Mr. Thomas I. Parkinson, president of the Equitable, in discussing the sales operations of his company stated that he was not operating the company for the purpose of keeping net cost down as low as possible but was rather trying to expand than to restrict service. He testified in this connection:[99]

> I could immediately, even with my little knowledge of the life insurance business, so restrict our activities territorially, occupationally, and otherwise that we could easily score a very much lower net cost. What we are trying to do is to give the widest possible and the fullest possible coverage to the greatest number of people at a cost which they will stand.

He likened the activities of his company to those of religious or educational institutions. Mr. Arthur Coburn, vice president of the Southwestern, on the other hand, described his company's sales program in the following terms:[100]

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[98] The testimony with respect to the operations of the Equitable may be found at pt. 13, R. 6505–6579, and with respect to Southwestern at pt. 13, R. 6581–6598.

[99] Pt. 13, R. 6539. Equitable policies have a high net cost and its expenses for acquiring new business are also high. The Southwestern, a stock company, has a slightly higher policy net cost than the Equitable which as has been stated is a mutual company. Southwestern's net cost has gradually lowered, however, and in fact it appeared that in spite of the great increases in average earnings of agents and the amounts expended for training and the consequent reduction in net cost the company's profits to its stockholders had increased in 1938 by over $300,000. However, as to those policyholders who die or lapse or surrender their policies at the early durations the cost in the case of the Southwestern is definitely lower. For example, if a $1,000 whole life policy of each company is compared for age 35 on the basis of the 1939 dividend scale such a policy terminating by either death or lapse at the end of the first year would cost about $7 more in the Equitable than in the Southwestern and at the end of the second year if terminated by surrender the policy would cost about $15 less in the case of the Southwestern. (Equitable and Southwestern 1939 Rate Books and Equitable 1939 annual dividend or refund pamphlet submitted in reply to a Commission questionnaire, pt. 13, R. 6561, 6587, 6588).

[100] Pt. 13, R. 6592.

The problem of compensation: Better-paid salesmen do a better job. The problem of turn-over: Reduce your turn-over and you inevitably reduce your lapses. Select a better class of citizen and they do a better job. Train them more thoroughly and they render a better public service, and in turn the public appreciates that service. All are intimately associated with one another.

A detailed consideration of the agency mechanism of these two companies will serve to emphasize more sharply the basic differences in the methods of operation employed. The Equitable is a mutual company with assets of over $2,000,000,000 and over 6¾ billion dollars of insurance in force. It takes in annually over $279,000,000 in premiums and operates in all States in the Union. It has 110 branch offices and 6,000 agents.[101] The Southwestern on the other hand is a stock company with assets of $65,000,000 and only $358,000,000 of insurance in force. It confines its operations entirely to the State of Texas, where it is incorporated and where all its stockholders reside. It has 10 managers and 396 agents.[102] Because of its size the home-office officials of the Equitable find it a more difficult problem to supervise and keep in intimate touch with the field force. It is significant that Mr. Coburn of the Southwestern was able to testify that he could keep in close contact with the field and that he knew personally 70 percent of the agents employed by his company.[103]

The Equitable uses many techniques to bring in new business. Starting with its original training course which includes suggestions for salesmen on some high-pressure tricks of the trade, it continually reemphasizes production through sales contests which are run on an individual basis by its managers and supplemented by company-sponsored contests and prizes. Though it appeared that these contests resulted in the writing of much fictitious or "hooey" business,[104] Mr. Parkinson stated that he thought the agents liked and expected contests. The Southwestern considers sales contests "highly detrimental" and conducive to maldistribution and lapse. No sales contests are sponsored by the company except for one traditional contest held each year in which only agents with a high persistency record are allowed to participate.[105]

The Equitable has no ceiling on the amount of new business it expects or desires to write.[106] The Southwestern, on the other hand,

[101] Pt. 13, R. 6506–6511.

[102] Pt. 13, R. 6582–6585.

[103] Pt. 13, R. 6510, 6585.

[104] Pt. 13, R. 6543–6550. An analysis of business written by the Equitable agents in the last 2 months of a sales contest ending December 31, 1937, disclosed that by the end of the following February $1,790,000 of business termed "phoney" by the Equitable's own representatives had lapsed (pt. 13, R. 6547). A letter written by the Kansas City General Manager of the Equitable stated (pt. 13, R. 6546):

"I am convinced we are getting quite a percentage of this lapse business in what I term in slang language as 'hooey' business. That 'hooey' business was developed largely through pressure from unit managers during campaigns."

With regard to sales contests Mr. Parkinson testified (pt. 13, R. 6545):

"You know the extraordinary thing about it is that they like it and they expect it. They like us to indicate, the agents and the managers, what we expect of them. They like us to put a little bit of a goal beyond what they might otherwise obtain. And they will stand more talking than any group of human beings that I have ever come across, and that is because the work they do is missionary and it is a drain not only on the nervous system but on the emotions * * *."

[105] Pt. 13, R. 6591. Mr. Coburn testified in this connection (id.):

"Mr. COBURN. I am absolutely unalterably opposed to high-pressure selling.

"Mr. GESELL. Do you believe that sales contests generally promote that kind of selling?

"Mr. COBURN. Highly detrimental."

[106] Pt. 13, R. 6540, 6541.

has a definite yearly limit on the amount of insurance which it desires to write and consistently passes up opportunities to write more business within the State of Texas in the interests of obtaining business of better quality and greater persistency.[107] The Equitable recently expanded its territory [108] while the Southwestern has refrained from doing so.[109]

Radically different methods of selecting new agents are employed by the two companies. Mr. Parkinson indicated that his company was willing to give almost anyone a try at selling insurance. He stated that— [110]

> * * * in these days when employment is not easy to get we do not shut the doors; we let them come in and try * * *.

The Southwestern on the other hand confines its selection to persons between the ages of 21 and 35 who have had a high-school education and who can pass the requisite aptitude test and physical examination.[111] The Equitable gives less training to the new agents selected than the Southwestern. Though the company is not certain as to the amount it expends for training, its best estimate is in the neighborhood of $600 a year per man whereas the Southwestern spends about $1,900 a year per man for the same purpose. In both cases the new agent receives a 2 weeks' training course before he is permitted to sell. In the case of the Southwestern, however, there is an additional feature of a mandatory 1-year training.[112]

The companies also differ as to the methods employed in compensating a new agent during the first year of his employment. The Equitable does not believe in a guaranteed minimum salary. Mr. Parkinson stated that it has been the experience of his company that it is better to pay a man a commission for what he does and thus keep an incentive in front of him.[113] The Southwestern, on the other hand, is in the process of experimenting with a guaranteed minimum salary and thus far has met with great success. It pays 40 percent of its new agents a guaranteed salary of $1,200 a year believing that adequate incentive is maintained by promising the agent commissions if his commissions under the regular agency contract would exceed the amount of the guarantee. The Southwestern has found that its procedure under the guaranteed salary plan has made their turn-over experience three times more favorable, having radically cut down the number of new agents employed and dismissed each year. It has

[107] Pt. 13, R. 6583, 6584.

[108] The Equitable of New York withdrew from Texas in 1906 in protest against a Texas law governing insurance investments. By 1937 Texas had become a prosperous State, and the company decided to reenter it although at that time there were about 140 companies doing business in the State. Mr. W. W. Klingman, who had been vice president in charge of agencies of the Equitable, was put in charge of the Texas operations. Offices were opened in Dallas, Houston, and San Antonio, and two of Mr. Klingman's sons, both without previous managerial experience, were put in charge of the offices in Dallas and in San Antonio. In an effort to develop the territory quickly, the Equitable relaxed many of its agency rules, ran contests, and made a studied effort to develop influence in the State. One of the means adopted for accomplishing the latter was the opening of numerous bank deposits in banks throughout the State. The cost to the Equitable of its first year's operations in Texas was $669,024 (pt. 13, R. 6565-6759).

[109] Pt. 13, R. 6584, 6585.

[110] Pt. 13, R. 6533.

[111] Pt. 13, R. 6586.

[112] Pt. 13, R. 6528, 6529, 6588. In its later reply to the Commission's sales questionnaire the company reported spending $2,175.44 to train an agent. The figure given in the paragraph above is that stated by Mr. Coburn in his testimony.

[113] Pt. 13, R. 6536.

also found that it prevents many bad sales practices from getting a foothold in the organization.[114]

The earnings of the average Equitable agent who stays more than 2 years with the company (that is, a successful agent) are about $804 a year, or $67 a month. A special study made of the compensation of agents connected with Equitable offices in the greater New York metropolitan area disclosed that 31.4 percent earned $750 or less a year, that 49.1 percent earned $1,250 or less a year, and that 78.4 percent earned $2,500 or less a year.[115] The average earnings of the agent of the Southwestern Life Insurance Co. were $2,643.[116]

The Equitable experiences a heavy agency turn-over. At the beginning of the year 1938, the Equitable had 5,894 agents; at the end of the year they had approximately 500 fewer agents. During the 12-month period, however, 2,721 were terminated. Recent figures for Southwestern indicated that it terminated approximately 4 out of 10 contracts.[117]

Mr. Parkinson stated that he believed it is better to have been insured for a while than never to have been insured at all. The lapse rate of the Equitable is high. In fact the lapse rate of the Equitable is half again as high as comparable companies and it appeared that during 1937 from forty to fifty million dollars more insurance lapsed off the books of his company than any other company in its rank. In certain individual cases general agents or managers of the Equitable were shown to have a lapse record over twice as great as that of the ordinary companies operating in their territory.[118] Though the Southwestern has an equally high lapse rate it has reduced its lapse rate by 50 percent in the last 10 years. Individual records are kept of the salesmen and dismissal results if a high lapse rate persists. In

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[114] Pt. 13, R. 6587, 6588.

[115] Pt. 13, exhibit Nos. 1329, 1330. The records of Equitable disclose that 25 percent of its agents produce 64 percent of its business (pt. 13, R. 6539). A memorandum prepared September 15, 1937, by Arthur M. Spalding, assistant to the Equitable's agency vice president, stated (pt. 13, exhibit No. 1332):

"Based on a life insurance sales reseaach study of a large number of agents, they report that out of 100 new, full-time agents in the United States without previous experience, 27 are left at the end of 2 years. Only 5 pay for as much as $100,000 in their first and second years. The average annual production of the 27 agents who stay at least 2 years is $56,000 which translated into earnings at the rate of $12 per $1,000, means about $672 a year or $56 a month.

"Comparing this with the study made of new full-time Equitable agents, they find that only 20.2 percent of the agents were left at the end of 2 years. The average annual production of those who stay" (that is the successful ones) "is $67,000 and translating that into actual earnings on the same basis as above means that these Equitable agents earn about $804 a year, or $67 a month * * *."

To the same effect was a letter dated June 10, 1938, from the Company's Pittsburgh, Pa., general agent which stated (pt. 13, exhibit No. 1334):

"Compliments to the Woods Company are at times embarrassing to the manager when such a situation as the following is true:

"On May 31 we had under contract 296 whole-time agents, and 119 part-time agents, a total of 415.

"By December next I hope that we will not have over 300 agents and with this number most of them substantial.

"Making a study of our records divulges the fact that 116 agents last year produced less than $50,000 apiece; therefore, earned not even a fair living. This 116—25 percent of our force then—produced 10 percent of our business and consumed, I would say, at least 50 percent of our time.

"If the Lord lets me live, I expect to see to it that a very large percentage of those who remain under contract are substantial agents, selling substantial amounts of insurance to substantial people. What is the use of talking about life insurance as a career when one-fourth of our people are not making a decent living, and when year in and year out we hire and fire about 10 people a month?"

[116] Pt. 13, R. 6589. See *infra*, at note 95.

[117] Pt. 13, R. 6588; exhibit No. 1330.

[118] Pt. 13, exhibit No. 1336.

addition special types of contracts and premium payment arrangements have been devised to reduce losses to policyholders from lapse.[119]

The expert testimony of Mr. Charles J. Zimmerman substantiated the analysis of agency problems inherent in this sharp case history contrast. Mr. Zimmerman testified: [120]

Mr. GESELL. * * * If there were less turn-over of agents you would have less lapse.

Mr. ZIMMERMAN. Yes, you would have less lapse, and yet it wouldn't affect it materially, in my opinion.

Mr. GESELL. If you had less turn-over of agents there would be lower net cost of insurance, would there not?

Mr. ZIMMERMAN. That is perfectly true.

Mr. GESELL. If you had better selected agents there would be less lapse, would there not?

Mr. ZIMMERMAN. Yes.

Mr. GESELL. If you had better selected agents there would be lower net cost, would there not?

Mr. ZIMMERMAN. That is true, Mr. Gesell.

* * * * * *

Mr. GESELL. * * * You have agreed that if we had less turn-over and better selection of agents we would have less lapse and lower net cost. Is that right?

Mr. ZIMMERMAN. That is right.

Mr. GESELL. If you had better trained agents there would be less lapse and lower net cost, would there not?

Mr. ZIMMERMAN. Yes.

Mr. GESELL. If there were less emphasis on the first year's commission, particularly in the case of inexperienced agents, there would be less lapse, would there not?

Mr. ZIMMERMAN. Yes; that would be a factor.

Mr. GESELL. If you paid a guaranteed minimum salary to men coming into the business until they had trained and proven themselves, you would have less lapse.

Mr. ZIMMERMAN. On the assumption that you attract better men, do a better job of training and supervising, that is right.

* * * * * * *

Mr. GESELL. * * * If you had fewer unfit agents you would have less lapse, would you not?

Mr. ZIMMERMAN. Yes.

Mr. GESELL. You would have lower net costs?

Mr. ZIMMERMAN. Yes.

F. CONCLUDING OBSERVATIONS

This discussion of company agency practices is of necessity somewhat limited. To develop fully the many ways in which bad training, selection and low compensation of agents, when coupled with high-pressure selling and turn-over, prevent the companies from giving adequate service to their policyholders would have required funds

[119] Pt. 13, R. 6589 6593.

[120] Pt. 28, testimony of Charles J. Zimmerman, February 28, 1940.

and a staff far greater than that available to the Commission. Letters received from life insurance agents and the hundreds of complaint letters received from policyholders throughout the country bear witness to the serious difficulties which exist. The summary of conditions which has been presented above, however, is sufficient to demonstrate how completely the companies as a whole have failed to adapt their agency organizations to changing times and the present needs of their policyholders.

The Commission's sales questionnaire forwarded to the 68 largest legal reserve companies was designed to obtain detailed information on the agency practices of the various companies. The returns to this questionnaire indicated that company managements were on the whole completely ignorant as to conditions within their own companies which had a vital bearing on the efficiency of their agency staff and the quality of the service which it was rendering to the public. In fact, the great majority of the companies failed to answer, on the grounds of unavailability of information, the more significant items in the questionnaire relating to many basic questions, as compensation of agents and expense of turn-over and training.

In seeking a formula for a solution of agency problems, companies must develop means of ascertaining the weaknesses which exist in their respective agency organization. Obviously, the absence of concrete information prevents companies from taking forthright steps toward the solution of their sales problems. Though many companies replying to the Commission's sales questionnaire acknowledged laudable sales objectives, such as adequate training, high compensation for agents, and the acquisition of persistent business, it was surprising to find that these companies were not in a position to submit information which would indicate whether or not progress was being made toward the achievement of these various objectives. The lack of realism which is thus exhibited is tantamount to self-deception, and is an obvious obstacle to the solution of the problems of the agency system. The fact, for example, that many companies who declare that one of their chief objectives was the adequate compensation of their agency force were obliged to admit in their reply to the sales questionnaire that they had no information relating to the compensation of their agents, is startling to say the least. Similarly, a large number of companies who acknowleged the importance of adequate training as an approach to the solution of certain agency problems admit in their questionnaire replies that they had neither knowledge of nor control over the training courses required of or offered to their agency force. Consequently, companies which have had the most progressive management with regard to problems of agency organization were uniformly the companies in a position to provide the Commission with complete replies to the questionnaire. This fact is indication in itself that a realistic approach can only be founded upon adequate knowledge.

There is obviously no single solution to the problems which confront the American agency system. Within certain limits, each company must work out its own cure. Some observations can, however, be made with certainty. The work of the life insurance agent

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must be recognized as something more than that of a salesman. Economic and management pressure on the agent to sell more and more life insurance must be reduced and in substitution thereof must come a willingness on the part of life insurance company managements to discard "growth for growth's sake alone" in favor of a selling program which has as its primary objective the sale of insurance in the manner which is most suitable to the policyholders' needs and their ability to pay. The unfit agent must be eliminated and only those persons equipped through careful selection and training to approach the public in a professional manner with a view to rendering expert service must be permitted to carry a rate book for a legal reserve life insurance company. Unless these things are done immediately through the combined effort of regulatory officials and company managements, the time will have arrived when the social disadvantages resulting from the system as presently conducted can no longer be ignored.

SECTION XVI

Cost of Ordinary Life Insurance

Because there are usually many companies writing insurance in the same territory, each offering a variety of policies, it is customarily thought that in selling life insurance there is keen competition, particularly on matters of policy prices and policy provisions. This is not necessarily true. In fact, many life insurance companies have made a determined effort to eliminate competition among themselves in these respects. This noncompetitive attitude has already been demonstrated in the previous sections of the report describing elaborate intercompany agreements to fix uniform rates for annuities and nonparticipating life insurance and various attempts to establish uniform surrender charges and to standardize practice in regard to settlement options.[1] The so-called replacement agreement to which the great majority of American companies have subscribed is another effort in this same direction in that the signatory companies have in effect bound their agents not to disturb for any reason insurance already in force in another company.[2]

The attempt to control sales competition in certain directions may be further demonstrated by an examination of instructions distributed by representative companies among their agents. The general attitude of many life insurance companies[3] in this respect is summarized in the following extract from instructions given to West Coast Life Insurance Co. agents:[4]

> The life insurance business enjoys an excellent reputation for business integrity and financial soundness. Most people believe that all life insurance companies are financially reliable. They think that all life insurance companies are good companies, and this feeling of confidence is a great help to the life insurance salesman. The life insurance salesman must therefore strive at all times to strengthen this attitude. He should avoid any disparagement of life insurance companies. Such criticism would tend to weaken public confidence in the whole institution of life insurance. At all times, the life insurance salesman should speak well of other companies and emphasize that all legal reserve life insurance institutions are safe, sound, and reliable.
>
> Most of your sales will be completed without any necessity for a discussion of the comparative merits of companies. An excessive desire to establish a superi-

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[1] See pp. 141 to 163, supra.

[2] See p. 162, supra.

[3] A few companies dissent from this attitude. The Northwestern Mutual, for example, tells its agents (The Northwestern Agent, Lesson 10, p. 23, submitted in reply to Commission's sales questionnaire): "The important thing to realize, first of all, is that competition is not an unmitigated curse, as the comments of some agents would occasionally lead us to think. It is not a curse at all. Active competition stimulates public interest and increases the sales of the best products. An experienced salesman offering a product of unusual merit prefers a highly competitive market because he knows that he will profit by the public attention which competition always directs toward the best product in its class." The Northwestern Mutual is a low net-cost company (pt. 10A, R. 282-314.)

[4] A Preliminary Guide, p. 58, submitted in reply to Commission's sales questionnaire.

ority of your own company may sow the seed of doubt in your prospect's mind, and perhaps make him feel that he can make a serious mistake by buying life insurance from the wrong company. Such an attitude of doubt may disappoint your prospect's existing confidence and replace it with indecision. If this happens it will be difficult to make a sale.

A textbook on the sale of insurance distributed by one company to its agents covers this point in detail: [5]

It pays to avoid competition altogether. Competition is putting life insurance on a par with commodity. Service is not and should never be made a matter of barter. Service cannot be weighed and a price fixed accordingly. An attorney renders a service—there is no barter. Service is a matter of confidence, knowledge, and judgment, and one man's service may command a price many times greater than another man's for doing the same work.

Competition is bad because:

1. It antagonizes the prospect's mind.
2. It takes time which could be more profitably spent in writing new business.
3. When you bring out the demerits of another company, the prospect puts you off until he can learn from someone else the demerits of your company.
4. Competition tends to discourage you and takes you out of your usual routine of work.
5. Competition is not an objection to buying life insurance, but an objection to buying it from you.

This textbook then goes on to point out things that cause competition to arise and which should, therefore, be avoided:

1. Emphasizing your company's advantage puts the idea into the mind of the prospect that there are other companies.
2. When you rely on a sample policy for points of benefits, the only thing the prospect sees is the difference in rates.
3. Delay in closing the case brings up competition because the time given the prospect for deliberation makes him want to "look around."
4. Selling life insurance as a mere commodity instead of a service brings up the question of price, and that makes comparison necessary.

Some companies go to the extent of preparing evasive answers for the agent to give to the prospect who says he wants to compare policies offered by different companies before he buys insurance. The Travelers suggests the following procedure if a prospect says he would like to get figures from other companies.[6]

If this objection is made before the policy is applied for, the following reply is suggested: "If I were in your position, Mr. Prospect, I would probably want to get competing figures, too. But as an agent in the business, I know that it is far more important to find out first of all whether you can qualify for a plan like this." (Proceed to sell him on this idea rather than getting in a competitive discussion of cash values, dividends, and policy provisions.)

If this objection is encountered when you are placing the policy, sell your prospect on the idea in what follows: "I know just how you feel, Mr. Prospect. You want to be sure you are getting full value for your money and that no other company can offer you more than we can. If I were in your position I would probably feel exactly as you do about it.

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[5] Guarantee Mutual Life Co., How to Solicit, by J. B. Duryea, pp. 55, 56. Submitted in reply to Commission's sales questionnaire.

[6] Agents' Handbook III H. 27, submitted in reply to Commission's sales questionnaire.

"But to make certain that you are getting the most for your money will require considerable time and study on your part. There are approximately 300 companies writing life insurance in this country. Of course, you would not want to obtain proposals from each 1 of the 300. You would probably be satisfied with 10, 15, or 25 of the larger and better-known companies. To write for their proposals, receive their replies, study and classify them as to all their features and premium outlay, is going to take time. It may take you 3 months, possibly 6 months or more. During that time your insurability may change on account of a neglected cold, sudden illness, or an accident. Here is our contract right in your hands now. Don't take a chance on your becoming uninsurable while making this study of other companies' proposals. Let me have your check for the first premium on this contract. That will put the plan in force immediately."

Guardian Life Insurance Co. has detailed answers of evasion prepared for the prospect who shows an inclination to compare companies or the rates of various companies. To the prospect who says: "I want to compare your proposition with one or two other companies," the agent is instructed to answer: [7]

Mr. Prospect, life insurance is not a commodity that can be bought at different prices at different stores. Life insurance is a service. All companies use the same or very similar tables in figuring actual rates for protection. You will get only what you pay for in every company. No company can give you greater protection for your money than another. You are purchasing a policy, yes—but back of the policy is the service of "the friendly company."

If the prospect says that the offering company's rates are too high, the agent is instructed to say: [8]

We get in this world, Mr. Prospect, just what we put into it and no more. All old-line insurance companies are on practically the same net cost basis.[9] It stands to reason that with competition as keen as it is today one company cannot give you the same thing for less money than you get it elsewhere. If this were the case, the low-cost company would soon be getting all of the business. I am not selling you a premium rate, Mr. Prospect; I'm selling you protection and in addition to a certain amount of protection, I am offering you Guardian service, which is unexcelled. Just let me tell you of a few features of the Guardian service program. Insurance may be considered safe and safer. By choosing a safer percentage basis in making up the premium rates, the Guardian can offer you safer insurance and, at the same time, agree to annually return to you the unused portion of the collected funds standing to the credit of the policy. These refunds we call dividends, and they have simply provided a larger margin of safety for the protection of you and your loved ones, while in possession of the company.

My company is rendering a service—we furnish complete protection. Protection to your family in event of your untimely death; protection to both you and the family in event of your living to old age; and protection against loss of income in case of total disability. You cannot get something for nothing. You receive full value for your investment. After all, protection is what you want; dividends are a byproduct.

[7] Pt. I, Course of Study for Guardian Agents, III B-39, submitted in reply to Commission's sales questionnaire.

[8] Ibid., B-37, 38.

[9] This, of course, is a direct misrepresentation of fact. Net costs differ widely. (See pt. 10A, R. 282-314, and pp. 242 and 243, infra.)

In the event the prospect says, "I want to investigate some other companies and their rates," the Phoenix Mutual makes these suggestions to its agents:[10]

1. Reduce this to an absurdity. If he is to make an adequate investigation, he will have to investigate several hundred different companies.

2. Emphasize the unique position you hope to occupy as his counselor, to give him service rather than just sell him a policy.

3. "You are an expert in your business; I am in mine. Just what would you like to know? I will get the information and then you can make your decision."

4. Stress the unique service of the Phoenix Mutual, and emphasize the fact that if he has reference to so-called "net cost" that that can never be anything but an estimate.[11]

To the insuring public the question of competitive costs which the companies thus evade is of prime importance. Since the financial strength of the principal American life insurance companies, in terms of ability to meet their contracts as they mature, is in most respects on a par, the policyholder has little to choose between insurance companies in this respect; thus the relative cost of his insurance should become the most important consideration when he is purchasing life insurance. The policyholder naturally desires to get the most insurance protection for his money. It is, however, very difficult for a prospective policyholder to compare costs as between policies or between companies, or even to determine the cost of any one particular policy. The policyholder who attempts to make the determination will quickly find himself in a maze of technical terms and obliged to make numerous adjustments for variable factors which might affect the cost.

Before a cost comparison between two companies can be undertaken the policies on which costs are to be compared must be on the same basis and provide substantially the same benefits. To determine which policies are thus comparable is no easy matter, for practically all companies have adopted the practice of issuing policies in almost innumerable forms. Though the laws of most States require that policies offered by companies authorized to do business shall contain certain basic provisions, these provisions are obscured by a mass of other policy detail. Even the basic provisions themselves are not similarly worded, and it may require much analysis to determine the differences in benefits provided by generally similar provisions. To indicate the nature of the problem, it is only necessary to refer to the great number of policies offered by representative companies and the variety of designations by which many substantially similar policies are known in different companies. The Aetna, for example, offers 92 different plans of insurance; the Lincoln National offers 102;

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[10] Sales Plans, No. ST 261 (3116), p. 9, submitted in reply to sales questionnaire.

[11] The Guarantee Mutual prepared this ruse for its agents if the question of cost should be brought up. The agent is instructed to say ("How to Solicit," p. 131, submitted in reply to Commission's sales questionnaire):

"It will not cost anything. This is a savings proposition, not one of expense. You never think of savings deposits in cost. Cost in 10 years? You figure it. Here are the facts: You deposit $263.50 with my company and die during the first year and we will give your wife and children $100 a month for ten and a quarter years—a total of $12,300. Or suppose you deposit for 10 years and then stop. You will have deposited $2,635. We will change the policy and pay back your $2,635 whenever you die and $1,710 in addition. That's all your money back and 64 percent in addition. Please figure the cost—I can't. If you can't we will see the doctor at 2:15."

the Mutual of New York, 125; and the Prudential, 136.[12] A statement of the names of some, but by no means all, of the policies offered is sufficient to indicate the confusion confronting an inquiring policyholder:[13]

Ordinary life.
Twenty-pay life.
Twenty-year term.
Life paid up at 70.
Endowment at 85.
Business preferred.
Berkshire benefactor.
Economic protector.
Economist.
Thirty-three-payment 35-year endowment.
Improved 20-year term.
Life-expectancy term.
Graded premium life.
Whole life double protection to 60.
Guaranteed paid-up additions.
Family special premium.
Family maintenance, 20 years.
Protector.
Term to expectancy.
Five-year automatic convertible term.
Annuity endowment at 65.
Special whole life increased benefits at 65.
Thirty-year endowment.
Fifteen-year convertible term.
Adjustable whole life.

When it is recognized that all of the above policy forms are among those most frequently sold by principal companies the extent of the policyholders' confusion becomes even more apparent. It has been said that there are, however, only four basic policies and that in spite of their many variations it is possible to reduce the policies offered by different companies to a common denominator through the use of which actual benefits may be compared. As has been indicated this is not a simple task but the statement finds some support. In the event a policyholder can make such an analysis of the policies offered, he is then and only then in a position to approach intelligently the question of the cost of his policy.

In order for the policyholder to determine the cost of insurance he may make calculations in either of two recognized ways—on the assumption that the policy is continued or on the assumption that it is surrendered. In the first case, an attempt is made to find the cost to the policyholder over a given period of time, the policyholder never surrendering his policy. Thus if the policy had been in force for 20 years and is continued in force the cost to the policyholder is the sum of all premiums paid less all dividends received. If the policyholder dies after the policy has been in force for exactly 20 years, his beneficiary will receive the face amount of the policy, and the total cost of the insurance will be the sum of 20 annual premiums paid less all

[12] Pt. 28, exhibit No. 2323.
[13] Ibid.

dividends received. Calculating the cost on the "policy surrendered" basis, it is assumed that the policy is kept in force for a number of years and then surrendered. In this case if the policy were kept in force for 20 years and then surrendered, the policyholder would receive a cash surrender value of an amount stipulated in the policy in lieu of his continuing insurance. The cost of the insurance for the 20 years, then, would be the sum of all premiums paid less all dividends received, less also the cash-surrender value received.

As has been stated, the factors which go to make up an insurance premium are the rate of interest assumed, the estimated rate of mortality, and a loading for expenses such as selling and administering the fund, profits in the case of a stock company and margins for contingencies. The rate of interest assumed is that which the company's management is prepared to guarantee it can earn on the reserve funds deposited with it; the estimated rate of mortality is based on one of the actuarial tables of mortality and the loading is an estimate of the amount which will be required to sell the policy and to pay its pro-rata share of conducting the business of the insurance company.

In the case of nonparticipating policies the initial premium rate thus computed is also the determinant of the net cost of the policy, which can be calculated with certainty. For a whole-life policy the net cost, continued basis, is the sum of the premiums paid from the date of the policy to the date of death. For a 20-payment life policy it is 20 times the given annual premium or the sum of as many premiums as shall have been paid between the date of the policy and the date of death. If the net cost of nonparticipating insurance is calculated on a discontinued basis it is the sum of all premiums paid less surrender values received. If any savings are made in mortality or administration or if a rate of interest higher than that guaranteed is earned, the company makes a profit for its stockholders but the cost of insurance to the existing policyholders is not affected.

In participating insurance the initial rate is not the determinant of the net cost because of dividends. The amount of the dividend is varied in that it is increased or decreased as profits or losses are realized from the operations of the company as a whole. At regular intervals, usually annual, a part of the surplus of the participating company is divided among its policyholders. This division is made by means of complicated formulas which attempt to divide the distributable surplus in accordance with the equities of the groups of policyholders which contributed to it, the policyholders being grouped by ages, year of issue, and by type of policy held. The factors of loading, interest, and mortality and sometimes gain or loss from special lines of business are given weight in these formulas.[14] Because of the many difficult allocations and assumptions involved, these formulas, which differ widely as between companies, can at best accomplish only rough

[14] Dr. S. S. Huebner describes the usual dividend formula thus (Life Insurance, 3d ed., p. 345):

"Stated in the form of a debit-and-credit account, the policy is credited under this plan with (1) the terminal reserve at the end of the previous year, (2) the premium paid under the policy, and (3) the interest actually earned on these two items minus investment expenses; and is debited with (1) actual expense of conducting the business, (2) cost of insurance as shown from the actual experience of the company, and (3) the terminal reserve of the policy at the end of the year. The difference between the two sides of the account is regarded as the surplus contributed by the policy under consideration."

justice in distributing the surplus according to the equities of the various groups.[15]

It will be readily observed that it is impossible to forecast what dividends will be paid in future years (except to the extent that it is possible to evaluate the efficiency of management) but it is possible to obtain some idea of comparative net costs in different companies by using the dividend scale for a given year. This, of course, will not produce the same results as a calculation of net cost from an historical point of view nor will it indicate with complete accuracy the net costs which may be expected to result in the future. However, one of the simplest and most effective methods of determining relative net costs of various companies is to use the premium rate and the dividend scale applicable to a given point in time.

A simple example will clarify the methods of determining the cost of insurance to the policyholder. A $1,000 whole-life participating policy issued by the Aetna on a person aged 35 calls for an annual premium of $26.57 at the 1939 rate. In 20 years this annual premium will have been paid 20 times, or a total of $531.40 will have been paid in. During those 20 years it is estimated that $105.50 in dividends will be paid on the policy. This estimate is made on the basis of the dividend scale in effect in 1939. At the end of 20 years, then, the policyholder will have paid in $531.40 of which $105.50 will have been returned to him, making a net cost to him of $425.90 if he leaves his policy in force. However, if at the end of the 20 years he decides to surrender his policy he will receive from the company a cash payment of $328 and his policy will be canceled. The total cost for the 20 years' insurance protection will then be $425.90 less $328, or $97.90.

A detailed study, along the lines indicated, of the premium rates and dividends paid by the various companies, shows a wide divergence in the cost of the insurance to the policyholders. Based upon the 1939 dividend scale, the costs to the policyholder in each of the 26 companies at the end of 20 years of a $1,000 whole-life policy, or the nearest comparable form of policy, issued at age 35, on both a continued and a surrendered basis, is as follows:[16]

[15] Sometimes the justice thus accomplished is exceedingly rough. For example, some companies calculate the mortality saving at a flat amount per $1,000 at risk, regardless of age. This favors policyholders at older ages. Other companies, having devised a dividend formula, use arbitrary percentage modifications of it from year to year. This of course changes the relative weights of the various factors involved in the formula (replies to Commission's investment questionnaire, item 48).

[16] Only a few net-cost comparisons are given here. On pp. 282–314 of pt. 10–A are tables showing the policy-continued and policy-surrendered net costs for 10- and 20-year periods of whole-life, 20-payment life, and 20-year-endowment policies, both participating and nonparticipating, issued at ages 25, 35, and 45, for the 26 largest companies. These costs are calculated on the basis of 1939 rates and dividend scales, and are calculated both without consideration of interest and on a discounted basis. Net costs of participating policies of the kinds and ages listed above, calculated on a historical dividend basis, are included in the record (pt. 28, exhibits Nos. 2343–1 to 2343–9, inclusive).

Standard participating policies—sold in the amount of $1,000 or more [1]

Company	Annual premium	20 annual premiums	20 years dividends	20-year net cost, policy continued	20th year cash value	Net cost, policy surrendered end of 20th year
Aetna	$26.57	$531.40	$105.50	$425.90	$328.00	$97.90
Bankers Life	26.91	538.20	110.93	427.27	331.45	95.82
Connecticut General	25.53	510.60	90.16	420.44	328.00	92.44
Connecticut Mutual	26.35	527.00	111.48	415.52	327.58	87.94
Equitable, New York	28.11	562.20	[2] 145.60	416.60	327.00	89.60
Equitable, Iowa	26.35	527.00	120.33	406.67	328.00	78.67
Guardian Life	26.35	527.00	90.67	436.33	327.58	108.75
John Hancock	26.06	521.20	101.40	419.80	331.00	88.80
Massachusetts Mutual	26.35	527.00	107.75	419.25	327.58	91.67
Metropolitan	25.35	507.00	122.06	384.94	[3] 348.74	36.20
Mutual Benefit	26.35	527.00	110.43	416.57	327.58	88.99
Mutual, New York	28.11	562.20	100.68	461.52	327.58	133.94
National Life	26.35	527.00	134.99	392.01	327.00	65.01
New England Mutual	27.00	540.00	127.03	412.97	327.58	85.39
New York Life	28.11	562.20	[4] 169.11	393.09	327.00	66.09
Northwestern	26.88	537.60	150.21	387.39	327.58	59.81
Pacific Mutual	26.36	527.20	118.71	408.49	328.00	80.49
Penn Mutual	26.35	527.00	[2] 126.84	400.16	327.58	72.58
Phoenix Mutual	24.58	491.60	79.38	412.22	319.00	93.22
Provident Mutual	25.88	517.60	129.10	388.50	327.00	61.50
Prudential	25.42	508.40	104.07	404.33	337.00	67.33
State Mutual	26.35	527.00	107.90	419.10	327.58	91.52
Union Central	26.30	526.00	93.09	432.91	327.00	105.91

[1] Pt. 10-A, R. 286, 287. The net cost figures given above are calculated on an undiscounted b and on the basis of the 1939 dividend scale. Both are subject to some objections. The undiscounted basis is objectionable in that $1 of premium paid, or dividends received, in the early years of the contract, is given equal weight with $1 of premiums, dividends, or cash values in the later years of the contract. This disregards the element of interest. As a result, this method of deriving net costs shows comparative figures which generally favor (1) participating policies over nonparticipating policies; (2) high premium participating policies over low premium participating policies; (3) participating policies which pay extra or special dividends at the end of 5-year periods or in later policy years.

The 1939 dividend scale was used because it provides the best available criterion of the 1939 position.

Net costs for the policy represented above, on a discounted basis (3½ percent) and on a basis using actual dividend rates for the last 20 years, are as follows (pt. 10-A, R. 302, 303; pt. 28, exhibit 2343-1 to 2343-9):

Standard nonparticipating policies—sold in the amount of $1,000 or more

Company	Annual premium	20 annual premiums	20 years dividends	20-year net cost, policy continued	20th year cash value	Net cost, policy surrendered end of 20th year
Aetna	$21.42	$428.40	0	$428.40	$311.00	$117.40
Connecticut General	21.42	428.40	0	428.40	311.00	117.40
Equitable Iowa	21.20	424.00	0	424.00	311.00	113.00
Lincoln National	21.88	457.60	0	457.60	325.00	132.60
Pacific Mutual	21.42	428.40	0	428.40	311.00	117.40
Travelers	21.42	428.40	0	428.40	310.75	117.65
Western & Southern	21.40	428.00	0	428.00	314.00	114.00

Standard participating policies—sold in the amount of $1,000 or more

Company	Discounted		Based on actual dividends	
	20-year discounted net cost, policy continued	Discounted net cost, policy surrendered end of 20th year	20-year net cost, policy continued	Net cost, policy surrendered end of 20th year
Aetna	$317.17	$152.33	$414.73	$83.73
Banker's Life	320.03	153.45	408.05	97.30
Connecticut General	313.43	148.59	404.03	93.03
Connecticut Mutual	310.69	146.06	405.04	77.40
Equitable, New York	311.76	147.42	396.12	[b] 69.12
Equitable Iowa	304.25	139.41	389.44	78.44
Guardian Life	324.67	160.04	410.16	82.58
John Hancock	314.78	148.43	410.11	99.11
Massachusetts Mutual	313.56	148.93	392.45	64.67
Metropolitan	291.39	[c] 116.13	370.15	[d] 37.31
Mutual Benefit	311.05	146.42	388.10	60.52
Mutual, New York	342.96	178.33	404.08	76.50
National Life	294.00	129.66	393.88	66.30
New England Mutual	309.75	145.12	387.58	60.00
New York Life	301.67	[e] 137.33	373.83	46.83
Northwestern	290.04	125.41	367.56	39.98
Pacific Mutual	306.54	141.70	435.36	132.36
Penn Mutual	300.77	[a] 136.14	364.06	56.48
Phoenix Mutual	306.71	146.39	410.38	78.93
Provident Mutual	291.79	127.45	371.79	61.79
Prudential	303.50	134.14	361.69	50.69
State Mutual	312.45	147.82	398.79	71.21
Union Central	322.42	158.08	407.72	97.72

[a] Includes discounted value of "extra" dividend payable at end of 5th policy year.

[b] See note 17 *infra*, at p. 244.

[c] Includes $9.92, the discounted value of "cash settlement" dividend, payable in addition to guaranteed cash value of policy, in event policy is surrendered at end of 20th policy year. After a policy has been carried for 17 full years, a "cash settlement" dividend is payable upon surrender, the amount of such dividend increasing with duration.

[d] Includes "cash settlement" dividend of 18.84, payable in addition to guaranteed cash value of policy, in event policy is surrendered at end of 20th policy year.

[e] Includes discounted value of "extra" dividends payable at end of 10th, 15th, and 20th policy years as follows: 10th year, $5; 15th year, $10; 20th year, $20.

[f] Includes "extra" dividends paid at end of 5th, 10th, 15th and 20th policy years.

Standard non-participating policies—sold in the amount of $1,000 or more

Company	Discounted	
	20 Year Discounted Net Cost-Policy Continued	Discounted Net Cost, policy surrendered end of 20th year
Aetna	$315.08	$158.78
Connecticut General	315.08	158.78
Equitable Iowa	311.85	155.55
Lincoln National	336.56	173.23
Pacific Mutual	315.08	158.78
Travelers	315.08	158.91
Western & Southern	314.79	156.98

[2] Includes "extra" dividend payable at end of 5th policy year.

[3] Includes "cash settlement" dividend of $19.74, payable in addition to guaranteed cash value of policy, in event policy is surrendered at end of 20th policy year. After a policy has been carried for 17 full years, a "cash settlement" dividend is payable upon surrender, the amount of such dividend increasing with duration.

[4] Includes "extra" dividends payable at end of 10th, 15th, and 20th policy years as follows: 10th year, $5; 15th year, $10; 20th year, $20.

These figures deserve some comment. It will be noted that on the participating policies the range in annual premiums is comparatively small although the annual premiums of three companies—Equitable, Mutual Life, and New York Life—are considerably higher than those of the other companies. In the twentieth year cash value also, the range is comparatively narrow. In the dividend estimates, however, there is a wide range with the result that there is a great deal of difference in the cost to the policyholder. An effective comparison may be made by looking at the figures for the three companies named: Equitable, Mutual Life, and New York Life. These companies all have the same initial premium rate of $28.11 which is the highest rate of any company listed and cash surrender values are practically identical, yet on the basis of 1939 dividends, policyholders who kept their policies in force for 20 years and then surrendered them would find that in the Equitable the 20 years' cost would have been $89.60; in the Mutual of New York, $133.94; and in the New York Life, $66.09.[17] On the nonparticipating policies the annual premium is consistently lower, as low as $21.40 in the case of the Western & Southern, but in almost all cases the ultimate cost to the policyholder over 10 or 20 years is less on the participating than on the nonparticipating policies. Nonparticipating companies have for many years criticized this type of cost comparison on the ground that it does not give sufficient weight to fundamental differences existing between participating and nonparticipating policies. Nonparticipating companies point out that they contract to provide life-insurance protection for a fixed annual premium during the life of the contract and that as a consequence their net cost is fixed while that of the participating companies may fluctuate. The persistent decline in interest rates has led the nonparticipating companies to contend that the participating companies will be obliged to cut dividend rates and thus increase their net cost. Only the future can demonstrate how valid this argument may be.[18]

Similarly striking differences in cost as between companies appear in 20-payment life and 20-year endowment policies. Based on the 1939 dividend scale the cost to the policyholder in each of the 26 companies at the end of 20 years of a $1,000 20-payment life policy and of a $1,000 20-year endowment policy each issued at age 35 on both a continued and a surrendered basis is as follows: [19]

[17] On the basis of actual dividends declared 1919 to 1939 the 20-year cost of a policy surrendered would have been $69.12 in the Equitable of New York. $76.50 in the Mutual of New York, and $46.83 in the New York Life (pt. 28, Exhibit Nos. 2343-1 to 2343-9, inclusive).

[18] For a more complete discussion of the various factors to be taken into account in comparing the net costs of policies issued by participating and nonparticipating companies, see pt. 28, testimony of Ernest J. Howe, February 29, 1940.

[19] Pt. 10A, R. 290, 296. Interest earned on the reserves in excess of the mortality and administration expenses, and returned at the end of the endowment period along with the contributions to the reserve, accounts for the minus figures in the table.

Standard participating policies sold in the amount of $1,000 or more

Company	20-payment life		20-year endowment	
	20-year net cost-policy continued	Net cost-policy surrendered end of twentieth year	20 annual premiums less dividends	Net cost-policy matured end of twentieth year
Aetna	$609.92	−$0.08	$864.12	−$135.88
Connecticut General	606.18	−3.82	850.77	−149.23
Connecticut Mutual	588.86	−21.06	829.76	−170.24
Equitable New York	598.48	[1] −10.52	849.18	[1] −150.82
Equitable Iowa	591.65	−18.35	847.41	−152.59
Guardian Life	624.52	14.60	884.34	−115.66
John Hancock	590.42	−19.58	829.23	−170.77
Massachusetts Mutual	587.89	−22.03	828.99	−171.01
Metropolitan	557.63	[2] −88.97	793.10	[3] −256.90
Mutual Benefit	591.58	−18.34	833.13	−166.87
Mutual New York	653.18	43.26	913.36	−86.64
National Life	575.46	−33.54	828.87	−171.13
New England Mutual	587.84	−22.08	827.32	−72.68
New York Life	565.75	[4] −43.25	821.92	[5] −178.08
Northwestern	565.31	−44.61	811.04	−188.96
Pacific Mutual	585.69	−24.31	835.84	−164.16
Penn Mutual	582.54	[1] −27.38	830.78	[1] −169.22
Phoenix Mutual	579.63	−7.37	836.97	−163.03
Provident Mutual	568.82	−40.18	818.14	−181.86
Prudential	555.84	−18.16	798.83	−201.17
State Mutual	590.11	−19.81	825.98	−174.02
Union Central	609.74	.74	854.28	−145.72

[1] Includes "extra" dividend payable at end of fifth policy year.

[2] Includes "cash settlement" dividend of $36.60, payable in addition to guaranteed cash value of policy, in event policy is surrendered at end of twentieth policy year.

[3] Includes "maturity" dividend of $50, payable in addition to guaranteed maturity value of policy.

[4] Includes "extra" dividends payable at end of tenth, fifteenth, and twentieth policy years as follows: Tenth year, $5; fifteenth year, $8.75; twentieth year, $17.50.

[5] Includes "extra" dividends payable at end of tenth and fifteenth policy years as follows: Tenth year, $5; fifteenth year, $5.

Standard nonparticipating policies sold in the amount of $1,000 or more

Company	20-payment life		20-year endowment	
	20-year net cost-policy continued	Net cost-policy surrendered end of twentieth year	20 annual premiums less dividends	Net cost-policy matured end of twentieth year
Aetna	$611.80	$45.80	$883.60	−$116.40
Connecticut General	611.80	45.80	883.60	−116.40
Equitable Iowa	600.00	34.00	878.60	−121.40
Lincoln National	626.80	59.80	886.40	−113.60
Pacific Mutual	611.80	45.80	883.60	−116.40
Travelers	611.80	45.65	883.60	−116.40
Western and Southern	590.40	24.40	872.40	−127.60

It will be observed from the first table, above, that in every case the annual premium is higher on the participating than on the nonparticipating insurance. This is the result of a custom existing among most mutual companies in the industry to add an extra large loading to the net rate.

Why this should be done year in and year out without change does not appear. The rate adopted by the nonparticipating companies is presumably not only adequate, but profitable, for the nonparticipating companies are obliged, if possible, to make a profit for their stockholders.[20] There is no compelling reason why the initial premium charged by the mutual companies should be so much higher. Some difference for contingencies may be desirable but the margins appear all out of proportion particularly in the case of the high gross premium mutual companies.

While no necessity for the practice appears, however, some effects of it can be observed. In the first place, by making ample funds available for administrative expenses, it enables the mutual companies to pay generous salaries and high commissions. At the same time it enables the companies to pay larger dividends, creating the illusion of very profitable operations, and giving to the policyholder the impression that he is receiving a windfall.

This custom of charging higher-than-necessary initial premiums not only deprives the policyholder of the interim use of his money and repays him only approximately in proportion to his contribution, but it is a direct item of expense. As one witness expressed it:[21]

> * * * you can never return to the policyholder in its entirety the additional amount you have collected because the agent gets his commission, the Government steps in and gets taxes; it costs a good deal of money to adjust these, to arrange these dividends and distribute them again. Then how can you pay back to the policyholder the overcharge?

Another effect of the extra premium charge becomes apparent in the light of the studied efforts of many companies to avoid cost competition. If the initial premium rates of mutual companies

[20] Mutual companies sometimes advance the argument that the extra premium is needed to take the place of the capital stock of the stock company. It should be observed, however, that in any established company this capital stock is an almost negligible percentage of the insurance in force. Furthermore, the mutual companies customarily keep a surplus which is as large, or larger, proportionately, than the capital and surplus of most stock companies. The following figures show the surplus, or capital and surplus, per billion dollars of insurance in force, as of December 31, 1938, in three mutual companies and in three stock companies:

Mutual companies, surplus per billion insurance in force

Metropolitan	$12,930,000
New York Life	18,330,000
Equitable of New York	11,680,000

Stock companies, capital and surplus per billion insurance in force

Travelers	$11,490,000
Aetna	8,880,000
Connecticut General	[a] 8,740,000

During the 10 years 1929–38 these three stock companies paid dividends to stockholders as follows:

Travelers, with a capital stock of $20,000,000	$35,200,000
Aetna, with a capital stock of $15,000,000	13,125,000
Connecticut General, with a capital stock of $3,000,000	[b] 2,750,000

[a] Best's Life Insurance Reports, 1939.

[b] Pt. 10 A, R. 15.

[21] Testimony of Mr. William Montgomery, president, Acacia Mutual Life Insurance Co. (pt. 10, R. 4343)

approximated those of the non participating companies, the latter would be forced to lower their rates as far as possible, and a true cost competition, based on efficiency of management, would necessarily result. This the companies seem particularly anxious to avoid.[22]

As a result of the efforts of the companies, competition on a cost basis is greatly minimized in the field of life insurance, and the policyholders' difficulty in determining net cost and comparative costs is correspondingly increased.

To the extent that a prospective policyholder cannot determine costs, or even make intelligent estimates of cost, he cannot purchase his insurance on the basis of cost, with the result that the prices of the commodity cannot react to competitive factors.

The insurance regulatory bodies in the United States are concerned only with minimum, or safety, rates. They do not attempt to control maximum rates. The actual effective rates are left to the discretion of company managements, and are sometimes actually arrived at by concerted action designed to eliminate competition.[23]

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[22] See p. 235, supra.

[23] See p. 141, supra.

SECTION XVII

Industrial Insurance

Industrial insurance [1] is a type of life insurance sold in small amounts primarily to persons of little means. Premiums for this type of insurance are paid in weekly or monthly installments and are regularly collected by agents who call at the homes of the policyholders. There are about 90,000,000 industrial policies in force in this country, held by about 50,000,000 [2] people or several times as many as hold all other forms of life insurance policies combined. In 1937 these 50,000,000 people made premium payments amounting to approximately three-quarters of a billion dollars on the $20,591,000,000 of industrial insurance in force.[3]

The amount of industrial insurance which can be purchased by the weekly or monthly contributions of the average wage earner is necessarily very small. An industrial policy taken out during 1938 in the Metropolitan at age 20, for example, would insure the policyholder in the amount of $113 if until his death or for the next 54 years he regularly pays a nickel a week to the agent who calls at his door. If his insurance was not taken out until age 35, a similar weekly contribution will purchase but $69 of insurance. If he purchased an

[1] There is no generally accepted definition of industrial insurance. The definition contained in the recently enacted recodification of the New York insurance law, sec. 201 (1), is a good example of a statutory definition:

"1. The term 'industrial life insurance,' as used in this chapter, shall mean that form of life insurance, either—

"(a) Under which the premiums are payable weekly, or

"(b) under which the premiums are payable monthly or oftener, but less often than weekly, if the face amount of insurance provided in any such policy is less than one thousand dollars and if the words 'industrial policy' are printed upon the policy as a part of the descriptive matter."

The District of Columbia Code once referred to industrial insurance as "the business commonly known as Industrial Insurance" (31 Stat. 1293, ch. 854, sec. 655).

Monthly debit ordinary insurance, which is a type of ordinary insurance sold in small amounts for monthly premiums collected at the homes of the insured, should really be classed with industrial, for the only real difference lies in a few policy terms, of which the average policyholder is unaware. However, this report deals only with the type of insurance classed as industrial in public records.

[2] The exact number of persons holding industrial policies cannot be ascertained, since many people hold several policies, frequently in more than one company (pt. 12, R. 5955). However, the best available estimate is that there are about 50,000,000 industrial policyholders in the United States. See Maurice Taylor's, The Social Cost of Industrial Insurance, 1933, p. 54. The Metropolitan actuaries estimate that there are about 22,500,000 holders of Metropolitan industrial policies. Since there are about 34,000,000 policies in force, each policyholder has an average of 1.5 policies (pt. 4, R. 1238, exhibit No. 950). If this figure is applied to the total number of policies in force, a figure of 59,000,000 policyholders is obtained. However, since many persons have policies in several companies, this is undoubtedly an overestimate. The 50,000,000 appears to be as close an approximation as can be made.

[3] Pt. 12, R. 5597, 5598, exhibit Nos. 945, 948, 949. The importance of industrial insurance can be measured in the following terms: As of December 31, 1937, it accounted for 19 percent of the life insurance in force, 23.4 percent of the amount paid in premiums to life insurance companies, and 72 percent of the number of policies in force (pt. 12, R. 5597).

Most of the data relied upon in the hearings and in this section of the report are from the Spectator Life Year Books and the figures given, unless otherwise indicated, are as of December 31, 1937. Detailed statistics on all companies writing industrial insurance are not available, since only 66 of the 138 companies writing this type of insurance were reported in detail in the Spectator Life Year Book as of that date. Id.

industrial 20-year endowment policy from the same company his nickel a week would purchase a $43 endowment if payments commence at age 20 and a $40 endowment if payments commence at age 35.[4] The average size of an industrial policy is only $232.

Traditionally, industrial insurance has been considered as burial insurance. Mr. John F. Dryden, former president of the Prudential, the first company to write industrial insurance on a large scale [5] in this country stated in 1905:[6]

> Industrial insurance provides primarily for the expenses of burial; therefore, since death is likely to happen to any member of the family and as the burden of funeral expenses would fall with nearly equal weight upon all the survivors, a small policy of insurance on the life of every member is evidently, for this object, a better provision than a large sum placed upon a single life.

That this primary purpose has not been abandoned in the case of the Prudential, now the second largest carrier of industrial insurance, was made apparent by the testimony of Mr. Henry B. Sutphen, vice president of that company, who testified in the present hearings that the purpose of industrial insurance is—[7]

> * * * to provide for the average workingman a fund payable upon death which will take care of the necessary funeral expenses and the incidental expenses in connection with the death, and a reasonable amount for the readjustment of the family, temporarily only.

Mr. Leroy A. Lincoln, president of the Metropolitan, the largest company, stated, on the other hand, that though he had no knowledge of the uses to which industrial-policy proceeds were put by those who were insured in his company, he did not consider industrial insurance burial insurance but rather, because it was available on the endowment plan and because it offered cash-surrender values and nursing service [8] as part of its benefits, chose to classify it along with all other forms of insurance as being but one phase of a single thing—life insurance.[9] Though it is true, as Mr. Lincoln's testimony indicates that industrial-policy benefits have been liberalized over the course of years, it is only the development of industrial endowment policies which have in any way changed the traditional character of this form of insurance. The writing of endowment insurance, which has been confined to a large extent to children, has been very expensive from the point of view of the policyholder and recently subject to great criticism and even legislative restraints.[10] Furthermore, as has been indicated above, the average amount of the industrial policy remains small and

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[4] 1938 rate book, Metropolitan, industrial department, table of rates for weekly premium and monthly premium industrial policies (male). This is, of course, an oversimplification. For a more complete discussion of cost, see pp. 283 to 289, infra.

[5] The first legal reserve life insurance on the industrial plan issued in the United States appears to have been written around 1870 by the Mutual Life Insurance Co. of Baltimore, Md., now the Monumental Life Insurance Co. (pt. 12, R. 5598; pt. 13, R. 6363).

[6] Address and Papers on Life Insurance and Other Subjects by John F. Dryden (1909), pp. 52–53. A similar statement appears in Industrial Insurance—Past and Present, by John F. Dryden (1912), p. 21. Mr. Dryden believed that industrial insurance helped to eliminate pauper burials (Armstrong report, vol. VI, pp. 4946–4947).

[7] Pt. 12, R. 5734. See also testimony of C. F. Williams, president, Western & Southern Life Insurance Co. (pt. 12, R. 5937).

[8] See p. 288, infra.

[9] Pt. 12, R. 5837–5843.

[10] See p. 302, infra.

it seems highly unrealistic to suppose that policy proceeds are sufficient to do more than cover burial and expenses incident to death. It is partly for this very reason that a large proportion of industrial insurance is written on the lives of women and children as well as on the lives of the breadwinners.

A. SIZE AND GROWTH OF INDUSTRIAL COMPANIES

From its inception in this country in 1870,[11] industrial insurance has had a remarkable and spectacular growth. On December 31, 1900, there were approximately 11,200,000 industrial policies in force in the United States, representing a face amount of $1,469,000,000.[12] It was about this time that Mr. John F. Dryden prophesied: [13]

> The progress which has been made [in industrial insurance] during a quarter of a century, wonderful as it is, will sink into insignificance in comparison with the progress which will be made during the next 25 years.

In terms of growth Mr. Dryden was not wrong. At the end of 1927, 25 years after his prediction, there were 82,246,402 policies in force, representing a face amount of $15,548,488,326.[14]

Ten years later, on December 31, 1937, with about 138 companies writing industrial insurance, there were over 88,900,000 policies in force, representing about $20,591,000,000[15] of insurance. From 1900 to 1937 the number of policies in force increased almost 700 percent, while the total population of the United States increased only 70 percent,[16] with the result that in 1937 it could be said that the amount paid in industrial premiums represented an annual average of $5.99 for every man, woman, and child in the United States.[17] During this same period, the amount of industrial insurance in force increased 1,402 percent. So great was the growth that by the end of 1937 the number of policies in certain States actually exceeded the total population. This was true in Connecticut, Delaware, District of Columbia, Massachusetts, New Jersey, New York, Rhode Island, and Mary-

[11] Following the introduction of industrial insurance in 1870 by the Mutual Life Insurance Co. of Baltimore, an organization known as the Widows and Orphans Friendly Society, under the guidance of Mr. John F. Dryden, began in 1875 to issue industrial insruance. This company later became the Prudential Insurance Co. of America. Mr. Dryden studied the methods used by the Prudential of London, and copied them in organizing the business here. In 1879 the Metropolitan and John Hancock also entered the industrial insurance field (pt. 12, R. 5598, 5599; pt. 13, R. 6363). Burial insurance in the form of legal reserve life insurance was originated in England in 1843. Among the Greeks and Romans, mutual organizations existed to provide for burial funds, and in China there have been burial tongs for many centuries (pt. 12, R. 5598).

[12] Pt. 12, exhibit No. 945.

[13] Address and Papers on Life Insurance and Other Subjects, by John F. Dryden (1909), pp. 60–61.

[14] Spectator Life Insurance Yearbook, 1928.

[15] Pt. 12, R. 5597, exhibit No. 949.

[16] Pt. 12, R. 5599, exhibit No. 945. Industrial insurance is sold principally in urban communities, so it is perhaps more appropriate to compare its growth with the 239 percent growth of urban population during this period (pt. 12, R. 5599, 5601).

[17] Pt. 12. R. 5606, exhibit No. 948. In 8 States premium income collected per person in 1937 amounted to an average $10 or more, ranging as high as over $13 in the case of 1 State, Rhode Island (pt. 12, exhibit No. 948). An analysis of industrial premium income collected during 1937 disclosed that 58.1 percent was collected from 6 States which can be listed in the order of their importance as follows: New York, Pennsylvania, New Jersey, Illinois, Ohio, and Massachusetts; 24 States and the District of Columbia accounted for 92.8 percent of the total industrial premiums collected during that year. Id.

land. In Maryland there were about one and one-half policies in force for each person resident in the State.[18]

In spite of this rapid growth the bulk of the industrial insurance business has remained concentrated in three companies. These companies, Prudential, Metropolitan, and John Hancock, together carry approximately 80 percent of the industrial insurance in force, or 36.78, 36.48, and 8.18 percent, respectively.[19] The 135 smaller companies writing industrial insurance are not to be considered insignificant, however, as they have millions of policyholders and collect millions of dollars of premiums every year. In fact, the companies other than the three largest wrote over 8,000,000 new policies during 1938, an amount representing about 55 percent of the total issued that year.[20] The following table shows the relative positions of

[18] Pt. 12, exhibits Nos. 945, 948. The relation of industrial insurance policies in force to total population in these States was as follows (pt. 12, exhibit No. 948):

States	Industrial insurance policies in force, 1937	Population, 1937	Industrial premium income collected per person
Connecticut	1,801,941	1,741,000	$11.86
Delaware	300,100	261,000	11.52
District of Columbia	772,700	627,000	10.47
Maryland	2,336,200	1,679,000	11.15
Massachusetts	4,731,032	4,426,000	11.32
New Jersey	5,429,457	4,343,000	12.75
New York	13,583,107	12,959,000	11.66
Rhode Island	841,500	681,000	13.86

[19] Pt. 12, exhibit No. 946.

[20] Pt. 12, exhibit No. 1092. In his Eighty-first Annual Report to the Legislature of the State of New York (1939) the superintendent of insurance reported that since 1933 the rate of growth of the Metropolitan and Prudential had declined while the rate of growth of smaller companies admitted to do business in the State had increased slightly. In this connection, his report stated (Life Insurance, extract from the Eighty-first Annual Report of the Superintendent of Insurance to the Legislature of the State of New York, Louis H. Pink, superintendent of insurance, p. 8 et seq.):

"While industrial insurance has been of great service to the lower-income groups in this country and has been a social factor in promoting thrift and bringing the benefits of life insurance to those groups which could not have had it but for this type of insurance, it has probably reached its peak. The indications are that while there is still necessity for industrial insurance it is becoming less essential than it was. The social-security program of the Federal and State Governments may displace it to some extent. New institutions such as savings-bank life insurance and, more particularly, group insurance, will undoubtedly offer competition. In view of the added costs of industrial insurance because of the expense of selling it and collecting on a weekly basis, this department is making every effort to encourage the purchase of monthly instead of weekly insurance and ordinary instead of industrial insurance. Then, too, there has been some improvement in the financial condition of the lower-income groups which makes it possible for them to buy other types of insurance. All of these things indicate a gradual slowing down in the sale of industrial insurance which will mitigate the rapid growth of our two large companies."

the companies having the largest amounts of industrial insurance in force at the beginning of 1938: [21]

	Stock or mutual	Industrial insurance in force (millions)	Percentage of total	Cumulative percentage of total
1. Prudential Insurance Co. of America	Mutual	$7,574	36.78	36.78
2. Metropolitan Life Insurance Co	do	7,512	36.48	73.26
3. John Hancock Mutual Life Insurance Co	do	1,684	8.18	81.44
4. Western & Southern Life Insurance Co	Stock	577	2.80	84.24
5. American Nation Insurance Co	do	461	2.24	86.48
6. National Life & Accident, Tennessee	do	393	1.91	88.39
7. Life Insurance Co. of Virginia	do	302	1.47	89.86
8. Monumental Life Insurance Co	do	200	.97	90.83
9. Life & Casualty Insurance Co	do	164	.80	91.63
10. Industrial Life & Health Insurance Co	do	85	.41	92.04
Total of above 10 companies		18,952	92.04	92.04
Total of 56 other companies for which information was available in published sources		1,639	7.96	100.00
Grand total of 66 companies		20,591	100.00	100.00

Unlike the three largest companies, most of the smaller companies selling industrial insurance are stock companies. No general discussion of the history and growth of industrial insurance would be complete without reference to the enormous profits which these companies have realized from the sale of this form of insurance.[22] An analysis of 44 such companies demonstrated that in the aggregate these companies, with a paid-in capital of $4,146,925, have paid to stockholders cash dividends in the amount of $66,238,943, stock dividends in the amount of $32,337,950, and, as of December 31, 1938, had accumulated aggregate surplus of $44,201,982.[23] The great profits that can be realized from industrial insurance business are demonstrated in the following table which shows the cash and stock dividends, surplus and original paid-in capital for 8 well-known stock companies.[24]

Company	Date organized as stock company	Original paid-in capital	Cash dividends	Stock dividends	Surplus
American National Life	1905	$100,000	$3,795,000	$1,750,000	$9,776,550
Home Beneficial	1899	5,000	4,111,000	170,000	1,830,156
Life Insurance Co. of Virginia	1871	100,000	14,177,423	5,200,000	5,307,844
Monumental	1928	550,000	1,830,000	1,500,000	2,576,172
National Life & Accident	1900	15,500	6,693,349	3,934,500	4,060,613
Sun Life Insurance Co	1897	15,000	2,103,900	1,483,000	1,036,954
Washington National	1911	300,000	2,994,790	975,000	1,477,020
Western & Southern	1888	100,000	[1] 19,102,500	14,900,000	8,807,683

[1] In addition, income taxes of officers, directors, stockholders, and employees were paid by the company amounting to more than $5,800,000 (pt. 12, exhibit No. 1015).

The extraordinary profits indicated above are particularly striking when it is recognized that no single stock company listed accounts for

[21] Pt. 12, exhibit No. 946.

[22] In describing industrial insurance, the Armstrong report of 1906 stated that, "* * * from margins small in individual cases, but large in the aggregate, enormous profits have been realized upon an insignificant investment" (Armstrong report, vol. X, p. 318).

[23] Pt. 12, R. 5614, exhibit No. 951. In considering the large profits paid by these 44 stock companies to their shareholders, it must be recognized that in most instances the shares are closely held by individuals prominent in the management of the company who receive substantial salaries in addition to the dividends on their stock. For information showing the 5 largest owners of stock of each of these 5 companies and the salaries paid to leading executives see pt. 12, exhibit No. 952.

[24] Pt. 12, exhibit No. 951.

more than 3 percent of all the industrial insurance in force in theUnited States. In general these profits result from gains from mortality, interest and lapse and surrender.[25]

B. DUTIES AND COMPENSATION OF AGENTS

Since industrial premiums are generally collected at the homes-of the policyholders, the industrial companies require an especially complicated agency system. The phenomena growth of this form of insurance demonstrates the effectiveness of the agency system in reaching the particular insurance market for which it was adapted. It is estimated that there are about 100,000 agents selling industrial insurance in the United States, of whom about 40,000 are employed by the Metropolitan and Prudential alone.[26] Each agent is assigned a debit; that is to say, he is given a specific territory from which he must collect premiums from policyholders insured in his company and within which he is expected to confine his selling activities. The debit can be technically defined as the life insurance measured by the premiums of the company's policyholders within a given area.[27] The territory covered by the debit of one company may, of course, and frequently does, overlap or coincide with the debits of other companies, and indeed it is not unusual to find that a single family may hold industrial policies of two or three different companies.[28] In the case of the largest industrial companies, the agent's debit, that is to say, the amount which he is required to collect, ranges in amount from about $200 to $400, while in the smaller companies and sometimes even in the larger companies if new territory is being opened up, the debits are smaller, frequently being less than $100.[29] In the four largest industrial companies, agents have an average of over 1,000 policies in their debit. The Metropolitan agent has an average of 1,335 policies while agents of other representative industrial companies range on the average from 500 to 1,000 policies per debit.[30]

[25] For a discussion of profit from lapse and surrender, see pp. 188 and 189, infra.

[26] Pt. 12, R. 5735, 5848, exhibit No. 990.

[27] Pt. 12, R. 5737.

[28] Pt. 12, R. 5743. A survey of 1,427 insured families revealed that 31 families paid premiums to agents representing three different industrial companies, and 303 families or 21.3 percent paid premiums to agents representing two or more different companies. See report of the staff of the Securities and Exchange Commission entitled "Families and Their Life Insurance" printed as Monograph No. 2 of the Temporary National Economic Committee at p. 53. This report is hereafter cited as Families and Their Life Insurance.

[29] Pt. 12, R. 5737, 5941, 6002, 6029, 6121, 6155, 6159.

[30] See following table:

Number of agents in eight representative companies, compared with the number of policies in force

Company	Number of agents	Number of industrial policies in force Dec. 31, 1938, excluding paid-up policies	Average number of policies per agent
Metropolitan Life Insurance Co	20,459	27,313,635	1,335
Prudential Insurance Co. of America	1[illegible],299	22,223,223	1,152
John Hancock Mutual Life Insurance Co	[illegible],960	6,198,396	1,040
Western & Southern Life Insurance Co	1,354	1,915,679	1,033
Monumental Life Insurance Co	865	699,565	809
Home Beneficial Association	834	586,510	703
Baltimore Life Insurance Co	619	312,731	505
Home Friendly Insurance Co	257	165,420	644

Pt. 12, R. 5720, 5735, 5941, 6043, 6094, 6112, 6121; exhibit No. 990; 1938 Convention Form Annual Statements.

The duties of the industrial agents are both exacting and varied and, to be successfully performed, require constant application to the job and a substantial knowledge of life-insurance technicalities. The agents are supervised by a district manager or superintendent who is answerable to the home office and is aided by approximately six assistant managers, each of whom in turn has charge of six or more agents.[31] Agents generally make the rounds to the homes of their policyholders on Monday in order to collect the premiums which, on weekly industrial policies, are customarily due on that day. On the following days repeat calls are made at homes where the premiums have not been paid, while the latter days of the week and usually some evenings during the week are spent primarily in canvassing the debit for new insurance.[32] Several days a week the agents report in to the branch office to turn in collections, and this occasion is frequently used for pep meetings and speeches designed to stir the agents into greater activity. The last workday of the week is devoted principally to the preparation of weekly reports and accounts.[33]

It must be pointed out again that the industrial agent frequently works among poorly educated industrial laborers.[34] To most of these policyholders the agent is the only point of contact with the company. He searches out the prospect in the first place and induces him to buy insurance.[35] He makes out the application for the insurance. In general practice the choice of policy is left to him. It is often his influence which determines which members of the family are to be insured and for how much.[36] If any programming of insurance is done the agent is expected to do it.[37] Dividend credits, cash-surrender values, and death benefits are all handled through him.[38] Not infrequently the agent changes companies, and the policyholders from whom he collects premiums change also or merely lapse their policies.[39] While on the debit the agent cannot be supervised, and in spite of the fact that some companies have developed special inspection services, it is recognized that the agent has great latitude both as to the manner in which he utilizes his time and the methods he may adopt in persuading people to buy his product.[40]

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[31] Pt. 12, R. 5757, 6026, 6050, 6051, 6063, 6081, 6090, 6107. Companies often maintain a system of inspecting the activities of agents in the field as a check on their work (pt. 12, R. 5746, 5865, 6083).

[32] Pt. 12, R. 5749, 5750, 5751, 6005, 6063, 6151, 6152. The industrial agents' selling activity is usually confined to his debit. In this connection, Mr. Sutphen testified (pt. 12, R. 5737):

"Mr. Gesell. Is there more or less an unwritten code among the agents that one fellow won't go over and raid another man's debit for new business? I mean, as a practical matter, does it work out that each agent has his own territory?

"Mr. Sutphen. You are speaking about industrial, because in the writing of ordinary quite a different situation obtains. The latitude and practice in connection with ordinary is entirely different.

"Mr. Gesell. We are talking about industrial:

"Mr. Sutphen. Yes; I think that that is fairly well established. It is no rule of the company.

"Mr. Gesell. But as a practical matter that is the way it works out, isn't it? The man has both the job of collecting in that area and usually is by far the principal selling agent of industrial insurance for the company in that area.

"Mr. Sutphen. That is correct."

[33] Pt. 12, R. 5749–5751.

[34] Pt. 12, R. 6001, 6018, 6049, 6058, 6068, 6069, 6153.

[35] Pt. 12, R. 5750, 5751. For form of application used by Prudential, see pt. 12, exhibit No. 974.

[36] Pt. 12, R. 5745, 5746, 5752, 5753, 6072, 6073.

[37] Pt. 12, R. 5745, 5746, 5753, 6072, 6128.

[38] Pt. 12, R., 5751.

[39] Pt. 12, R. 5722, 5739, 6149.

[40] Pt. 12, R. 5765.

Generally speaking, agents have been paid by commission based upon production or increase of business, by a system known as "times increase," and by a collection commission for collecting premiums on their debits, while managers and assistant managers have received a basic salary, plus a commission based on the amount of business written by the agents under their immediate supervision.[41] This method of compensating field representatives is designed to encourage the production of new business. By writing a contract of employment with their agents and managers which emphasizes the obtaining of new policies, industrial companies have placed their selling force under a strong economic compulsion to sell more insurance and have created a condition which influences the entire activities of their field organization.

During the first 60 years after the inception of the industrial insurance business the method of compensating agents in general use was the payment of a "collection commission" ranging from 10 to over 20 percent of the premiums collected, plus a "special salary" calculated on a "times increase" basis.[42] "Times increase" means that the agent receives a special salary after he has written enough business during the week to give him an increase in the premiums on his debit for that week. The increase must be a "net increase"; that is, the premiums on lapsing policies are deducted from the premiums on new policies written.[43] If he is "on increase" he receives

[41] Manager and assistant managers are also frequently paid on the times-increase basis.

[42] The Prudential of London originally devised the collection commission and times-increase method of compensation. It now pays agents' compensation on a straight salary basis. In American companies, however, it is a general belief that the use of a straight salary, no part of which is dependent upon production of new business, would be unsatisfactory. Mr. Lincoln testified that if the agents were on a straight salary basis (pt. 12. R. 5882):

"We wouldn't have any company in a short time * * *. Because if you put your agents on a salary basis the human equation with respect to building the company is going to vanish and you simply have a company that becomes moribund right away.

"Mr. GESELL. You mean that without a system of compensation which requires the ability of a man to keep good business and produce new business, your company would deteriorate.

"Mr. LINCOLN. It is true in any selling organization, whether it is vacuum cleaners or automobiles or life insurance."

The testimony of Henry B. Sutphen, vice president of the Prudential, in charge of industrial agents, provides an interesting analysis of the reasons behind the compensation system of that company, still based in part on the writing of new business (pt. 12, R. 5765):

"Mr. GESELL. Has your company given any thought to the desirability of paying agents a salary?

"Mr. SUTPHEN. We have thought about it many times.

"Mr. GESELL. What have been the reasons for discarding that as an approach to the problem?

"Mr. SUTPHEN. The difficulty of arriving at a figure that would be fair to the men. We have men today that because of their ability and because of their experience in the business are making considerably more than the average, and you have other men with less ability and less experience and less inclined to apply themselves who probably on an average would be paid too much for the service that they are rendering to the policyholder.

"Mr. GESELL. I should think it would be possible to take many of those factors into account the same way any other salaried office does by recognizing ability and paying for it.

"Mr. SUTPHEN. It is a difficult thing to evaluate services of a large body of men. You would undoubtedly continually have men asking for the highest rate that is being paid, and it is a very difficult matter to satisfy them that they are not entitled to it. Keep in mind that our men work very largely on their own. It is not like the clerks that you refer to that are given a certain number of columns to run and they sit right before your eyes all day and you see exactly whether they do their work and how they do it. The agent is out on his own on a commission basis very largely, and he can utilize his time or not utilize the time as he happens to feel about it, and we have always felt that there should be an incentive feature in the payment of men under those conditions."

[43] For instance, suppose an agent is assigned a debit which calls for the collection of $100 in premiums every week. The agent then writes 5 new policies during the following week, each policy calling for a premium of 10 cents per week, making an aggregate gross increase of 50 cents. If during the same week three 10-cent policies on the debit lapse, the agent would have a net increase of 50 cents less 30 or 20 cents. The special salary would then be calculated by multiplying 20 cents by the appropriate number of times according to the agent's contract.

a certain number of times the net increase of premiums. This number varies from about 15 to 45 times.[44] Under the "times increase" system of compensation the amount of the premium is the only operative factor; the amount of insurance and the plan of insurance are of no significance. Therefore, it is to the agent's advantage to have the policyholder buy the policy which calls for the largest weekly premium.[45]

The collection commission is paid for the work of administering a debit, including the advice to policyholders in various matters and the collection of premiums.[46] It has always been the general belief that industrial policyholders will not maintain their insurance in force unless agents call at their homes to collect premiums. However, many policyholders do pay their premiums on their own initiative at offices of the companies, and several companies allow a reduction in premiums in consideration of such payments. The Metropolitan, Prudential, and John Hancock policies now offer a rebate of 10 percent of the premiums if they are paid at a company office continuously for 1 full year. In the Metropolitan, which began to grant this allowance as early as 1911, about 28 percent of the premiums are now paid at company offices.[47]

All but one of the smaller companies whose representatives testified before the committee were still paying industrial agents on the "times increase" system.[48] A variation of the "times increase" system of compensation was introduced by the three largest companies in 1934.

[44] In many companies the number of times increase varies according to the length of service of the agent, and sometimes according to the character of the business, such as white or Negro (pt. 12, R. 6040).

[45] Pt. 12, R. 6069. One agent testified as follows (*Id.*):

"The determining factor in most instances is the agent, and the determining factor in the agent's status is the salary, so, because we can get more writing an endowment, we can usually sell an endowment." (See also pt. 12, R. 5953, 5960.

[46] The collection commission paid by the Metropolitan and the Prudential at the time of the Armstrong investigation was 15 percent of the debit, and has continued to be 12 to 15 percent ever since. The following table shows the amounts of collection commissions and the number of times increase now being paid by a group of representative companies (pt. 12, R. 5943, 6040, 6055, 6090, 6107, 6145, 6150, 6159, (exhibit No. 1067):

Company	Collection commission	Number of times increase
American National Insurance Co. ... percent	15	25–40
Baltimore Life Insurance Co.	[a] $20	25–35
Equitable Life Insurance Co. (District of Columbia) ... percent	[b] 10–50	15–30
Home Beneficial Association ... do	15–20	15–30
Peoples Life Insurance Co. (District of Columbia) ... do	20	25
Virginia Life & Casualty Insurance Co.	[c] $22	20
Western & Southern Insurance Co. ... percent	[b] 12–30	20–25

[a] The average debit in this company was $99.37 (pt. 12, exhibit No. 1082).

[b] The larger percentages are paid only on smaller debits (pt. 12, exhibit No. 1067; R. 5943).

[c] The average debit in this company is $91 (pt. 12, R. 6090).

[47] Pt. 12, R. 5853. For several years the Prudential credited a policyholder with 52 weeks' premiums if 47 weeks' premiums were paid in advance, and several smaller companies now follow this practice (pt. 12, R. 5720, 5751, 6121, 6122). In some of them, however, the policies do not contain a notice that such a privilege is available. There may be a tendency on the part of the agent to overlook advising policyholders that a premium discount arrangement is available, since the agent receives from 12 to 15 percent of all premiums which he personally collects. *Supra*, note 47.

[48] Pt. 12, exhibit No. 1091.

This was the calculation of the "special salary" on the basis of the increase for a 13-week period, in an effort to provide a more uniform weekly compensation.[49] This change in the "times increase" system, however, made it profitable for an agent to pay the renewal premiums for some policyholders who would otherwise have allowed their policies to lapse and to pay the first premiums on a few new policies himself in order to put his production at a higher level and enable him to obtain a higher salary for a whole 13-week period.[50]

In 1938 a new contract,[51] designed to eliminate all incentive for the agent to pay premiums himself, was introduced by the Metropolitan, Prudential, and John Hancock. It provides for three types of remuneration: Collection commission, new-business commission, and conservation commission. The collection commission amounts to from 12 to 15 percent of the weekly premiums and 4½ percent of the monthly premiums collected.[52] The new business commission maintains the interest of the agents in the production of new business. It provides for the payment of a commission on the amount of premiums actually collected in the first year after the issuance of a new policy.[53] The conservation commission ranges up to $6 per week and is computed according to a complicated formula based on the relationship between the lapse record of the individual agent and the lapse record of the company as a whole.[54] The contracts containing these provisions have been drafted with great care, but the system is so complex and the terminology so abstruse that few of the agents are likely to be able to understand much more than the general principles involved.[55]

In spite of these various changes and modifications in the compensation system, the fundamental principle, namely, a compensation system which maintains production of new business as the basic incentive for the agent, remains unchanged. In this regard, Mr. Frederick H. Ecker, chairman of the board of the Metropolitan testified:[56] "* * * that is inherent in the insurance business. Insurance agents are paid on the basis of their production—a commission on the premiums on the new business." Another witness, Mr. Henry B. Sutphen, vice president of the Prudential, testified that

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[49] Pt. 12, R. 5760, 5761, exhibits Nos. 976, 994, and 1085.

[50] For instance, suppose he paid premiums for policyholders amounting to $5. This might keep his net increase at such a figure that he would receive $1 every week during the next 13 weeks' period. He would, therefore, be $8 ahead.

[51] Pt. 12, R. 5858. For agent's agreements with these companies, see pt. 12, exhibits Nos. 976, 994, and 1085.

[52] In the debit of these 3 companies the average weekly collection is $217 for the Metropolitan, $257 for the Prudential, and $220 on the John Hancock (pt. 12, R. 5743, 5853, 6121). The Metropolitan average monthly premium debit is about $360.

[53] The Prudential and the John Hancock pay 35 percent of the premiums paid on the whole-life and limited-payment-life policies and 25 percent of the premiums on endowment policies. The Metropolitan pays 37 percent on whole-life policies and 28 percent on endowment policies.

[54] The Prudential permits an agent to compare his lapse record with his own district if it would be more favorable to him. The John Hancock conservation commission ranges from $2 to $6; the Metropolitan and Prudential pay no conservation commission in case the agent's ratio is below a certain percentage (pt. 12, exhibits Nos. 976, 994, and 1085.

[55] Pt. 12, exhibit No. 997. Industrial agents are frequently better paid than agents selling only ordinary insurance, particularly in the larger companies. In the case of the Metropolitan and Prudential, the average earnings of industrial agents exceed $50 a week.

The average Metropolitan agent receives $52 a week, while the average Prudential agent receives $50.07 a week (Pt. 12, R. 5852, exhibits Nos. 975, 990). For other information concerning industrial agents' compensation, see Pt. 12, R. 6002, 6030, 6042, 6075, 6085, 6107, 6108, 6117; exhibit No. 1053. The average weekly compensation for superintendents and managers in the Prudential and Metropolitan is $141.51 and $191, respectively (pt. 12, R. 5859, exhibit No. 975).

[56] Pt. 4, R. 1252.

both from the point of view of the production of new business and the conserving of business already on the books, his company felt it desirable that the agent be compensated in the manner which gave him a financial stake in the achievement of the results desired by his company. That is to say, his compensation should give due emphasis to persistency of business written as well as the production of new business. In this connection he stated:[57]

Mr. SUTPHEN. Not only get new business written but to give proper attention to the business that is already in force. It is essential, we believe, that an agent should have a financial interest, not only in the production of business but in the conservation of the business that is in force. As a matter of fact, we have an interest in writing new business, of course; that is the purpose of life insurance, the purpose of life insurance companies; that is what they were established for in the first place, to provide protection for the American public.

Mr. GESELL. And you think that there is a better chance of selling more insurance if you emphasize that through your compensation methods?

Mr. SUTPHEN. Absolutely.[58]

C. THE PRESSURE FOR NEW BUSINESS

The system of compensation, although very effective in encouraging production, is not the only device used to that end. Other devices take the form of sales contests, quotas, and prizes, all of which fall into a pattern of operation whose thrust is continuously in the direction of producing more new business. In furtherance of this design, home-office officials impress upon their local managers the necessity of obtaining greater amounts of business, and the managers, in turn, drive their agents.

Sales contests are very popular means of increasing production.[59] They may be sponsored by the home office or by the local manager and

[57] Pt. 12, R. 5765, 5766.

[58] In this connection, Mr. Sutphen testified (pt. 12, R. 5758):

"Mr. GESELL. The commissions that the agent, the assistant superintendent, and superintendent received are based to some degree upon the production of new business are they not?

"Mr. SUTPHEN. Yes.

"Mr. GESELL. Then there is a very definite motive on the part of all people actively in the field to produce new business, is there not?

"Mr. SUTPHEN. Yes."

[59] There is real danger that contests result in putting business on the books which does not persist. Agents in their enthusiasm to do well are apt to accept applications which in the ordinary course of events they would reject. Mr. Sutphen spoke of his company's attitude toward contests (pt. 12, R. 5756, 5757):

"Mr. SUTPHEN. It is criticized sometimes. We have tried to adopt a reasonable middle ground on the basis that anything that is done must be sensible and reasonable and not resort to high pressure and try to force men to write business that should not be written, or to ask them to do things that they cannot do.

"Mr. GESELL. Do you find that business produced by what we will call improper contests or too strenuous contests is of poor persistency and poor quality?

"Mr. SUTPHEN. Yes; that is the reason we have tried to cut it out.

"Mr. GESELL. And bad in the interests of the policyholders and everyone else concerned?

"Mr. SUTPHEN. Yes.

"Mr. GESELL. So I take it your company is against any extreme form of sales contest?

"Mr. SUTPHEN. That is right.

"Mr. GESELL. And your company does, not as a company, sponsor any company contests, put out any cash prizes, bonuses, or anything of that sort?

"Mr. SUTPHEN. No we do not."

The Metropolitan and the John Hancock are also opposed to unlimited sales contests on the ground that they are deleterious. Mr. Leroy A. Lincoln testified that his company was decidedly opposed to sales contests (pt. 12, R. 5872):

"Because there would be a human tendency toward an effort to produce a class of business which we wouldn't want on the books. We don't want business that will not persist. We don't want business

his assistants, or by the assistant managers alone. In fact, it is not unusual to have more than one contest going on in a given office at the same time.[60] Company-sponsored contests are usually of relatively long duration and tend to become a traditional part of the company's operations. Many companies have annual conventions for their leading producers, and there may be additional contests to honor a particular officer or anniversary, or to stir up competition between sectional divisions of the field force. Bonuses, trips, and prizes constitute the usual awards.[61]

Literature distributed in connection with typical contests reveals their general quality and tone. The assistant superintendent of agencies of the Home Beneficial Association, for example, sent the following letter to one of his managers in connection with a baseball contest which was then in progress: [62]

Batter up! The game is on—baseball season has started and for 9 weeks in July and August— weeks full of excitement, thrills, weeks on the anxious seat—who will be the winner?

It's a big league you are in—every team anxious and ambitious and none giving or asking favors, every team for itself. There are no soft spots. Minor league performance won't win.

A schedule such as this is one that tests the mettle of every team and every man on the team. The winners should have and will have the acclaim and respect of all of us. It's going to be hard work but lots of fun.

The winning team will be the team that puts all it has in each game, never letting up until the last man is out in the ninth inning of the last game—the team that hits hard for new business and fields clean with close collections.

The star players will be those who realize that there will be no pinch hitters, no relief pitchers—that the team's standing and their own standings at the end of the season depend entirely on the efforts of the individual players.

Team trophies, pen and pencil sets, and fountain pens are the rewards for the good hitters, good fielders, and the fellows who don't give up.

Hit that old apple on the nose and hit it often, and when the winners are announced let us take our hats off—to you and to your district.

Another letter written in 1936 in connection with "Life Insurance Week" read in part as follows: [63]

From now on it is your fight. You have been organized and drilled in your part. The last instructions are being given to you. What you are when Life Insurance Week is over, depends on whether you are a producer or just another man in your district.

It's zero hour. "Over the top" is being sounded and you are on your own. They are out there—let's go and get 'em.

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which is written without regard to the family requirements and the family ability to pay, and we believe that those contests may have that effect. Insofar as it is possible to discourage them, we are doing it."

However, the Prudential and the John Hancock permit "reasonable contests" sponsored by local superintendents, and the Metropolitan in recent years has conducted contests for which the prize was attendance at a "star salesman congress" or membership in a "star salesman club" (pt. 12, R. 5755, 5756, 5871, 5872, 6129, 6130, exhibit No. 995). Significantly, the production of new business is always one of the elements in determining the winners of all these contests. (For attitude of Western & Southern, see pt. 12, R. 5949. See also pt. 12, R. 6115.)

[60] Sales contests are by no means infrequent occurrences. One agent for the Equitable of Washington testified that with company contests and local contests going on continuously throughout the year, a week without a contest of some kind was rare indeed (pt. 12, R. 6064).

[61] Pt. 12, R. 6062, 6064, 6093, 6097, 6098, 6109, 6147, exhibits Nos. 1066, 1074, 1077.

[62] Pt. 12, exhibit No. 1066.

[63] Pt. 12, exhibit No. 1063.

Local office contests are carried on in the same tone, but are usually more or less informal affairs. Men may choose sides among themselves for the competition and put money in a "kitty" to give the winning side a luncheon or dinner. Frequently a prize is offered such as a pen and pencil set, a traveling bag, a suit of clothes, or, in some cases, a cash bonus to the agent or group of agents obtaining the greatest number of applications or the biggest increase for a given period.[64] Sometimes a contest may take on the aspects of a game. The Monumental Life Insurance Co., has, for example, a "horse race" contest in which cardboard horses are put on a blackboard, each bearing the name of an agent, and the horses are moved forward in accordance with the amount of increase in business made by the agent. Cash prizes are awarded to the first man to reach the goal.[65]

Another method used by some companies to encourage the production of new business is the setting of quotas or allotments which establish a minimum amount of new business which must be written by a company's agents or branch offices. In the industrial companies, allotments and quotas are usually measured in terms of increase rather than writing; that is to say, emphasis is placed upon the ultimate gain in new business to be accomplished rather than the amount written.[66] The situation is handled differently by different companies. In many instances quotas and allotments are simply a goal to "shoot at," and no strict disciplinary action is taken in the event they are not attained.[67] This is understandable, since the quotas and allotments may represent the generous hopes of the management and may not be justified in terms of practical results particularly when economic conditions change or unforeseen conditions arise. Even when quotas are handled in this fashion they serve as a means of increasing emphasis upon production and give to the managers a concrete idea of what is expected of them and what they in turn may demand of their agents.

[64] Pt. 12, R. 6007, 6045, 6051, 6052, 6064, 6093, 6109. Compare Armstrong report, vol. X, p. 393.

[65] Pt. 12, R. 6081.

[66] The following schedule indicates the quotas or allotments set by a representative group of industrial companies:

Name of company	Industrial quota or allotment	Ordinary quota or allotment	Quota or allotment fixed by—
Prudential	Lump sum for district offices.	([a])	Home office.
Western & Southern	10 cents week increase	$1,500 per month	Do.
Life & Casualty	50 cents week increase	([a])	Manager.
Peoples	35 cents week increase	$2,000 per month	Home office.
Home Beneficial	10 cents to 40 cents per week increase, depending on size of debit.		Do.
Equitable Life (District of Columbia).	55 cents week increase	$500 per week, plus $250 managing district office and gain in force of $500.	Do.
Monumental	25 cents week increase	$2,000 per month	Manager.
Virginia Life & Casualty	40 cents week increase	do	Home office.
American National	$1.50 writing per week	([a])	Manager.
Baltimore Life	Lump sum for district offices	([a])	Home office.

[a] If quota is set it was not disclosed in the testimony (pt. 12, R. 5747, 5748, 5949, 6005, 6041, 6059, 6078, 6085, 6092, 6108, 6113, 6114, 6146, 6155.

[67] Pt 12, R. 5746, 5747.

Furthermore, though an agent is not dismissed for failure to achieve his quota, in the case of some companies he may still be subjected to various types of embarrassment by the home office or his local manager. Thus one company makes it a practice to send a letter of "regret" to the offending agent.[68] Another arranges a dinner at the home office for those who fill their quotas, excluding those who do not.[69] These practices may be as effective as the threat of dismissal. Occasionally the nature of the disciplinary action to be taken against agents who fail to make their quotas is left to the discretion of the local office manager, some of whom testified that they were inclined to be lenient in such matters.[70]

Mr. Ambrose J. Watkins, vice president of Home Beneficial Association of Richmond, Va., testified that his company took a stronger position with respect to quotas. A letter written by the Home Beneficial to its Washington manager read in part as follows: [71]

To reach our goal of $100,000,000 insurance in force by the end of 1938, it is going to take a lot of planning and a great amount of work. It will be a big job, and we should fully realize the futility of any delayed start. There is only one way in which we can reach that goal, and that is for each district, each staff, and each agent to make its proportionate amount of ordinary and industrial increase each week, as it goes. To do this it is necessary that we keep our allotments before us for each week, to know each week in the year if we are ahead or behind in our allotments. Only by doing this can we expect to know where we are at the end of each week and whether or not we are keeping pace with our allotments.

In order that every district may keep its allotment on ordinary and industrial increase before it each week in the year, we are shipping you two large graphs. One of these graphs is for ordinary increase and the other is for industrial increase.

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[68] Pt. 12, R. 6114.

[69] Pt. 12, R. 6086.

[70] *Supra*, note 67. The testimony of Mr. L. H. Hannah, vice president and manager of agencies for the Equitable Life (District of Columbia), is illustrative (pt. 12, R. 6060):

"Mr. GESELL. Do you rigidly enforce that quota, Mr. Hannah?

"Mr. HANNAH. No, sir.

"Mr. GESELL. In other words, if an agent doesn't meet it, nothing happens to him?

"Mr. HANNAH. Well, we set that up as a goal to work to, and many of them surpass it.

"Mr. GESELL. What about those who don't? What happens to them?

"Mr. HANNAH. Well, they don't make as much salary.

"Mr. GESELL. Is there any disciplinary measure taken against them by the company?

"Mr. HANNAH. Nothing of a serious nature.

"Mr. GESELL. What of a nonserious nature is done with respect to them?

"Mr. HANNAH. We write to the manager, pointing out at times the standing of the different ones, and let him see if he can't find ways and means to bring about an improvement.

"Mr. GESELL. You mean you write the manager and say, 'We notice agent so-and-so in your office hasn't met these quotas. Please speak to him and try to get him up to snuff?'

"Mr. HANNAH. Yes, something to that effect.

"Mr. GESELL. You leave it with the manager to take disciplinary action if he feels it desirable?

"Mr. HANNAH. He can make the recommendation.

"Mr. GESELL. Are men dismissed in your company for failure to get these quotas on occasion.

"Mr. HANNAH. None that I know of.

* * * * * * *

"Mr. GESELL. What is the reason for fixing them?

"Mr. HANNAH. As a goal, just like football, something to work for.

"Mr. GESELL. The language of the letter would indicate that it was little more than a goal. It was pretty definite instructions as to what the man should turn in, was it not?

"Mr. HANNAH. That was the quota to fight for."

[71] Pt. 12, exhibit No. 1061.

Both of the graphs are to be placed in a prominent position in the agent's room, where they will be plainly visible to everyone.

* * * * * * *

These graphs are to be marked each week, and only in the meeting on Saturday morning.

* * * * * * *

We feel certain that you will use these graphs to the best of advantage in your meetings and that they will assist you in keeping before your district the allotments of the district. The record of your district will be very closely watched this year. Can we count on your district to do its part in reaching our goal of $100,000,000 insurance in force by getting its allotment on both ordinary and industrial? This is your opportunity to demonstrate your leadership ability.

Mr. Watkins testified: [72]

Mr. WATKINS. I did mention to you from the beginning the industrial increase of from 10 to 40 cents a week, according to the size debit.

Mr. GESELL. Are those allotments strictly adhered to? Do you insist upon a man getting those allotments unless he has some particularly valid excuse?

Mr. WATKINS. We put those allotments so reasonable we feel that men ought to make those allotments.

Mr. GESELL. What do you do to a fellow who doesn't make them?

Mr. WATKINS. I say we leave that to the discretion of the manager of the district. There are some men who, where we find they couldn't make that progress over a period of time, it would really be better to have out of the business.

Without regard to the attitude of their home offices, local managers sometimes exact pledges from the agents under their supervision.[73] One industrial agent who had been employed by his company as a whole-time agent for over 12 years stated that in his district agents were compelled to give a written pledge from time to time stating the amount of new business both ordinary and industrial they would write. These pledges were demanded by the office manager. A letter written by the agent's manager in this connection read: [74]

I am surprised that you only made one ordinary canvass (each) Thursday and Friday. That does not indicate to me that you care very much about fulfilling the company program of one ordinary sale each week. You realize that the responsibility of the record of this staff is on my shoulders and I therefore must insist that you make a sufficient number of ordinary canvasses each and every week to give you an ordinary sale each and every week, and I know of no better time for you to do that than on Thursday and Friday, but you cannot do it on two canvasses.

This old stuff of "leave it to me" and "I will arrive" is getting to be the bunk with me, for I'm looking for results and not excuses. You will please give me a written statement outlining just what I may expect of you each day and each week. It is necessary that I have this so I may know what course and action to follow in my responsibility and supervision of your activities.

It also appeared that if an agent connected with this office failed to sell an ordinary policy of $1,000 or more each week or failed to write a certain amount of new industrial business during any working day he was required to fill out a written explanation for his manager, who

[72] Pt. 12, R. 6045. See also testimony of John H. Ruehlmann, vice president, Western & Southern, pt. 12, R. 5948–5949.

[73] Pt. 12, R. 6108, 6155.

[74] Pt. 28, exhibit No. 2598.

communicated with him in the abusive terms of the following questionnaire letter: [75]

IMPORTANT

In re your pledge of $33,000 placed ordinary and one placed accident from September 6, 1937, through December 1937

Mr. ————

DEAR SIR: In view of the above and our company's increase requirement for 1938 sales congress qualification, how do you explain the fact that you've allowed another week to go by with you "blank" in ordinary production and/or writing and "blank" on accident written?

How many ordinary canvasses did you make during the writing week that ended last night? Give date of each canvass you made. Full name of the prospect. Amount and plan you canvassed him for.

How many ordinary prospecting interviews did you make during the writing week that ended last night? Give date of each. Full name of the prospect. Amount and plan you canvassed him for?

Please have your exact and definite reply on my desk not later than next Wednesday a. m., October 27, 1947.

Thanks and regards,

Yours for success,

———— ————.

Contests and quotas are not the only means by which home-office executives keep managers alert to the necessity of producing business. From many company home offices there emanates a constant stream of correspondence cajoling, threatening, and bullying managers and agents into writing more and more new policies.[76] This correspondence is illustrative of the vigor with which these demands are made and may be quoted without comment.

On one occasion the Washington, D. C., district manager of the Life & Casualty Insurance Co., of Nashville, Tenn., was instructed by letter from his home office to "ask your superintendents to contact their agents immediately in order to make a determined effort to double their production of collected on business for this week." [77] Another similar letter stated: [78]

Let's put on a drive this next week for the biggest production we have ever had in the southeastern division. Contact all of your men Saturday, either by letter, telegram or personally and ask them to give you 100-percent cooperation in this drive.

Still another letter contained this peremptory order: [79]

Now, we need to keep this drive up through this next week. Upon receipt of this letter, I wish you would contact all of your men either personally, by telegraph, telephone or by letter and let them know what we are up against and ask them to really "turn on the heat" for production this next week. I am counting

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[75] *Id.*

[76] Pt. 12, exhibits Nos. 997, 1042, 1043, 1044, 1054, 1055, 1061, 1062, 1063, 1074, 1075, 1076, 1086. Practices of industrial companies are not identical in this respect. The three largest companies, for exemple, appear to place less emphasis upon browbeating tactics, being content to allow the natural results of the compensation system to have their effect. The record contains no evidence of such tactics by the Prudential or John Hancock. In the case of the Metropolitan, the evidence is not so clear.

[77] Pt. 12, exhibit No. 1045.

[78] Pt. 12, exhibit No. 1042.

[79] Pt. 12, exhibit No. 1043.

on you, your superintendents and agents to put this drive over and make it a great success. Let's go after a minimum writing of $2 for each agent.

Letters written to the Washington, D. C., supervisor of the Home Friendly Insurance Co. office also reveal the pressure to which managers and agents are subjected. Portions of two such letters are reproduced below: [80]

I note from your report of field operations for the week of October 25 you wrote nine applications for $1.75 while collecting open debit No. 331, and your district consisting of six agents only submitted $5.95, which is less than $1 per man. Frankly, I am disappointed that you have not formulated plans that would be the means of securing satisfactory results. The writings of your district during the contest have been one of the poorest of any of the branches.

* * * * * * *

Please impress upon your entire organization that they must submit adequate writings and obtain a good percentage for collections if they expect to be retained. Your district should submit at least $9 per week, which would be equivalent to $1.50 per man. The writings of your district on a per-man basis do not compare favorably with other districts. At your meeting Thursday, advise your agency force that your are going to expect each man to produce in a satisfactory manner.

In many cases these letters serve a double purpose. Not only do they spur managers and assistant managers to increase production but often these managers read them to the agents to goad the agents on.

The use of "board calls" or "pep meetings" is frequent. Most managers hold such meetings daily or weekly, at which time they try to work the agents up to the highest possible selling pitch by commenting on individual records,[81] offering hints on how to break down sales resistance,[82] or flatly ordering the agents to bring in more business on threat of dismissal.[83] The testimony of one agent on this point was as follows:[84]

Mr Gesell. Do you have meetings?

Mr. McCarry. Practically every morning.

Mr. Gesell. Tell me about those meetings.

Mr. McCarry. Why, they are mostly conducted by our manager, sometimes our vice president comes from Richmond, and when the manager doesn't speak, the assistants speak to us. The first thing, I think, you referred to a board call. They call it marking the board, and if production has been very low, we are given fits, so to speak.

[80] Pt. 12, exhibit Nos. 1075, 1076.

[81] Pt. 12, R. 6025, 6051, 6052, 6063.

[82] These are sometimes called door openers. Mr. Sheehan, assistant superintendent in the Washington office of the American National testified to some interesting ones (pt. 12, R. 6156):

"Mr. Gesell. Tell us some of these door openers he gives you.

"Mr. Sheehan. Well, for instance, you might be calling on a regular old policyholder and collecting and you would ask the lady's name next door and in that way that is a very fine opener, you can get in that way by saying that "Mrs. So and So recommended you to me" and you get in the door that way; that is one of the best ones I used to sell.

"Mr. Gesell. Give me some more.

Mr. Sheehan. Well, another one is making a little survey in the neighborhood. You really are making a survey; you are finding out what the program of their insurance is and whether they could stand any more or not without overloading them, and you would like to ask them a few questions, tell them who you are and what company you operate from.

"Mr. Gesell. You mean you go in and say, 'Mrs. Jones, I am not here to sell you insurance. I am here to conduct a survey.'

"Mr. Sheehan. That is right."

[83] Pt. 12, R. 6066, 6085, 6086, exhibit No. 997.

[84] Pt. 12, R. 6085, 6086.

Mr. GESELL. What do you mean, you are given fits?

Mr. McCARRY. Well, "heck" in other words.

Mr. GESELL. How does the manager give you "heck"?

Mr. McCARRY. Well——

Mr. GESELL. What he says, in other words?

Mr. McCARRY. There are some threatening notes. He says that the management of the company at Richmond is not at all satisfied with the production, and we are threatened sometimes with finals.

Mr. GESELL. If you don't produce?

Mr. McCARRY. If we don't produce.

Another agent employed by the Peoples Life of Washington, D. C., testified that there was a "board call" in his office every morning, at which time each agent whose name was posted on a blackboard was asked to state publicly the amount of business he had written the preceding day. If the agent had not been successful in writing any business a cross was placed opposite his name and in the "pep meeting" which followed the manager would single out an agent from the floor and pointing to crosses opposite his name would refer to them as crucifixes and berate the guilty agent, accusing him of having crucified his manager.[85]

Most descriptive of the tactics employed are the following excerpts from letters written to Mr. Leroy A. Lincoln, president of the Metropolitan, during 1937 by members of his company's field force, giving evidence of the pressure for new business to which the industrial agent is subject.[86]

Our manager is the militant and dynamic type. Unfortunately, however, he has been using the browbeating method so long that he knows no other method of getting results. I have tried to reason with him on occasions without success.

* * * * * * *

The high pressure in ———— brought about what the managers called meetings 3 or 4 times daily, often as late as Saturday midnight and Sunday a. m. reports to the office, occasional telegrams (collect) to agent's home, if his report was below expectation.

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It is hard to describe in words the suffering and humiliation forced on men by these so-called managers and assistant managers. Here are some expressions used by them during their "pep" talk meetings, "Why don't you go on relief; you are too old to be useful." "I will give you 2 weeks to make good or get out." "You are yellow." "You are a coward." Once I heard the manager tell a man, who was with the company over 11 years, that he was a yellow dog if he did not resign, and for that they receive $500 or more per week, or about $30 per week for humiliating each man. They never go out in the field with the men, they constantly threaten them with dismissal, and do not prove to them that it is possible to get business. Instead of lending a helping hand to the man who is down, they force him to desperation.

About a year ago I was called by my manager into his private office and was bluntly told to tender my resignation, because my ordinary and A. & H. record

[85] Pt. 12, R. 6065.

[86] On November 17, 1937, Mr. Lincoln addressed a personal letter to each member of the Metropolitan field force, in which he discussed various company problems, and suggested that any agent might communicate with him (pt. 12, exhibit No. 996). An analysis of 271 replies received was introduced into evidence (pt. 12, exhibit No. 997). Excerpts printed in the body of the text are selected from these replies, which covered a multitude of different problems.

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was poor. I pleaded and begged for my job, reminding him that I was a married man with two children and that I was the only breadwinner for my home, that if I lost my job my family's financial structure would collapse. It would ruin me and the innocent ones at home. It would cause untold suffering to my dear ones. He relented a bit and said, "Well, if you get me a $5,000 application and two A. & H.'s by the end of the week, you may continue working."

When I walked out of that office, I was in a quandary. I was dazed. That night I could not sleep, thinking and thinking where I could get the $5,000 application and the two A. & H.'s. Mr. Lincoln, you know those kind of prospects do not grow on trees. I only had 3 days to get the business. The next 48 hours I canvassed every eligible prospect that I knew. The only success I had was a $1,000 application and one A. & H. I was sure this would not pacify my chief, so in desperation and as a last resort I went to a relative of mine who could not afford to buy the insurance, and I offered to pay the first premium on a $4,000 life insurance and also the semi-annual premium on the A. & H. as long as he would help me keep my job.

He readily agreed: the applications were submitted and issued. I paid out $48 of my hard-earned money. Now, I am not one of the average agents who you claim earn $3,225 a year. My average weekly salary in reality is about $40 so for months my family and myself were denied some of the necessities of life.

From the foregoing it is not difficult to understand why the vice president of one industrial company stated in a letter to one of his managers:[87]

Business put on at a time when the agent is worked into a frenzy is worth very little to the agent or to the company.

He might well have added:

* * * or to the policyholder.

Pressure encourages many undesirable practices from the point of view of the policyholder. The undue emphasis upon the writing of new business leads to a higher cost for insurance, more lapse and overloading of policies, and maldistribution of insurance within a family group. From the point of view of the agent, it fosters undesirable working conditions and results in high agency turn-over and poor service to existing policyholders. Finally, from the point of view of the company itself, emphasis upon the writing of new business, if carried to an extreme, makes the sale of industrial insurance purely a merchandising venture and thus places management in a position where it may lose sight of the social implications of its action. A few practices of the industrial agent, consequences of the pressure to which he is subject, may be mentioned at this time.

In his enthusiasm to put business on the books, the agent often pays the first premium himself.[88] Sometimes this is the beginning of a purely dummy sale in which the agent pays premiums until his real increase is great enough to withstand the lapse of the fictitious policy.

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[87] Pt. 12, R. 6010.

[88] Pt. 12, R. 5944, 6011, 6027, 6028, 6066, 6087. This is one explanation of the high termination rate experiences after the first premium has been paid. The actuary of the Equitable Life (District of Columbia) testified that 11.9 percent of his company's policies terminate after payment of one premium, largely as a result of this situation. Pt. 10, R. 4314.

This has been called writing "tombstones" or "lampposts." [89] Besides paying the first premium on real policies and putting fictitious policies on the books, agents often pay renewal premiums for people on their debits to keep the policies from lapsing. This is called "carrying excess." [90]

Once the policy has been sold, it is to the interest of the agent to keep it sold. Not only must it not lapse, but the policyholder must not be allowed to terminate it in any other way, if possible.[91] However, if he insists upon surrendering it for cash, the agent may attempt to sell a new policy to replace it. The companies have made some concessions in the form of allowing cash-surrender values for persons in dire need before the surrender value is contractually available.[92] Nevertheless, the agents have frequently been urged to see that part of the cash thus obtained through surrender be used to pay the first premiums on a new policy as well as the renewal premiums on old ones.[93] Sometimes this practice results in the policyholder's having

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[89] Pt. 12, R. 6071. In this connection Mr. Cohen, an agent of the Equitable Life (District of Columbia) testified as follows (Id.):

"Mr. GESELL. Have you ever heard of what are called 'tombstones' or 'lampposts'?

"Mr. COHEN. Yes; that is a common ailment.

"Mr. GESELL. Will you tell us what it is?

"Mr. COHEN. It is a policy sold to a person who has no intention of maintaining it. We do this in order to maintain production.

"Mr. GESELL. You mean in order to meet the quota or present an increase which would be acceptable to the manager you write bogus applications known as 'tombstones' or 'lampposts'?

"Mr. COHEN. That is correct.

"Mr. GESELL. Is that a fairly prevalent practice?

"Mr. COHEN. I think it is.

"Mr. GESELL. Have you done it?

"Mr. COHEN. I have done it.

"Mr. GESELL. Who paid the premiums on it?

"Mr. COHEN. The agent, naturally.

"Mr. GESELL. How long do you keep these 'lampposts' or 'tombstones' in existence?

"Mr. COHEN. Only so long as it takes to feel it is safe to take it off the book because we may be able to make some increase and so we maintain our jobs.

"Mr. GESELL. I suppose that if a man goes off the debit and a new man comes on he may frequently find on that debit quite a few 'tombstones' or 'lampposts'?

"Mr. COHEN. When I first went on my debit I found it in such a condition.

"Mr. GESELL. How many did you find?

"Mr. COHEN. Several solid pages of it, but it was all lapsed off immediately.

"Mr. GESELL. Were you charged with those lapses?

"Mr. COHEN. Not at the time; no; except, pardon me, with one exception. It was rather interesting that when I was introduced on the debit my training was confined to 3 days with an assistant manager who spent two of the days assuring me that he owned the company and everything in the company and the third day showing me how to write tombstones, and these I did have to pay for when they were lapsed off.

"Mr. GESELL. The assistant manger himself instructed you how to write these tombstones?

"Mr. COHEN. Yes."

[90] Pt. 12, R. 5739, 5740, 5857, 5858, 5944, 5945, 6066, 6087.

[91] In an effort to prevent lapse, the Equitable Life of Washington, D. C., distributes to policyholders the following warning which is printed across the face of a sample policy (pt. 12, exhibit No. 1071):

"I am a lapsed policy. A widow's tears have stained my withered surface. I am only a scrap of paper consigned to the trash heap where I now belong. Once I was a living contract. I was proud of my ability to guarantee my owner's wife a regular income should she have to go on without him. I represented comfort and security for his family. I was a guaranteed estate free from taxes and administrative costs.

"But something happened. The money from my premium was used for other things much less important. And then came Death. Suddenly and unexpectedly it took my owner away. Its swiftness stunned his family, and when they turned to me for help they found me as I am today—a lapsed policy."

[92] Pt. 12, R. 5970.

[93] Pt. 12, R. 6072. The Metropolitan even encouraged this practice by having a special form, P. S. 200, which was used for this purpose. However, the Metropolitan, Prudential, and John Hancock now discourage this practice by means of a clause in the agents' contracts providing that no commission may be paid upon the issuance of a policy to a member of a family in which another policy lapsed or was surrendered within 13 weeks. See agents' contracts, New York Insurance Report, 1932, Part III. Appendix p. 208.

a larger premium to pay than before the surrender. A situation of this kind was described by the agent of the Equitable Life Insurance Cc [94]

Mr. GESELL. Have you any cases of that—individual cases that you could call to our attention—specific cases in your debit?

Mr. COHEN. Yes; I have a case on Tennessee Avenue where a woman was paying for $2.12 worth of insurance a week in the Equitable and because her husband was in the hospital she had to surrender some insurance to meet her current expenses. She cash surrendered 30 cents with me, but after I had finished writing new business in the house her weekly premiums instead of being $2.12 were $2.79.

Mr. GESELL. You say when she cash surrendered 30 cents; you mean she surrendered policies amounting to 30 cents a week payment?

Mr. COHEN. That is correct.

Mr. GESELL. So that at the end she ended with more insurance than when she started?

Mr. COHEN. That is correct.

Another source of cash used for the sale of new policies is the premium credit dividend annually allowed by the Metropolitan and John Hancock. The policyholder, who is ready to pay his regular weekly premium, is told by the agent that the premium for that week is waived on account of the dividend. Therefore, some cash is available for a new policy, and frequently the agent takes this opportunity to make another sale.[95] Considerations of social desirability are of little weight in discouraging these practices on the part of agents whose jobs and commissions depend upon the issuance of as many new policies as possible.

D. TURN-OVER OF AGENTS

In measuring the effect upon the agent of the constant demands for new business, it must be recognized that many agents are inexperienced. Industrial agency organizations are in a continuous state of flux, and the agency turn-over is phenomenal. This problem of agency turn-over has for many years confronted companies writing industrial insurance. In 1908 the Metropolitan's agency staff experienced a turn-over from "chargeable finals" equal to about 76 percent of the entire staff, while in 1910 Prudential's turn-over reached a high point of 84.90 percent.[96] These companies have made very substantial progress in reducing chargeable finals, so that by the end of 1938 the figures for one company, the Prudential, had dropped to 7.02 percent.[97] That the problem is still a pressing one, however, can be demonstrated from recent figures. During the 11 years from 1927

[94] Pt. 12. R. 6072.

[95] See Families and Their Life Insurance, p. 69.

[96] Pt. 12, R. 5850, exhibit No. 972. Generally speaking, the term, "chargeable finals," is applied to termination of an agent's contract as a result of his resigning from the service, or being requested to resign, and does not include deaths, retirements, disabilities, promotions, and transfers, which are considered "nonchargeable finals" (pt. 12, R. 5739).

[97] Pt. 12, exhibit No. 972. For the first 7 months of 1939 Metropolitan turn-over was 7 percent (pt. 12, R. 5849). John Hancock experienced a 22 percent turn-over in 1938, and 15 percent for the first 9 months of 1939 (pt. 12, R. 6124).

to 1938 the Metropolitan alone, which employs about 20,000 agents, hired 74,607 new agents, while in the single year of 1928 it hired 9,500.[98] Similarly, the Prudential appointed 25,336 new agents from 1931 through 1936.[99] In the smaller companies high rates of turn-over still exist. Recent figures for the Western & Southern show a turn-over equal in number to over 42 percent of the entire agency force while the Baltimore Life, Peoples Life, and Equitable Life (D. C.) all show an experience of about 60 percent, ranging as high as 69 percent in the case of the latter company.[100] In fact the testimony showed that in certain branch offices of some of these companies the turn-over was equal to 100 percent of the agency force.[101] As a natural corollary of this turn-over the average period of service for an agent in the industrial companies is low. In the case of the Metropolitan it is slightly over 7½ years, while in the Monumental it is 4 years.[102] It should be recognized that these averages are somewhat confusing. In fact in the case of the Metropolitan 7,903 agents have been with the company for less than 5 years.[103] Company representatives stated that it was difficult for them to estimate the exact cost of replacing one agent for another and undoubtedly this cost varies as between companies. The Metropolitan, however, has estimated that the cost is as high as $530 per man, at which rate the 74,607 "finals" which the Metropolitan experienced between 1927 and 1937 would have cost in the neighborhood of $39,500,000 if every "final" represented an appointment during the period.[104]

An officer of the Western & Southern presented the following highly informative analysis of the cost of agency turn-over.[105]

Minimum cost of a final direct and immediate losses

One-half of superintendents average weekly earnings during final and introduction (3 weeks)	$78. 06
Manager's time recruiting and training new agent—10 hours at $2.80	28. 00
Special commission—average per final in 1938	[1] 85. 03
Deficiencies—average per final in 1938	1. 55
Cost of new agent's minimum earnings guarantee	10. 86
To manager—three-fourths time on final lapses	3. 97
To superintendent—four times on final lapses	21. 16
Multiply number of your finals by this figure	228. 63

[1] These items demonstrate that under the times increase method of compensation used by the Western & Southern and many other companies a lapse on the debit of an agent who left the company can be especially expensive because it is then impossible to offset, against commissions on policies thereafter written, the commission already paid to him with respect to the lapsing policy.

[98] Pt. 12, R. 5852.

[99] Pt. 12, exhibit No. 973.

[100] Pt. 12, exhibit Nos. 1017, 1069, 1082, 1088.

[101] Pt. 12, R. 6063, 6087.

[102] Pt. 12, R. 5723, exhibit Nos. 1072, 1130.

[103] Pt. 12, exhibit No. 1130.

[104] Pt. 12, R. 5849, 5850. For the cost estimates of other companies, see pt. 12, R. 5722, 5946, 6003, 6004. 6124, 6149. It is significant that a vice president of the Prudential states his company has no information as to the cost of recruiting and training a new agent (pt. 12, R. 5738).

[105] Pt. 12, exhibit No. 1020.

Losses not measurable in dollars

Morale

Production

Goodwill and prestige on debit

By other agents needing superintendent

Wasted home office supervision and expense

Policyholders' business needlessly sacrificed

Poor collections, conservation, and lower compensation

Causes of turn-over are numerous. Many agents find themselves unsuited to the business and dissatisfied with the pressure for production to which they are subjected, and resign voluntarily. Other agents are discharged either for failure to produce, which is frequently termed "lack of success," or for deficiencies and irregularities in their accounts.[106] A memorandum from the files of the Western & Southern Life Insurance Co. analyzing causes for 160 finals during 1939 presents a fairly typical situation and reads in part as follows:[107]

1. *Lack of training.*—Eighty-nine finaled because of nonsuccess, inability to produce, dissatisfied, insufficient earnings, other employment, not qualified for business. Sixty-seven of these had been with the company less than 1 year. Practically no one in this group ever made sufficient money to really become interested in the business.

2. *Lack of supervision.*—Forty-three finaled for deficiency, manipulating company funds, irregularities. Twenty of these were in service less than a year * * *.

The reference to deficiencies deserves special analysis. The memorandum in question bore the following interesting notation after the second paragraph relating to lack of supervision, namely "Who taught them to be crooked?"[108] Mr. John H. Ruehlmann, vice president in charge of agency operations for the Western & Southern, testified that this comment was intended to point out the fact that new men could only have learned to manipulate accounts and create deficiencies through their contact with the older agents.[109] The problem of deficiencies and irregularities is one confronting many companies and constitutes one of the principal causes for turn-over. In some instances actual thefts of money collected and the juggling of accounts such as, for example, the crediting of one policyholder's advance payments to the account of a policyholder in arrears for the purpose of preventing a lapse, appear. In other instances agents advance their own money to pay premiums for policyholders. This latter practice, called "carrying excess," appears to be common among industrial agents. As has been indicated it arises from the system of compensation by which the agent is penalized for policies which lapse and often finds it profitable to keep a policy in force with his own money for a short time.[110]

[106] Pt. 12, R. 5739–5742, 5856, 5857, 5943, 6018, 6031, 6032, 6044, 6057, 6077, 6113, 6124.

[107] Pt. 12, exhibit No. 1018.

[108] Id.

[109] Pt. 12, R. 5944.

[110] See p. 257, supra. Also pt. 12, R. 5740, 6057. The agents' contract now used by Prudential specifically forbids this practice. Pt. 12, exhibit No. 976.

In the case of the Prudential from 1931 to 1936 the company "finaled" over 5,300 agents, or over 20 percent of all agents "finaled" during this period, because of deficiencies or irregularities in their accounts.[111] To suggest that the thousands of agents discharged for deficiencies and irregularities were actually dishonest in all cases would certainly be unrealistic. The reasons are rather to be found in the pressure exerted for new business and the system of compensation, both of which have already been commented upon.

E. MALDISTRIBUTION AND OVERLOADING OF POLICIES

Insurance sold under the conditions described cannot be carefully underwritten.[112] This is made strikingly apparent by a recognition that the class of people purchasing industrial insurance is unable to understand its insurance needs and, as one debit agent of an industrial company suggested, can be sold anything if the installment is sufficiently small.[113] That such should be the case appears almost

[111] Pt. 12, exhibit No. 973. Prudential realized a shortage of $44,125.68 from deficiencies in accounts of agents finaled during 1938 for this cause. It is only in a very blatant case that the company initiates criminal prosecution against agents finaled for deficiencies (pt. 12, R. 5743, 5767).

[112] A recent report by a committee of the New York State Legislature which made an extensive study of industrial insurance is of interest in this connection:

"The committee's investigation of the industrial business reveals that the great number of lapses is one of the chief causes for the present dissatisfaction with this business. Various factors bring about the high lapse ratio. The number of lapses is principally due to the pressure and force employed by everyone concerned with the sale of the industrial policy. The cycle commences with the home office and ends with the agents. All seek to establish records for premium income. Agents' compensation is paid in the form of commissions on total premium income, as distinguished from the number of policies sold. Managers' and assistant managers' salaries or income depend in part on increase in premium volume. The increase of the premium income is a determining factor whether or not a manager, assistant manager, or agent is promoted or demoted. The very contracts which the companies have with the agents provide that most of the agents' income shall come from the industrial business.

"In order for the managers, their assistants, and agents to keep pace with the company's efforts to increase business, a system has been created whereby intense pressure has been brought to bear upon the low-income groups who are the principal purchasers of industrial insurance."

* * * * * * *

"The pressure exercised on the agents for the sale of industrial policies has driven them to the point where they have been forced to depart from the ethics of their calling. An agent, because of his close contact with the people, is in a position of public trust. Policy purchasers usually accept the agent's advice in their choice of policies. If an agent is compelled to reach a certain quota of premium income in order to maintain a standard with the company, he is not likely to give his best judgment to his customers" (Legislative Document (1939) No. 101, State of New York, Report of the Joint Legislative Committee on Revision of Insurance Laws, pp. 20, 21).

[113] Pt. 10, R. 4316. One agent described his sales approach in these graphic terms (pt. 12, R. 6068, 6069):

"Mr. GESELL. Can you tell a little of what your sales talk or canvass is, Mr. Cohen, when you go to a prospective policyholder with a view to selling him a policy? What do you tell the policyholder?

"Mr. COHEN. Well, it will largely depend upon the type of person the policyholder is. Since the bulk of mine are Negroes, I will metaphorically draw a hearse up in front of his door and park it there until he signs.

"Mr. GESELL. What do you mean by that?

"Mr. COHEN. I mean I will have to paint pictures of the Grim Reaper and everything else to frighten the person into believing that unless the person is actually covered with insurance, death might take place almost momentarily.

"Mr. GESELL. Then the sale campaign is primarily directed toward showing the policyholder that in his present circumstances, if he dies he won't have funds to bury him?

"Mr. COHEN. That is correct.

"Mr. GESELL. Do you find that policyholders on your debit can distinguish between a 20-payment life, an endowment policy, or a whole life policy?

"Mr. COHEN. In the year and a half I have been with the company I have only had one policyholder read his policy and that was because he misunderstood the word epilepsy to be the word leprosy and was scared.

"Mr. GESELL. So, by and large, you don't think policyholders read their policies?

"Mr. COHEN. I know they don't.

"Mr. GESELL. What determines the fact that a policyholder will take out an endowment policy or 20-payment life policy or whole life policy?

inevitable when it is recognized that industrial insurance is sold by agents who are in many cases not only inexperienced but insufficiently trained and who are, in addition, subject to a constant pressure to place new policies for the sake of bringing in a daily or weekly increase in their debits.[114]

Maldistribution and overloading of policies take several forms. In some families, particularly those on relief, or in the especially low-income brackets, too much insurance may be sold with the result that an excessive amount of the family income is taken from essential living expenses to meet premiums as they fall due. Furthermore there is ample evidence that the pressure for new business to which the agent is subjected prevents adequate adjustment of a policyholder's program to meet changing conditions and actually encourages the writing of policies which from the outset are not properly adapted to the policyholder's requirements. Certain situations appear with regularity in the examination of policies held by industrial families. Not only are industrial endowment policies too frequently sold on children under 10 years of age in lieu of policies which more properly should be placed on the lives of the breadwinners, but there is a general tendency to sell the more expensive types of industrial policies, notably endowments and 20-payment life policies, under circumstances which leave no doubt that the policyholders would be better off to have the increased protection which the purchase of a whole life policy might have afforded.

In considering maldistribution and overloading, one should not lose sight of the fact that in many families several different forms of insurance may be held on the members and even on a single life. It is not unusual to find both ordinary and industrial insurance in force in the same family, and these may be accompanied by group life or fraternal policies. It must also be recognized that several different industrial companies may succeed in placing policies within a given family group. Thus the situation is presented in which a variety of classes of insurance may be in force in a single family and even several different industrial companies may have a stake in the family's insurance program.

In order to obtain first-hand information on insurance holdings of low-income families—information which the companies themselves

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"Mr. COHEN. The determining factor in most instances is the agent, and the determining factor in the agent's status is the salary, so, because we can get more writing on endowment, we usually sell an endowment.

"Mr. GESELL. Do you find you can usually pretty well decide for the policyholder the type of policy he wants?

"Mr. COHEN. I think the average agent could if he were properly schooled. I am afraid that this isn't actually the case, because the agent, when he approaches the policyholder, does so from the viewpoint of the agent's own pocketbook aud not from the interest and well-being of his prospect." (See also pt. 12, R. 5795.)

[114] In this connection, see testimony of Mr. C. F. Williams, president of Western & Southern Life Insurance Co. (pt. 12, R. 5939):

"Mr. GESELL. I wanted to know whether you didn't think it was more difficult for an agent to sell industrial insurance today than it was during the pioneer days.

"Mr. WILLIAMS. I think he must be a better salesman today than ever before.

"Mr. GESELL. And as a result, the tendency may be to push men a little more.

"Mr. WILLIAMS. Yes.

"Mr. GESELL. And the result of that may be a poor grade of business.

"Mr. WILLIAMS. It will be a poor grade of business.

"Mr. GESELL. Written in families which may not be able to afford additional business.

"Mr. WILLIAMS. That is right.

"Mr. GESELL. And that will result, you feel, in bad selection of risks, maldistribution of insurance within the family and from an over-all point of view poorer earnings to the company and the agents.

"Mr. WILLIAMS. Yes * * *."

failed to furnish—the Commission sponsored a Work Projects Administration survey of the insurance habits and holdings of 2,132 families residing in the greater Boston area. The results of this survey have already been published,[115] but it is desirable that certain findings be repeated at this time since they throw considerable light on some aspects of the problem of overloading and maldistribution.

The survey demonstrated that 4 out of 5 of these families were covered by insurance at the time they were interviewed and that a considerably larger number had previously carried life insurance. In fact, it appeared that 92 percent of all the families were either insured at the time of the interview or had been insured at some time in the past. There were 1,666 insured families concerning whose holdings detailed information was obtained. Of this number 415 families were on relief. In these insured families there were 6,050 persons who held 10,150 separate life insurance policies. This group was, generally speaking, chosen from the low-income brackets, and had average incomes in the case of nonrelief families of around $400 annually per family member, and, in the case of relief families, about $243 per family member. Forty-eight percent of the persons in these relief families were insured. Forty-two percent of the total number of insured families, or 701 families, carried no class of insurance except industrial insurance. Of the remaining families, however, a substantial number carried industrial insurance in conjunction with other forms, notably fraternal, ordinary and group, with the result that 88 percent of all insured families held some industrial policies. The average person carrying insurance of any kind was insured for $683 and paid an average annual premium of $20.79. In the aggregate, the group of insured families paid 4.92 percent of their income for life insurance or $125,800 annually.[116] Numerous cases were found, however, where a percent of the income much in excess of the average was contributed to industrial insurance. This was particularly true in the case of the relief families of whom there were 415 covered in the insured group. Of this number over 64 percent contributed 5 percent or more of their income to insurance premiums, and it is interesting to note that 33 families contributed 6 percent, 5 contributed 7 percent, 5 contributed 8 percent, and 7 contributed 9 percent or more. An instance was found where as high as 16.4 percent of the family income was spent for insurance premiums. In this case the family, consisting of father and mother and nine children, held 19 policies, of which 14 were industrial. In spite of a family income of $1,248 (an average income per family member of only $113) 16.4 percent of this income was spent on industrial policies. In another instance, a family consisting of a father and mother and eight children with an annual income of $4,220, or $422 per family member, spent 10.9 percent of its income on 35 industrial and 7 ordinary policies which were in force on its members. A record of the family holdings disclosed that on the life of the son, age 7, there were in force four 20-year endowment policies for a total of $600 and one 15-year endowment policy in the amount of $130. It appeared from the survey that the lower the economic status of the

[115] See Families and Their Life Insurance.

[116] Ibid., p. 75.

family the greater was the percentage of its income which it paid for life insurance premiums.[117]

Some interesting facts indicating maldistribution within the family group were revealed. The insured families, of which it will be recalled there were 1,666, held 8,214 premium paying industrial life insurance policies. Of this number 9.7 percent had been in force for less than 1 year; 46.9 percent for less than 5 years and only 28.4 percent had been in force for 10 years or more. In addition it appeared that the great bulk of industrial policies were on the lives of policyholders who were under the age of 30. It is indeed significant that a form of insurance designed primarily to provide a fund for the expenses incident to death and burial should have its greatest distribution in a group under 30 years of age. The study disclosed that 60 percent of the industrial policyholders were in this group and that 42.1 percent of the industrial policyholders were under 20 years of age.[118] This startling fact is to a large extent accounted for by the extraordinarily large number of sales of endowment insurance to children under the age of 10 years. It was found that 42.2 percent of the total industrial premiums was paid for endowment policies and that 55.8 percent of these endowment policies were issued on the lives of children under age 10 and 24.8 percent were issued on the lives of infants less than 2 years of age. In fact the survey disclosed that 256 families, or 17.5 percent of all the families which had industrial policies, were paying all their premiums on endowment policies while 8.95 percent of the families receiving relief were in this class. Five hundred seventy-four families, 83 of them receiving relief, were paying over 50 percent of their total premiums for endowment policies.

As might be expected from the highly concentrated sale of industrial policies to persons under the age of 30, there were frequently cases where the chief breadwinners of the family or other persons contributing substantially to its support were either underinsured or entirely without insurance in spite of the fact that other members of their family held industrial policies written on the endowment or other expensive plans. In the insured families 11.58 percent of the chief breadwinners were entirely without insurance and 20.21 percent of other breadwinners, namely those persons earning 50 percent or more of the average annual income per family member, were not

[117] Families and Their Life Insurance, p. 48.

[118] Families and Their Life Insurance, p. 24. An analysis made of weekly premium and monthly premium industrial policies issued by the Metropolitan from January 1, 1934, to December 31, 1938, disclosed that the greatest number of policies, or 19.43 percent, were issued to policyholders between the ages of 16 and 25 whereas the second largest number, or 11.69 percent, were issued on or before age 1 (pt. 12, exhibit No. 989).

insured. This situation was particularly aggravated in the case of the chief breadwinners of relief families.[119]

It is obvious that the above discussion presents averages and general figures which do not disclose the degree of maldistribution and overloading which was found to exist in the case of individual families. The report on the W. P. A. project sets forth in detail selected case histories. A few of these case histories may be briefly summarized at this stage for purposes of illustration.[120]

One family, which consisted of 10 members, paid 5.4 percent of its income for premiums on 23 different policies in force on its various members. The total family income at the time of the enumeration was $3,120 or $312 per family member. This case illustrated an all too frequent occurrence where insurance on the parents had been sacrificed in order that policies could be carried on the children. A schedule of family insurance holdings disclosed that neither the father nor the mother were insured, having lapsed or surrendered any insurance they had previously held, whereas each of the children was insured, as was a niece, 23 years of age, who was not living with the family. In spite of the fact that the average annual income per family member was only $312, a total of 15 industrial policies, including 13 20-year endowments and 2 whole life policies were in force on the 3 younger children, age 11, 14, and 16, respectively.[121]

The case of the "Blank family" is equally startling. This family lived in a dilapidated house in the industrial section of Cambridge, Mass., and consisted of the father, mother, mother-in-law and 10 children, ranging from 8 months to 21 years of age. The father had been on W. P. A. since its inception and prior to that on relief rolls for a period of 2 years. During the past year he had received a weekly wage of $13.75 or a total of $715 a year. No other member of the family had been able to obtain any work except one daughter, who worked in a shoe factory. The total family income amounted to $1,117 including the value of food and clothing issued in lieu of cash by relief agencies. Thus the average annual income per family member was $85. In spite of the meagerness of this sum it appeared that the family expended 6.5 percent of its income on insurance, all of

[119] Families and Their Life Insurance, p. 142. In this connection attention is called to the following table from the New York Insurance Department's recently concluded "Special Field Investigation of Industrial Insurance."

Average insurance in force per family

	Number of policies	Amount of insurance	Annual premium
On head of family	1.22	$1,433	$38.41
On wife or dependents	1.03	421	18.66
On the children	2.33	664	35.04

In commenting on this table the Superintendent of Insurance stated:

"It is significant that among the families interviewed almost as much of the family income is spent on insuring children as on insuring the wage earner. This is an uneconomic distribution of insurance within the family. The inducement to the agents to sell insurance on wage earners rather than on their children should be made more compelling." (Industrial Life Insurance, Recommendation to the Joint Legislative Committee for Recodification of the Insurance Law. Louis H. Pink, Superintendent of Insurance of the State of New York, p. 19.)

[120] Families and Their Life Insurance, pp. 57–74.

[121] Families and Their Life Insurance, p. 62.

which was written on the industrial plan. Although the maximum protection was on the mother-in-law, father, and mother, insurance was also carried on many of the children. The family still had in its possession 10 industrial policies which were worthless, having lapsed before nonforfeiture values became available. An analysis of the 5 policies most recently lapsed disclosed that on January 30, 1939, six 10-cent weekly premium industrial 20-payment life policies had been issued exactly 1 week after a $6 dividend had been recorded in the premium receipt books. It appeared that the dividends had been used to purchase new insurance and that the insurance had lapsed in 5 out of the 6 cases within 3 weeks' time. An analysis of two premium receipt books revealed that insurance holdings had been increased by dividends in 1933, 1936, and 1937, as well as in 1939. Since during all or most of this time the father of the family had been on relief rolls or W. P. A., it is quite conceivable that the savings represented by these dividends could have been put to more effective use.[122]

It is not necessary to confine the discussion of these case histories to information disclosed by the Work Projects Administration survey. A particularly striking and admittedly exceptional case was obtained from the files of the Policyholders' Advisory Council. This was the so-called case of the "unfortunate fortune Family" which consisted of three members. In addition Mr. Fortune was paying premiums on six policies written on his brother who was not living with the family. The head of the house was the father, a longshoreman by trade, and his income constituted the sole support for his wife and son.[123]

In May of 1938 this family held 44 insurance policies, 4 of which were written on the ordinary plan, and 40 of which were written on the industrial plan. These policies gave total protection of $18,000 and cost an annual premium of $926.89, or approximately $51 per thousand. The annual premium represented about 55 percent of the father's yearly income at the time.

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[122] Families and Their Life Insurance, p. 67. In this connection, the testimony of Mr. Bert B. Cohen, an agent of the Equitable Life Insurance Co. of Washington, D. C., is of interest. Mr. Cohen testified (pt. 12, p. 6069):

"Mr. GESELL. Do you have a pretty good idea of the family income of the various families on your debit?

"Mr. COHEN. Generally, you know your people.

"Mr. GESELL. Can you give us some idea of what percentage of their money is going for premiums, not only in your own company, but in other companies?

"Mr. COHEN. I actually have colored families who pay more for insurance in two or three or four different companies than they get in a week, and how they do that I sometimes don't know.

"Mr. GESELL. Do you think there are a considerable number of families on your debit who are paying as much as 15 or 20 percent of their income for premiums?

"Mr. COHEN. Oh, yes.

"Mr. GESELL. Have you your debit book here with you, by any chance?

"Mr. COHEN. No; I don't.

"Mr. GESELL. Can you give us, from memory, a case history of any particular family where there may be a considerable number of policies sold against a small amount of income?

"Mr. COHEN. Well, yes. I have a colored widow woman who has her whole family and all of her relatives and friends insured with the company. She has a poor woman's salary; I think she told me it amounts to $7.50 a week and in the Equitable alone she pays $2.42 a week in insurance, and she pays as much in other companies, I am sure, as what she carries with the Equitable.

"Mr. GESELL. Can you give us another case?

"Mr. COHEN. I have a cab driver, a Negro, also who tells me that his profit at the end of a week is not over $10. His insurance in the Equitable is $1.75, and he has insurance in two or three other companies, I think equal to what the Equitable amounts to."

[123] The facts of this case, discussed in the body of the text, may be found at pt. 12, R. 5813-5818; exhibit No. 980. There is some evidence that the family income had been greater in previous years. Pt. 12, R 5866. For a discussion of the Policyholders' Advisory Council, see pp. 299 to 303, infra.

The policies were divided among 3 companies, the Metropolitan, the Prudential, and John Hancock, which collected annually $362.35, $336.48, and $227.56, respectively. Mr. Fortune, the head of the family, carried 15 policies which included 1 ordinary policy for $2,000, 1 intermediate policy for $500, and 13 industrial policies. Six of these 15 policies were written on the whole-life plan, 6 on the 20-payment life plan, 2 on the 20-year endowment plan, and 1 on a 38-year endowment plan. The mother of the family held 13 policies and the son held 10.

The order in which these policies were sold to the Fortune family discloses the constant pressure to which it was subjected. The first policy was purchased in 1919 from the Metropolitan. Another policy was sold by the Metropolitan in 1920. In 1921 the John Hancock succeeded in placing a policy in the family. In each of 1922 and 1923 the Metropolitan sold an additional policy. In 1924 the John Hancock sold two policies. In 1925 the Metropolitan sold another. In 1926 three additional policies were sold by Metropolitan. In 1927 the Metropolitan sold five more policies and at this time was joined by the Prudential which sold three. In 1928 the Prudential sold one, the John Hancock five. In 1929 the Prudential sold one, the John Hancock two. In 1930 the Prudential sold a policy and the following year, 1931, sold five more. In 1932 it sold still another policy and after a year had elapsed, in 1934 the Metropolitan sold one policy, the Prudential sold one policy, and the John Hancock sold two. In 1935 two more Prudential policies were placed, and finally in 1936 the John Hancock sold one and the Prudential two. The records indicated that in one instance the John Hancock sold four $250 industrial policies to Mr. Fortune at the same time.

There will be occasion to consider other aspects of maldistribution in subsequent sections.[124] Enough has been said already, however, to indicate the serious character of the problem, and it must be noted that there is no evidence that industrial companies have taken vigorous steps to prevent its continuance. Some companies have avoided selling policies to Negroes or have attempted to keep out of the "suitcase" and "red light" districts, but in the main the selection of risks and the type of insurance to be sold rests with the agent whose financial interest combined with the driving of his manager force him to secure policies at any cost.[125] No company seems to restrict its representatives as to the maximum percentage of family income which may be expended for insurance premiums. A few companies, among them the Metropolitan, have apparently recently attempted to keep some check over this question of family income in relation to policy premiums but the facts reviewed above do not indicate that the methods adopted have as yet met with any success.[126]

There is emphatic need for immediate improvement in this direction.

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[124] See pp. 289 to 303, infra.

[125] Pt. 12, R. 5753, 5949, 6001, 6035, 6117, 6128, 6129, 6150, 6157. Industrial companies will not write insurance on the lives of persons engaged in very dangerous occupations such as wild-animal trainers, motorcycle racers, divers, etc. Pt. 12, R. 5753.

[126] Pt. 12, R. 5865, 5869, 5870. For example, the Metropolitan has a corps of employees who examine applications on an individual case basis. It is more or less an unwritten rule at the home office that not more than 10 percent of a family's income may be utilized for insurance premiums. An applicant for insurance must indicate the amount he carries in all companies. The Metropolitan has inspectors who make test checks of the accuracy of the information contained on the application. It is interesting to note that these inspectors reported for the year 1936 that the biggest item under misstatements or omissions on

F. LAPSE

Maldistribution and overloading inevitably lead to lapse.[127] The previous discussion of lapse and other modes of policy terminations has made it clear that a lapse deprives a policyholder of all of his reserve and defeats the purpose for which the insurance was written.[128] It is only necessary herein to point out the extraordinary amount of industrial insurance which has terminated by lapse, for, from the bare statistics themselves, it will be apparent that the amount of lapse in industrial companies is so great as to give irrefutable evidence that most of the policies issued do not fulfill their essential purpose.

Company managements cannot justify their drive for new business unless it results in a steady increase in insurance in force which has some reasonable relation to the amount of new business written. If the drive is offset by an equally heavy lapse rate the insurance machinery has stalled. The selling procedure is then a "squirrel cage" operation through which the public is sold policies which lapse only to be sold again. The insurance service is not appreciably extended. The policies which terminate in death or mature as endowments number but few in comparison with those which lapse. This is the situation which unfortunately prevails in the case of industrial insurance, as may be readily seen from an examination of the experience of the industrial companies for the period from 1928 to 1937. In this period of time, the companies wrote and revised 193,714,338 policies or a number well in excess of the total population of the country. At the end of the period, however, the total gain of policies in force was only 6,635,400 policies. The tremendous difference between the number of policies written and the increase achieved results from heavy policy terminations, the vast majority of which have always occurred by lapse. It appeared that, in the given period, of the 187,760,806 industrial policies terminated, only 4.45 percent terminated by death while less than 1 percent terminated by maturity.

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applications was that referring to insurance already in force. (Id.) For the results of a special survey conducted by the Metropolitan of families paying a large percentage of their income for insurance, see pt. 12, R. 5872, 5873. On the basis of information submitted in the applications the Metropolitan believes its industrial families do not spend in excess of 3 percent on the average for premiums. Pt. 12, R. 5874, 5875, 5876. This should be compared with the average of 4.9 percent found in the Works Progress Administration survey of 2,132 Boston families.

The Prudential has handled the matter in a more general fashion. In its manual of instructions for agents, it states that it shall be one of the duties of the agents "to advocate the class of insurance most suitable to the applicant's position in family insurance program and not to press for a larger amount of insurance than the applicant is able to maintain" (pt. 12, R. 5746).

[127] This was recognized in a recent report by the legislative committee investigating insurance in New York State.

"The reason for the vast number of sales of policies to children is that an appeal is made by the agent to a mother to protect her child. It is not difficult to arouse the human emotions of a mother or father to 'protect' a child. A real protection to the child would be to have the father insured instead of the child.

* * * * * * *

"Many families have several industrial policies on the lives of the children, and no insurance upon the father. When the father dies, not only does the family lose his support but the industrial policies on the children are lapsed for nonpayment of premiums. This is another primary cause for the high lapse rate.

* * * * * * *

"Another major cause of the great number of lapses in the sale of industrial policies is the large number of relief recipients who purchase industrial policies. The committee has been informed by the State department of social welfare that about 60 percent of the families on public relief are paying for industrial insurance."—Legislative Document (1939) No. 101, State of New York, Report of the Joint Legislative Committee on Revision of Insurance Laws, pp. 23, 24, 25.

[128] See pp. 184 to 191, supra.

On the other hand, 20.47 percent terminated by surrender and 70.68 percent or 132,708,931 policies lapsed.[129] Thus only slightly more than 5 percent of the policies which go off the books of the industrial companies terminate in a manner which represents the accomplishment of the purpose for which the insurance must be deemed to have been taken out.

The experience of the larger companies, though somewhat better than that of the smaller companies, does not demonstrate a result much better than the average and both large and small companies reached the same unsatisfactory results during the prosperous years from 1924 to 1928 as they did in the subsequent years. Figures for the industrial business as a whole demonstrate the acute nature of the problem for during the period 1918–37 there were only 17,596,437 policies which terminated by death or maturity while 202,366,266 terminated by lapse.[130] The following schedule shows for a group of seven companies the percentage of their respective total terminations resulting from death and maturity of policies and the percentage resulting from lapse.[131]

Percentage of total terminations

DEATH AND MATURITY

	1924–28	1929–33	1934–38
Metropolitan	7.15	4.76	6.99
Prudential	5.99	4.36	6.34
Western & Southern	3.01	2.55	5.41
Life Insurance Co. of Virginia	4.85	3.35	3.72
Equitable (District of Columbia)	1.95	2.01	2.15
Washington National	1.22	.96	1.11
Peoples (District of Columbia)	1.23	1.18	1.48

LAPSES

	1924–28	1929–33	1934–38
Metropolitan	76.48	58.72	50.31
Prudential	76.26	64.18	[1] 22.50
Western & Southern	88.23	87.52	[1] 60.18
Life Insurance Co. of Virginia	83.13	78.96	79.65
Equitable (District of Columbia)	92.08	82.04	84.94
Washington National	98.40	95.77	96.80
Peoples (District of Columbia)	98.74	98.67	97.31

[1] The sharp decrease in lapse for the Prudential and Western & Southern, as shown by a comparison of the 1929–33 figures with those for 1934–38, is explained by changes in policy terms, which were designed to minimize loss due to lapse by means of providing an automatic nonforfeiture benefit in the form of extended term insurance after policies have been in force for 3 weeks in the case of whole life, and 2 weeks in the case of endowments. Thus, terminations by expiry for these 2 companies increased in the indicated period from 5.54 to 33.05 percent, and from 0.02 to 13.73 percent, respectively. This highly desirable realization of policy benefits was partially adopted at about this same time by the Metropolitan and John Hancock, which provided for a similar automatic benefit after 26 weeks. It must be realized that the reduction in lapse resulting from this change in procedure does not indicate that the problem of lapse has, to that extent, been eliminated. Actually, the policies terminating by expiry still are a manifestation of the sale of policies to persons who discontinue premium payments soon after sale.

[129] Pt. 10, exhibit No. 685. The experience for the period 1918 to 1927 is comparable; 85,057,157 policies terminated in that period, as compared with new policies issued, plus revivals amounting to 127,753,763. Of the policies terminating, 81.90 percent terminated by lapse, 7.39 percent by surrender, 1.49 percent by maturity, and 7.34 percent by death. Id.

[130] *Id.*

[131] Pt. 10, exhibit No. 686.

The above figures require no particular comment other than to point out the extraordinary lapse experience of the last two companies on the list. It will be observed that in the case of each of these companies terminations by death and maturity never equaled 2 percent of the total. Terminations by lapse were always in excess of 95 percent and reached the amazingly high figure of 98.74 percent in the case of the Peoples Life Insurance Co. of the District of Columbia.

There can be no doubt that, as the table indicates, the experience of the smaller companies is worse than that of the larger. An examination of 84 industrial companies disclosed that there were 14 which lapsed more policies during the year 1938 than they had in force at the end of the year and that an additional 29 companies lapsed an amount equal to 50 percent or more of the total policies in force at the year end. The 14 companies showing a percentage ratio of over 100 percent for the number of policies lapsed to the number of policies in force as of December 31, 1938, are listed below. These companies accounted in the year 1938 for 2,311,736 policies terminated by lapse.[132]

Company	Number of policies lapsed during year	Percentage ratio of number lapsed to number in force Dec. 31, 1938
Industrial Life & Health Co	1,407,606	149.6
Kentucky Central Life & Accident Insurance Co	186,751	104.9
Supreme Liberty Life Insurance Co	190,663	141.5
American Life & Accident Co. of Kentucky	119,395	103.8
National Burial Insurance Co	86,275	135.1
Lincoln Income Life Insurance Co	84,949	162.4
United Insurance Co	39,085	113.1
Guaranty Life Insurance Co	40,765	139.4
Star Life of America	27,518	121.3
Union Life Insurance (Arkansas)	26,514	118.1
State Capital	26,299	143.0
Cincinnati Mutual Life	44,658	267.2
American Life of Alabama	20,804	159.7
Santa Fe National Life Insurance Co	10,454	106.4

A brief comparison between the general termination experience of ordinary and industrial companies further illustrates the serious nature of the industrial lapse experience. The following table[133] reflects three modes of termination expressed as percentages of total amount of insurance terminated for the two classes of insurance for the periods indicated. It will be seen that the industrial lapse is almost twice as great as ordinary.

[132] Pt. 12, exhibit No. 950. In this connection it is interesting to note that there were 6 companies where the number of policies lapsed during 1938 was greater than the number issued. These companies had the following percentage ratio of number lapsed to new issues (id.):

Afro-American	112.4
Globe Life Insurance Co	361.6
Alta Life Insurance Co	235.2
Star Life of America	102.2
Cincinnati Mutual Life	101.8
Security Life Insurance Co	199.7

[133] Pt. 10, exhibit No. 683.

	1922–25		1926–29		1930–33		1934–37	
	Ordinary	Industrial	Ordinary	Industrial	Ordinary	Industrial	Ordinary	Industrial
Lapse	52.59	83.75	53.16	81.66	42.19	73.67	36.47	63.32
Maturity	2.86	.90	1.31	.36	.99	.26	1.69	.68
Death	7.94	5.14	8.29	4.7	6.66	3.11	9.88	4.01

That much industrial lapse is the result of overenergetic selling may be demonstrated by the early date at which most policies go off the books. A very large proportion of the total lapses in the industrial companies occurs during the first few months after the issuance of the policies. A special study of the experience of the Metropolitan during 1935, for example, showed that almost 16 percent of all the policies written during that year lapsed after the premiums had been paid for only 1 to 4 weeks. Approximately 30 percent lapsed after they had been in force for less than 26 weeks, and 35 percent lapsed during the first year after issue; 1,471,995 policies, or 42.67 percent of all those issued in 1935, lapsed before they had been in force for 3 years. During 1938 and 1939 slightly over 20 percent of the policies issued lapsed before premiums had been paid for 26 weeks, and the actuary of the company testified that this is the currently expected experience.[134]

The actuary of the Equitable Life Insurance Co. of Washington, D. C., a stock company, testified that about 12 percent of the policies issued by his company lapsed after only 1 week's premium had been paid. He stated that a considerable amount of this lapse represented cases in which the first premiums were paid by the agents themselves and, of course, the policyholder suffered no loss. However, in this company, 60.2 percent of the policies which terminated during the first 3 months of 1939 represented policies which had been in force for less than a year. Even if the 12 percent on which the agent may have paid the first premium were eliminated, still almost 50 percent of the remainder lapsed in the first year. Almost 80 percent of the terminations represented policies which lapsed before they had been in force for 3 years.[135]

The Western & Southern has also experienced a large amount of lapse after premiums have been paid for only 2 or 3 weeks. In 1931, more than 25 percent of the policies issued lapsed before the fifth premium had been paid. This percentage, although it has decreased in the following years, is still large. In 1938 about 13 percent lapsed before the fifth premium had been paid. In 1931, 55 percent lapsed after 26 weeks and in 1937, 30 percent. In 1931, 65 percent lapsed

[134] Pt. 12, R. 5970; exhibit No. 992.

[135] Pt. 10, R. 4313–4317; exhibit No. 688.

after after they had been in force under 1 year, and in 1937 almost 39 percent lapsed during the first year.[136]

Company representatives urge that industrial policyholders are of small means and cannot be expected to sustain even a limited savings program. They further point out that such policyholders are subject to a certain insecurity of income because of uneven employment and when they lose their jobs are consequently apt to lapse their policies.[137] Unquestionably these are factors to be considered. Of equal importance are high-pressure selling, excessive agency turn-over and the other agency conditions which have been considered above and which are subject to the control of the companies.[138]

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136 Pt. 12, exhibit No. 1022. For information on lapse experience of the Monumental Life, see pt. 12, exhibit No. 968.

As has been indicated, a lapse is one of the sources of profit accountable for the large stockholders' dividends paid in the case of stock companies. Because of the nature of life insurance accounts it is impossible to determine with accuracy for all companies the amount of profit attributable to this source. See p. 188, *supra*. The testimony of one company actuary was of value in this connection, however. The actuary of the Equitable Life (District of Columbia) testified that though the company had no definite information on the profits it received from lapses there was probably a profit on all lapses between the second and third year (pt. 10, R. 4315, 4316). In this connection it is also interesting to examine the testimony of actuaries of the Metropolitan and Prudential who describe their companies' practice of allowing nonforfeiture values after 26 weeks or 2 weeks, respectively. These actuaries indicated that the benefits were possible because the policies had paid for themselves, i. e., had commenced to build up a reserve in excess of the cost of acquisition (pt. 12, R. 5907, 5908, 5959).

137 Pt. 12, R. 6020, 6072, 6118. An officer of the Baltimore Life Insurance Co., Mr. Albert Burns, who had been in the business for 37 years, testified to this feature as follows (pt. 12, R. 6118):

"Mr. GESELL. You say that many people are out of work and they lapse, and if they do have a job they keep their payments up? I gather then that you think this lapse rate which your company shows, which is pretty well typical of other industrial companies, is attributable to a condition which has existed over many years in this country, not a product of the depression, necessarily?

"Mr. BURNS. I think that is correct.

"Mr. GESELL. You believe there is just that high a turn-over in jobs and ability of policyholders?

"Mr. BURNS. I wouldn't say that was the average for the country, considering all kinds of jobs, but we are considering now only industrial jobs having in mind steel mills, coal mines, textile factories, industries of that type."

138 In some cases, industrial policies are lapsed at the initiative of the companies. This seems to occur primarily with certain companies which write industrial policies carrying health benefit clauses. One such company, the Life & Casualty Insurance Co. of Nasvhille, Tenn., provides its agents and managers with a special form known as the "pink lapse sheet." This is a form on which the field force reports lapses which are induced by the company in order to avoid the accumulation of further sick claims. A special form is provided in order that the agent on whose debit the policy was in force is not charged with the lapse when his compensation is computed. An instance of how this procedure operates was disclosed in the record. The associate medical director of the company wrote its Washington, D. C., manager referring to the case of a policyholder who had "a long list of $5 claims." The letter stated (pt. 12, exhibit No. 1047): "The qucker you can get rid of this case the better it will be. Make special note of it and watch for an opportunity. . We are willing to leave the handling of this to your own good judgment."

The manager testified that a lapse resulted and that he had undoubtedly adopted his usual procedure which was to have the agent on the debit make a minimum number of calls and to permit the policy thus to fall in arrears (pt. 12, R. 6012–6015, 6021; exhibits Nos. 1047, 1048, 1049). A similar situation was shown to exist in the case of the Home Friendly Insurance Co. of Baltimore, Md., which gave its office manager instructions from time to time to "lift policies" (pt. 12, R. 6101, 6102). An agent of the Equitable Life Insurance Co. (District of Columbia) stated that he had been instructed by his home office not to collect premiums at the home of one family. He described a case when subsequently he and one of his assistant managers walked by the home of the policyholder in the following vivid terms (pt. 12, R. 6073): "* * * we went by the house one day when the woman was on the porch with the money and the book waiting for us and although she hollered to me I was told that I didn't hear anything, it was just the wind, and we kept on walking and the policy did lapse."

It should be mentioned in passing that one feature of the industrial policy makes this procedure possible; namely, the fact that the company is not bound under the terms of the policy to collect premiums at the homes of the insured. Once having established a regular procedure of collection with follow-up calls, it is obviously an easy matter for the routine to be changed and thus an unwary policyholder may be forced to lapse his policy (pt. 12, R. 5770. See also pt. 12, R. 6046, 6047.)

G. COST

Closely related to the problem of lapse is the high cost of industrial insurance. It is indeed an anomalous situation that this form of insurance, sold to low-income families, should be the most expensive form of life insurance available.

In selling industrial insurance emphasis is generally placed on the weekly premium to be paid instead of the amount of insurance provided by the policy. The following table shows the premiums for a group of representative companies at two of the most representative ages, for both whole-life and 20-year-endowment policies. Policies are not in all respects comparable, but the policy forms shown are those offered as substitutes for, or entirely comparable with, the whole-life form.

Amount of insurance which can be purchased for 5 cents weekly premium, 1939 rates [1]

	Whole life		20-year endowment	
	Age 1	Age 25	Age 1	Age 25
American National	$210	$102	$50	$44
Colonial Life	200	91	----------	(2)
Equitable (District of Columbia)	215	105	53	48
Franklin National	210	96	50	42
Home Beneficial	215	97	50	----------
John Hancock	200	96	----------	(2)
Life Insurance Co. of Virginia	215	105	53	48
Metropolitan	200	96	----------	(2)
Monumental	200	100	55	42
National Life & Accident	210	97	50	42
Peoples	215	105	50	42
Washington National	200	96	50	----------
Western & Southern	210	97	50	42

[1] Pt. 12, exhibits Nos. 1023, 1024, 1025, 1026. In some instances, these figures are subject to explanations or qualifications, which are indicated on the exhibits from which the table has been compiled. Whole-life policies, for example, may be paid up at different ages while in some cases premiums are payable until death (id.). Infantile policies call for the payments of smaller sums if death occurs during the first few years after issuance (pt. 12, exhibit No. 1030). The scales of graded benefits are not uniform in the various companies and only careful examination of each policy will enable the policyholder to know just what the benefits are in each year. The number of policies issued on the lives of children makes this lack of uniformity a significant factor contributing to the confusion of the policyholder; 11.69 percent of all the Metropolitan policies issued from 1934 to 1938 were on the lives of children who had not yet reached their first birthday, while about 28 percent of all the policies issued by the Metropolitan and the Prudential in that period were on lives of persons aged 10 or under. About 40 percent of all industrial policies written are issued on persons 15 years of age or under and almost one-third of these are issued at age 1 next birthday (pt. 12, exhibits Nos. 989, 1002).

[2] Not written in 1939. See p. 302, infra.

It may be seen from the foregoing that the amounts of industrial insurance which can be purchased from the indicated companies for a 5-cent weekly premium vary within narrow limits. If, however, the net costs for a given amount of insurance are considered, a much wider variation will be found. The accepted method of determining the net cost of a life insurance policy over a given period of time has already been described; the cash-surrender value available at the end of the period is deducted from the aggregate amount of premiums

paid during the period, less the dividends declared. The following table indicates the net cost of $250 of industrial insurance computed for a whole-life policy or nearest equivalent form according to this accepted method. Dividend rates for 1939 have been used in all cases, and the figures reflect net costs on surrender of policies at the end of the twentieth year. It will be seen that whole-life policies for $250 of industrial insurance differ as much as $36.22 on a 20-year net-cost basis.[139]

Company	Whole life	
	Issue at age 1	Issue at age 25
American National	$28.11	$72.89
Colonial Life	29.06	79.09
Equitable Life (District of Columbia)	31.18	68.56
Franklin National	------	------
Home Beneficial (Virginia)	43.77	88.38
John Hancock	16.99	48.13
Life Insurance Co. of Virginia	30.89	68.58
Metropolitan	18.93	52.16
Monumental	46.19	77.85
National Life & Accident	26.36	73.15
Peoples Life (District of Columbia)	42.15	74.55
Washington National	29.37	73.91
Western & Southern	32.59	78.77

The spread between the net cost of endowment and whole-life policies is even more striking. Endowment policies have higher premiums per dollar of insurance than whole-life policies. The amount of this difference is shown by the fact that a $250 policy issued by the Metropolitan at age 1 on the whole-life plan, paid up at age 75, costs $3.25 a year. A 20-year endowment policy based on the 1938 rates, issued for the same amount and at the same age, would cost $13 a year. The $9.75 difference principally represents the extra savings element in the endowment policy.

If an industrial policyholder applied for a whole-life policy and every year deposited in a savings bank the difference between the premium for an endowment policy and the premium for a life policy, at the end of 20 years his savings account would be practically as large as the amount of the endowment he would have received. In addition, he would still be insured at the original rate based on his age when the policy was issued. If he defaulted in premium payments during the first few years, he would not lose the money that he was paying in order to have a small fund at the end of 20 years. If at the end of 20 years he no longer wanted any insurance, he could surrender the policy and his cash would then be at least as much as the original endowment would have been. Thus a Metropolitan 20-year endowment policy issued in 1918 at age 2 would cost $13 per year for a $250 face value. A whole-life policy, paid up at 75, issued by the same company at the same age, would call for a premium of $3.04 for a $250 face value (these rates were not changed during the next 20 years). If the insured deposited in a savings bank every year for the next 20 years the difference between these premiums, with appropriate adjust-

[139] Pt. 12, exhibits Nos. 1023, 1024.

ments for dividends and with interest calculated at the rates then available, the fund at the end of 20 years would be $233.63. The cash value of the policy would be $42.16 making a total of $275.79. The endowment policy would have matured at the end of 20 years for $250. In 1938 the Metropolitan voluntarily paid a maturity dividend of $25, making a total of $275. If the holder of the endowment policy wished to continue to be insured, he would have to take out a new policy at age 22 for an annual premium of $6.13 for a $250 face amount, while the holder of the life policy could continue his policy by the payment of $2.28 per year, or less, depending on the dividend payments.

It will be noted that the rates of the Prudential have not been indicated in the foregoing analysis. This is because that company's policy forms were changed in 1937 to provide for level premiums for the first 5 years, with a 20 percent increase thereafter, and for that reason there is no experience available to make the necessary computations.[140] This change in procedure represents such a notable reform in company practice that it deserves special mention. The Prudential's scale calling for a 20 percent increase after the fifth year was established in 1937. It is expected that dividends will be sufficient to offset the stipulated increase. As a result, the policyholder will have had the benefit of approximately 12 to 15 percent more insurance per dollar of premium before dividends are usually payable. The value of this procedure is clear when one considers the volume of industrial policies which terminate during these early years. The officers of the company realized that the sharp increase in the amount of insurance which occurred in the later years by the customary application of dividend additions was not as desirable for the average policyholder as larger coverage in the beginning and a more uniform face amount throughout the life of the policy.[141]

Another result of this system is the establishment of lower reserves during the first 5 years. Hence the cash surrender values are lower, and the terms of extended insurance under the automatic nonforfeiture benefit are shorter. However, at the end of the tenth and twentieth years these values in the Prudential are substantially the same as in the Metropolitan.[142] It is also significant that a policyholder who defaults in premiums during the first 5 years will have paid less in the Prudential than in the other companies for at least the same amount of insurance, and, with its more liberal nonforfeiture benefits, the Prudential policyholder will have had considerably more for his money.

As has already been indicated, industrial insurance whether written on the endowment or whole-life plan costs more per dollar of protection than ordinary life insurance. Any comparison of the cost of industrial and ordinary insurance is of course subject to some qualification since these forms of insurance are in many respects different both in the manner in which they are sold and the type of mortality experience which may be reasonably anticipated. The following tables show the comparative net costs of industrial policies in leading companies compared with the net cost of the most comparable ordinary policies issued by these companies. In order to make the schedule comparable, figures for both ordinary and industrial insurance are based on $1,000

[140] Pt. 12, R. 5976

[141] Pt. 12, R. 5906, 5909, 5910.

[142] Pt. 12, exhibit No. 1031.

of insurance. Striking differences between the net costs of ordinary and industrial insurance are clearly evident.

Net cost of ordinary and industrial insurance, 1939 dividend scale [1]

[Age 25—whole life—$1,000 of insurance]

	10-year net cost				20-year net cost			
	Policy continued		Policy surrendered		Policy continued		Policy surrendered	
	Industrial	Ordinary	Industrial	Ordinary	Industrial	Ordinary	Industrial	Ordinary
Metropolitan	$243.72	$152.39	$156.96	$63.39	$454.60	$284.14	$208.64	$39.28
John Hancock	241.12	161.62	157.56	61.62	438.48	308.47	192.52	75.47
Western & Southern [2]	268.00	158.00	184.48	91.00	536.00	316.00	315.08	101.00
American National [2]	254.80	154.80	175.76	82.80	509.60	309.60	291.56	103.60
Life Insurance Co. of Virginia [2]	247.60	155.10	164.08	90.10	495.20	310.20	274.32	97.00
Monumental [2]	260.00	161.30	182.08	81.35	520.00	322.60	311.40	115.61
National Life & Accident [2]	268.00	[3] 89.20	182.12	[3] 61.80	536.00	[3] 302.00	292.60	[3] 89.20

[1] Pt. 12, exhibit No. 1023; pt. 10A, R. 285.

[2] Nonparticipating.

[3] Rate for $2,500 minimum.

Net cost of ordinary and industrial insurance, 1939 dividend scale [1]

[Age 25—20-year endowment—$1,000 of insurance]

	10-year net cost				20-year net cost			
	Policy continued		Policy surrendered		Policy continued		Policy surrendered	
	Industrial	Ordinary	Industrial	Ordinary	Industrial	Ordinary	Industrial	Ordinary
Metropolitan	$557.28	$416.73	$189.64	$33.73	$1,039.60	$772.56	−$60.40	[2] −$277.44
John Hancock	551.36	422.43	183.72	14.43	1,002.68	798.70	2.68	−201.30
Western & Southern [3]	619.20	427.60	251.56	49.60	1,238.40	855.20	133.40	−144.80
American National [3]	590.80	422.70	232.84	46.70	1,181.60	845.40	180.60	−154.60
Life Insurance Co. of Virginia [3]	541.60	430.70	174.00	58.70	1,083.20	861.40	83.20	−138.60
Monumental [3]	619.20	421.90	248.00	38.28	1,238.40	843.80	238.40	−156.20
National Life & Accident [3]	619.20	418.00	251.56	22.00	1,238.40	836.00	238.40	−164.00

[1] Pt. 12, exhibit No. 1025; pt. 10A, R. 296. The Metropolitan and John Hancock did not issue endowments in 1939, and the figures herein set forth are based upon rates given in the latest rate books of these companies which included endowment policies. Further light on the difference in cost between ordinary and industrial insurance may be gained from an analysis comparing the cost of insurance benefits on the industrial plan with the cost of corresponding benefits on the ordinary plan which was prepared by the actuary of the Prudential. This analysis, which was based on the recent mortality and expense experience of that company, demonstrated that the cost of ordinary insurance was from 13 to 20 percent less than industrial (pt. 12, exhibit No. 1004). Interest earned on the reserves in excess of the mortality and administration expenses, and returned at the end of the endowment period along with the contributions to the reserve, accounts for the minus figures in the table (pt. 12, R. 5979). Additional insight into the comparative net cost of industrial and ordinary policies may be obtained from an examination of special net cost studies prepared by an actuary of the Commission (pt. 10, exhibit Nos. 1034 and 1035). These studies were prepared on a basis which took into account certain fundamental differences between ordinary and industrial insurance such as dividend procedure and mortality experience. For a discussion of the adjustments made and the method used in preparing these studies see pt. 12, R. 5987.

[2] Includes "maturity" dividend of $50 payable in addition to guaranteed maturity value of policy, when policy matures at end of twentieth year.

[3] Nonparticipating.

Two of the principal factors responsible for the higher cost of industrial insurance are the rate of mortality experienced at all ages among industrial policyholders and the greater agency expenses incurred in the distribution of this form of insurance.[143] Other factors contributing to high cost are agency turn-over, pressure for new business, large profits in stock companies, and incidental expenses such as nursing services and health programs.

Reasons for the higher mortality of industrial policyholders are readily apparent. Not only is this form of insurance sold to people whose general living and housing conditions are inferior, but it is also a characteristic of industrial insurance that it is usually sold without medical examination. Practically the only check upon the company's taking an undesirable risk is the agent's appraisal of the health condition of the policyholder and there are great possibilities for error or abuse in this connection. In the Metropolitan, only about 15 percent of the applicants for industrial insurance are medically examined, while in the Prudential medical examination is required only if the applicant is over 45 or 50 years of age, depending on the size of the policy being written.[144]

More important as a factor contributing to the high cost of industrial insurance is the agency system through which this form of insurance is distributed. It is obvious that the maintenance of the complex field organization required to make weekly or monthly calls at the homes of the policyholders and to maintain the complicated records necessary to keep track of innumerable policies purchased by small installments would be greater than that encountered in the conduct of the ordinary department of the business.

Some indication of the great expense required to maintain a field force for an industrial company may be obtained by comparing premium receipts with field expenses. The following shows for three of the larger companies the percentage of such receipts used to cover field expenses: Metropolitan, 18.1 percent (1934–38); Prudential, 20.2 percent (1938); Western & Southern, 20.6 percent (1938)[145]

An analysis of the Prudential's total industrial income disclosed that during 1938, 16.12 percent of this income was spent for field expenses; 3.52 percent of the receipts were used for home-office and general expense, making a total, when added to field expense, of 19.64 percent. This is to be compared with the figure of 61.48 percent, representing the percentage of total industrial receipts paid out to policyholders for claims, matured endowments, dividends, and surrender values. In other words, an amount almost equal to one-third of the total disbursed to policyholders had to be spent for field and home-office expenses. Specific break-downs of premiums paid on the same amount of insurance for the industrial or ordinary plans showed that for three typical policies, whole life paid up at age 70, 20-payment life, and 20-year endowment, at five representative age levels, a far greater amount was required to meet commission expenses in the industrial department than was required for the same purpose for an equal amount of ordinary insurance. The expenses for commissions to field representatives were shown to be almost three times as great

[143] Giving the reasons for the higher cost, Mr. Leroy A. Lincoln testified (pt. 12, R. 5860):

"Because of a higher mortality of the lower income groups usually insured under industrial policies, and because of the nature of the payment or collection of the premiums, the premiums are collected by the agents at the homes of the insured on a weekly basis."

[144] Pt. 12, R. 5753, 5754, 5763, 5861. See also pt. 12, R. 5903.

[145] Pt. 12, exhibit Nos. 991, 1003, 1021.

in the industrial department under each of the above plans and at each representative age.[146]

One method of demonstrating the manner in which the field organization expenses contribute to the ultimate cost of industrial insurance is to compare the relative cost of weekly and monthly industrial insurance sold by the same company. As might be expected, weekly premium insurance is more expensive than monthly premium insurance whether sold on the straight industrial or monthly debit ordinary basis. This, of course, is due primarily to the lower cost of making 12 instead of 52 calls for the collection of premiums on a given policy during a year that it is in force. Furthermore, the agent of the Metropolitan, Prudential, or John Hancock who collects premiums on a monthly policy receives a commission of only 4½ percent while he is paid from 12 to 15 percent for collecting premiums on weekly policies.[147]

Another factor contributing to the amount of money necessary to maintain the industrial field force has already been indicated and need be but reiterated here. The high rate of agency turn-over and the consequent expenses entailed in the continual training of new agents add greatly to the agency expense and are reflected in the cost of insurance which the industrial policyholder purchases.[148]

Still another element of expense which increases the premium of the industrial policyholder who purchases insurance from either the Metropolitan or the John Hancock is represented by the health and welfare programs upon which these companies are engaged at the present time. The holder of a policy in these companies may make use of a visiting nurse service in case of illness, provided, of course, that such nursing service is available in his particular locality. The John Hancock policyholder, however, may use the service only if he has paid premiums for a full year.[149]

The two companies are in a position to make this benefit available either by organizing their own nursing service or by contracts which they have entered into with the Instructive Visiting Nurse Service.

In the Metropolitan, which has been engaged in this program since 1909, a total of $98,603,807 has been expended for nursing service, general welfare work, and contributions to the Life Extension Institute. Of this sum a total of $83,873,743 has been assessed against the industrial department whose policyholders have, of course, received the greatest benefits. Due to the increase in health and welfare activities in recent years the annual cost per weekly premium policy in the Metropolitan for this service has increased from 5 cents to approximately 16 cents.[150]

It should be noted that there are no policy provisions which give the policyholder a contractual right to the ministrations of a visiting nurse in case of illness. It is also true that all policyholders are assessed for this expense regardless of whether or not they reside in a locality which makes the service available.[151]

The health and welfare activities of the Metropolitan and John Hancock are not traditional to the life insurance business, and indeed, in view of Government-sponsored programs looking in the same direc-

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[146] Pt. 12, exhibit No. 1004.

[147] Pt. 12, exhibits Nos. 976, 994, 1085.

[148] See pp. 268 to 271, supra.

[149] Pt. 12, R. 5838, 5839, 5840, 6130, 6131. See also exhibits Nos. 985, 986.

[150] Pt. 12, R. 5841, 5842, exhibits Nos. 985, 986.

[151] Pt. 12, R. 5840, 5841.

tion, the exact effect of these activities cannot be measured accurately. The Metropolitan urges that its health and welfare service has led to a reduction in the mortality rate and that with this reduction there has been an increased longevity on the part of its policyholders which has reflected itself in lower-cost insurance. It is, however, problematical whether this reduction has effected a savings equivalent to the increased cost resulting from expenses incurred in administering the service itself.[152]

H. CONFUSION OF THE INDUSTRIAL POLICYHOLDER

Unfortunately the industrial policyholder does not always receive understanding assistance in the formulation of his insurance program. Indeed, lapse and the maldistribution or overloading of policies would be less prevalent if the policyholder were fully informed and in a position to compare the relative cost of policies offered by different companies or to appraise the differences which exist in policy provisions and various policy plans offered by the industrial companies. As the situation now exists the industrial policyholder either lacks sufficient knowledge of the subject, or is confused and uncertain not only as to what he should buy but as to the terms and benefits contained in the policies which he owns. He has no guide to assist him in these matters except his agent whose importunings and advice may all too often be prompted by a personal interest in the outcome of the transactions. Considering the general characteristics of the group which purchases industrial insurance, there appears to be great need for simplification and a more uniform presentation of industrial insurance.

Of all the factors which lead to the confusion of policyholders, the question of cost is the most important. Unless the purchaser of an industrial policy is in a position to know the relative cost of different types of policies and to compare the cost of similar policies offered by different companies, he cannot be expected to buy intelligently. As has been indicated, industrial insurance costs vary widely. Complex differences in benefits and dividend procedure tend to obfuscate the matter still further, with the result that the purchaser of an industrial policy cannot determine in advance in which direction his advantage lies. It must not be overlooked in this connection that there are at least as many as 10 industrial life insurance companies operating in at least one-half the States and that in as many as 8 States there are 20 or more such companies doing business.[153] Thus a wide choice is available to most prospective purchasers of industrial insurance, and careful selection might be made by such purchasers if adequate information were available and company practices more uniform.

Illustrative of the difficulties confronting the prospective purchaser of an industrial policy is the great variation among the industrial companies in dividend procedure which so significantly affects net cost. Take, for example, the manner and time for payment of dividends. The Metropolitan and John Hancock pay annual dividends on weekly premium policies in the form of premium credits. All policies issued in a given year receive a certain number of weekly weeks' premium free without distinction as to age at issue or plan of

[152] For a detailed history of Metropolitan's health and welfare activities see pt. 12, exhibit No. 985.
[153] Pt. 12, exhibit No. 947.

insurance. The Metropolitan's scale in 1939 ranged from 5 weeks' premium credits on issues of 1935 to 26 weeks' on policies issued before 1900. The John Hancock allowed 9 weeks' free premiums on issues of 1934 and increased the amount of its dividends to 26 free premiums on all policies issued before 1909. In sharp contrast with the method pursued by the Metropolitan and the John Hancock is the practice of the Prudential, which distributes its annual dividends in the form of paid-up additions to the face amount of the policies.[154]

It also should be noted that the Metropolitan and certain smaller companies have adopted a practice different from the Prudential and John Hancock with respect to paying mortuary and maturity dividends. These dividends are in addition to the regular dividends considered above and amount to a percentage of the face amounts of policies which mature or terminate by death. The mortuary and maturity dividends are, in effect, a reward for persistency, since they are not paid to the numerous policyholders who voluntarily withdraw. The dividends are not uniform from year to year, and it is not only impossible for the policyholder to determine in advance what the amount of his mortuary or maturity dividend is to be but even to learn that the dividend is available, since its existence is not indicated in any way on the face of the policy. For this reason any effort to compare in advance the cost of the Metropolitan's policies, for example, with those of the Prudential and John Hancock runs into immediate obstacles.[155]

Another indication of the substantial differences which exist between industrial policies offered by the leading companies may be obtained from an examination of the differences in cash values and extended term or paid-up insurance benefits which are available in these companies for a similar amount of insurance taken out under the same plan. At age 25, for example, the amount of cash value available on a $250 whole-life policy at the end of the fifth year on the basis of issues of 1939 in this representative group of companies ranges from $5.76 in the case of the American National to $10.47 in the case of the Metropolitan. Extended-term insurance benefits at the end of the fifth year in the case of policies where such option is available ranges from 2 years and 21 days in the case of the American National to 4 years and 230 days in the case of the Monumental Life. Similarly, paid-up insurance benefits range from nothing to $28.35 in the case of the National Life & Accident. Comparable discrepancies were found to exist as at the end of the fifth, tenth, and twentieth year.[156] Thus, to recapitulate, the policyholder anxious to determine which company offers the cheapest protection must not only thoroughly acquaint himself with the complex differences in dividend formulas, but he must also be capable of making the complicated mathematical computations which are necessary in order to allow for differences in surrender charges, cash values, and so forth.

Furthermore, a policyholder equipped with the knowledge and inclination to pursue this complicated procedure would still not be in a position to obtain access to the basic material necessary for such an undertaking. Only one conclusion, therefore, seems possible,

[154] Letter of Mr. Leroy A. Lincoln to Metropolitan field force dated December 30, 1938, in re dividends on weekly premium policies for the year 1939; Prudential booklet entitled "Weekly Premium Industrial Policies Amounts Payable as Regular Death Claims When Death Occurs April 1, 1939, to December 30, 1939, Inclusive"; and special information submitted by John Hancock in response to Commission's request.

[155] Id.

[156] Pt. 12, R. 5983–5985; exhibit No. 1031.

namely, that the policyholder cannot know the relative cost of his policy in advance and the difficulties in this connection are so great that companies must be held responsible for having created such insurmountable barriers.

Policy terms are as obscure as net cost. Though it is true that in recent years the three largest companies have greatly reduced the number of policy forms offered, which was in part due to the restrictions on the sale of endowment insurance, the great bulk of the companies still continue to offer the policyholder a wide range of choice. The following plans were found in the industrial portfolios of various companies throughout the country.

Whole life.
Whole life paid up on the anniversary of the policy after ages 75, 74, 70, and 69.
Thirty-payment life.
Twenty-one-payment life.
Twenty-payment life.
Fifteen-payment life.
Fourteen-payment life.
Ten-payment life.
Endowment at ages 80, 75, 70, 65, 60, 50, and 21.
Forty-year endowment.
Thirty-year endowment.
Twenty-five-year endowment.
Twenty-year endowment.
Fifteen-year endowment.
Ten-year endowment.
Twenty-payment 30-year endowment.
Ten-payment 30-year endowment.
Nineteen-year endowment.
Thirteen-and-one-half-payment endowment at 75.
Term, to age 75.[157]

It is indeed a rare industrial policyholder who has sufficient knowledge of the science of life insurance to enable him to select from all this hodgepodge the plan best suited to his purpose.

Added confusion results from substantial differences in policy terms which, as will be indicated, are of far greater importance than the variations in policy plans mentioned above. In considering this question of policy terms it must be recognized that State laws are of little protection to the industrial policyholder. Few States have extensive statutory regulations affecting industrial policy provisions; and in fact, as many as 35 States have no laws requiring standard provisions for industrial policies.[158] In order to demonstrate the wide

[157] Pt. 12, R. 5769.

[158] Pt. 12, R. 5779. In 6 States the law requires that the superintendent or commissioner examine the policies to see whether or not they conform to law, and in some instances States assume authority in this regard in spite of the fact that the statute is not clear. In the State of Maryland, such approval is required. In spite of this fact, however, a policy issued by the Star Life Insurance Co. of Baltimore, Md., during 1938 was found to contain no incontestable clause, no provision for automatic nonforfeiture benefits, no provision for a cash value, no table of nonforfeiture benefits, and no statement of the premium-paying period. It appears to be a "whole life" policy, and calls for a weekly premium. It contains a special accidental-death benefit of double the amount insured, but the death must result from accident within 24 hours of injury in order to warrant the additional payment. Only one-half of the stipulated sum payable for natural death will be paid in case death is caused by tuberculosis, heart disease, pneumonia, cerebral hemorrhage, paralysis, or other chronic disease which had its beginning within 24 months from the date of the policy. State laws regulating industrial insurance are lax in many respects and far less stringent than laws governing ordinary insurance (pt.12, R. 5777–5779).

disparity in policy terms which exists the Commission has made a special study of over 1,000 policies selected from the issues of 60 representative companies.[159] This study disclosed that there is no standard form of industrial policy in use, that the clauses appearing in the policies are worded so diversely by the different companies that it is frequently very difficult to understand their exact import, and that substantial differences may be found in policies which appear at first glance to contain identical provisions.

Some of the more substantial differences in policy terms revealed by the Commission's study may be briefly mentioned. One of the most important provisions of a life insurance policy is that provision which establishes the nonforfeiture benefits. These are benefits designed to give the policyholder alternative ways of securing some benefit from the reserve which has accumulated on the policy, in case he does not continue to pay premiums and has kept his policy in force for a stipulated period of time. Typical industrial policies have 3 principal nonforfeiture benefits: Extended-term insurance, paid-up insurance for a reduced amount, and a cash-surrender value.[160] Policies issued by 3 companies having over 400,000 industrial policies in force were found to make no provisions for nonforfeiture of the reserve, and 7 companies were found issuing policies in which there was no automatic nonforfeiture benefit.[161] In those latter cases the policyholder could only obtain the benefit of his reserve by demanding it within 13 weeks from the date of the last premium payment. These 7 companies issuing this type of policy were authorized to do business in 13 States and were shown to have an aggregate of over 700,000 policies in force.[162] In most companies other than the 4 largest, nonforfeiture benefits are available after premiums have been paid for 3 years, but 9 companies were found to issue policies which had no nonforfeiture benefits until premiums had been paid for 5 years. Frequent cases were also disclosed where the policy failed to state the amounts of the nonforfeiture benefits available.[163]

The practice with respect to automatic nonforfeiture benefits available in the case of the four largest companies also varies. The Prudential and Western & Southern allow automatic extended term insurance if the policyholder defaults at any time after premiums have been paid for 3 weeks; and in the case of endowment policies, 2 weeks. The Metropolitan and John Hancock also have extended-term insurance as the automatic nonforfeiture benefit in their industrial policies, but in the case of these companies it is not until the policy has been in force 26 weeks that the benefit becomes available. Many other companies, on the other hand, used paid-up insurance for a reduced amount as the automatic nonforfeiture benefit; and in fact, this form of automatic benefit, though of little value, was used by the Metro-

[159] Pt. 12, R. 5768–5777.

[160] Pt. 12, R. 5772.

[161] Pt. 12, R. 5771.

[162] Id. See testimony of Mr. Alexander M. Schwartz, Public Assistance Division, Department of Public Welfare, Washington, D. C., for an account of the hardship caused by the absence of automatic nonforfeiture benefits (pt. 12, R. 5795).

[163] Pt. 12, R. 5772.

politan for over 30 years prior to its recent change to the extended term arrangement.[164]

Another of the more important terms is the "facility-of-payment" clause. A typical clause of this type reads as follows:

> The company may make any payment or allow any benefit provided for in this policy to any relative by blood or connection by marriage of the insured appearing to the company to be equitably entitled thereto.[165]

Some companies have used a facility of payment clause similar to the above permitting the payment to be made to "any person appearing to the company to be equitably entitled thereto." Many of these clauses, as in the form quoted above, permit the companies to use the "facility of payment" procedure even in paying cash-surrender values.[166] This may be advantageous in some cases where the insured is a minor, but such a privilege does not further the principal purpose of the clause, which is to expedite the payment of claims despite policyholders' careless omissions to change beneficiaries when circumstances warrant it.[167] The Metropolitan, Prudential, John Hancock, and many other companies now use a facility of payment clause which permits the naming of a beneficiary, but if no claim is made within 30 or 60 days, the company may select the person to whom the proceeds are to be paid from among the insured's relatives. Most companies require that the beneficiary must file a claim within a certain period of time after the death of the insured. However, 8 companies with a total of over 3,000,000 policies in force issue policies under which the proceeds will be paid to the beneficiary without restriction if he is living at the death of the insured. The time within which beneficiaries must make claim varies. Four companies state that claim must be made within 15 days, 17 permit 30 days, and 4 companies grant a period of 60 days.[168]

The Commission found frequent evidence of an attempt by smaller companies to mimic the wording of policies offered by larger companies, but all too frequently a vital word was omitted and the safeguards in the original were found missing from the copy. This situation is notably true in the case of the important provisions relating to

[164] Id. In 1938 the average paid-up policy in the Metropolitan amounted to $46.36 (pt. 12, R. 5954). The substitution of a table which reflects the present improved mortality experience among industrial policyholders in place of the Standard Industrial Mortality Table, or any other table, would have more effect on the period of extended insurance or the amount of paid-up insurance than on any other feature of the business. The use of such a table would probably increase the term of extended insurance at all ages and on all plans. Since this is the automatic nonforfeiture benefit granted by most of the companies, it would result in a substantial decrease in the cost of the policies. Since policies in force on nonforfeiture benefits are now contractually nonparticipating, mortality savings do not accrue to the holders of these policies. The report of the committee of the National Association of Insurance Commissioners appointed to study the need for a new mortality table and related topics (June 21, 1939) indicates at pp. 51 and 91 that the mortality experience under the extended-insurance option may be expected to be greater than the experience reflected in the new table (pt. 12, R. 5911, 5968).

A change to a modern table would not necessarily increase or decrease the aggregate reserves held by the companies. Cash-surrender values would vary upward and downward, depending on the age at issue. However, the increase in the term of extended insurance alone would justify the use of a new table.

[165] Pt. 12, R. 5773.

[166] Even the Metropolitan and the Prudential used a form of "facility of payment" clause which applied to nonforfeiture benefits as well as death payments as recently as 1935.

[167] 3 companies were found to follow the custom of ordinary companies and to have no facility of payment clause. One of these companies, the National Life & Accident Insurance Co. of Tennessee, had over 2,800,000 industrial policies in force (pt. 12, R. 5773).

[168] Pt. 12, R. 5773.

accidental death benefit. Many of the smaller companies have followed the lead of the larger companies in granting these benefits, but there is a wide variety in the benefits allowed; many of the provisions are drafted so as to have the appearance of the liberality of the larger companies without the substance.[169]

Most companies write policies containing an incontestability clause which makes the policy incontestable after it has been in force for a given length of time. Though such clauses are now universally accepted as good practice, 4 companies issue policies which do not contain such clauses. Furthermore, though policies of most companies provide that the incontestability clause shall be operative after 2 years, policies of 10 companies provide that it shall be operative within a shorter period, and 3 companies were found to be writing policies incontestable from date of issue.[170]

Most companies issue a policy containing a "grace period" which permits the policy to remain in force for a short period after premiums are in default. This provision is designed to prevent hardship due to default, and benefits policyholders who have neglected to pay premiums through oversight or temporary financial embarrassment. In the case of six companies, however, this grace period was found to be nonoperative unless an actual death claim arose in the period, thus making the provision delusive, as far as its essential purpose is concerned.[171]

Another important question involving policy terms is the matter of revival. Most companies permit the policy to be revived within 1 or 2 years after the last premium payment if the cash-surrender value has not been paid. One company, however, gives only 6 months for revival, another permits a period of 3 years to elapse, and nine companies were found to allow revival at any time after default in premium payment.[172]

Lack of uniformity of one other feature of the industrial life insurance policy leads to confusion. Customarily such policies state that the provisions set forth therein constitute the entire contract between the company and the insured. Industrial policies generally do not have the original application attached but merely contain a written representation by the insured that he was in sound health on the date of issue. There are only 4 companies, including the Prudential, which attach applications to any of their industrial policies. Eleven other companies, however, were found which issue policies stating that the policy and the application together constitute the entire contract. This is stated in spite of the fact that in the case of these 11 companies the application is not attached. The seriousness of this situation is, of course, increased when it is recognized that policyholders rarely fill out the applications themselves and may in more cases than not simply have signed an application prepared by an agent which con-

[169] Pt. 12, R. 5776, 5777. The Metropolitan, Prudential, and John Hancock pay double the face amount of the policy in case death occurs "through external, violent, and accidental means." There are certain exceptions which limit the liability under these clauses, such as accidents occurring in mines or on railway tracks, and the injury must have been sustained at some time between the ages of 15 and 70. The companies also have a limited disability allowance providing that the face amount of the policy, or one-half the face amount, will be paid in the event of the loss of hands, feet, or eyesight. In any such case, the policy will be continued in force as a paid-up policy for the full face amount.

[170] Pt. 12, R. 5771.

[171] Id.

[172] Pt. 12, R. 5774.

tains incomplete or inaccurate statements. These misstatements might, in turn, easily become the grounds for a contest on a policy which went to claim prior to the expiration of the contestable period.[173]

On the basis of the foregoing it is clear that the companies do not compete on matters of rates or policy terms. Policyholders are necessarily so confused under the situation which exists that a discriminating purchase is impossible and company representatives are free to rely entirely on the persuasiveness of their selling presentation without regard for the relative merits of the product they have to sell.

I. ADVISORY SERVICES FOR INDUSTRIAL POLICYHOLDERS

Selling methods, maldistribution and overloading, lapse, high cost and the lack of uniformity in policy provisions have led many policyholders to seek advice from persons other than their life insurance agents. Why it is impossible for such policyholders to obtain the advice they desire from their own agents, it is not difficult to see. Much of the explanation probably lies in the fact that the agent is an interested party, interested in keeping insurance in force and in fact selling new insurance while the policyholder may desire to adjust his insurance or even abandon policies in order to make some change which he feels better suits his economic circumstances. Naturally, the situation is complicated manyfold when, as frequently happens, an industrial family finds that it holds industrial policies of several different companies and in addition carries some other form of insurance as well. Here it would be unrealistic to presume that each agent approached would not counsel keeping insurance in his company and urge the policyholder to discontinue or adjust insurance which he might hold in some other company. Thus the policyholder is on the horns of a dilemma and is obliged to seek outside advice.

There have been several different types of ventures established for the purpose of giving policyholders this advice. The first was undertaken by the principal industrial companies themselves when the Metropolitan, Prudential, and John Hancock organized in 1931 the Life Insurance Adjustment Bureau in response to a general demand among the administrators of governmental relief and private charities who were concerned with the maldistribution of industrial policies among families receiving relief benefits. The Life Insurance Adjustment Bureau was authorized to act on behalf of these three companies to adjust the amounts and types of insurance carried by clients of welfare agencies throughout the country. Every case handled by the bureau involves persons who have made application for relief or who are receiving relief at the time. To date, 1,715 public agencies and 490 private agencies have made use of the bureau's services and in the period from 1932 through 1938 it handled adjustments for 594,839 families. Eighty-five to ninety percent of the policies held by these families were industrial policies and the bureau reported that in addition to making changes from one kind of insurance to another it was able to recover $25,885,000 in cash for the families who sought its services.[174]

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[173] Pt. 12, R. 5774, 5775. At the other extreme are 7 companies which issue policies that contain reference neither to the application nor to the fact that the policy contains the entire contract with the insured. In the case of these policies, in the absence of State statutes on the subject, the company might even refer to its bylaws in contesting claims. Id.

[174] Pt. 12, R. 5783, 5784, 5792, exhibit Nos. 977, 978.

Mr. Edwin Eklund, the manager of the Life Insurance Adjustment Bureau, pointed out that this kind of service could not be done very well by an individual company because so many of the clients held policies in several different companies. He testified:[175]

Mr. GESELL. I don't quite understand why your bureau functions in this manner. Why wasn't this a situation which resolved itself as between the policyholder and his company?

Mr. EKLUND. That goes back to the origin of the bureau again. I neglected to mention the fact that a great many people have insurance in two or all three of these companies, and of course to make an adjustment which would be fair and cover all the policies would take some sort of organization as ours that was equipped to function for all three companies to make the adjustment.

Mr. GESELL. You mean it was the thought of the companies themselves that in a family which needed such an adjustment where there were policies sold by several different companies, no single company was in a position to work out the type of arrangement which might be necessary?

Mr. EKLUND. Correct.

In making adjustments, the bureau first attempts to obtain whatever surrender values are available on policies which appear to have lapsed. Over 27 percent of the families coming to the bureau had lapsed policies and the bureau reports that they found cases where cash value was available on policies apparently considered worthless.[176] With respect to policies still in force and on a premium paying basis, adjustments are made to reduce the premiums to a minimum. In line with this practice all endowment policies are surrendered or changed to whole life, an attempt being made to leave sufficient insurance protection on the various members of the family to provide a burial fund. The bureau finds cases of maldistribution where the breadwinner or wage earner is not sufficiently covered and the children and wife are at least relatively overinsured. It takes the position that its efforts should be confined to rearrangement of existing policies.[177]

The Life Insurance Adjustment Bureau, as has been indicated, has confined its activities to relief clients. Except for advice which persons not on relief might obtain from their insurance agents there appear to have been few, if any, organizations created until recent years to which a policyholder might go for independent advice. Recently there have become active in many metropolitan areas of the country

[175] Pt. 12, R. 5788, 5799.

[176] Pt. 12, R. 5786, 5790, 5791. See also pt. 12, R. 5795.

[177] Pt. 12, R. 5785, 5786. An example of an adjustment made by the Life Insurance Adjustment Bureau may be found in the following summary of Bureau Case No. 617,633. This was a case of a white family of 4 members which reported no income except from relief sources. At the time the family came to the bureau it held 11 different industrial policies which had been sold to it at various times between June 1931 and May 1938. There were three policies in force on the father of the family, 1 whole life for $711 and two 20-payment life for $62 and $500, respectively. On these the father paid 90 cents a week. There were 4 policies on the mother; two 20-year endowment policies for $82 and $205, respectively, one 15-year endowment and one 20-payment life. These policies required a total weekly premium of 80 cents. The 2 children, both boys, carried 2 policies apiece, 1 a 20-year endowment and a 15-year endowment for a total face value of $390 which required 45 cents a week and the other a 15-year endowment and 20-year endowment with a total face value of $295 which required 35 cents a week. Thus the family was paying $2.50 a week for its 11 industrial policies, all of which were in the Metropolitan. Following the adjustment the family was paying 70 cents a week and receiving protection in the total amount of $1,434 as against protection which previously amounted to $2,670. In addition they had received as a result of the adjustments $172 in cash. In the main the adjustments which brought about this result involved changing endowment policies and 20-payment life policies to the whole life plan (pt. 12, R. 5787, 5788).

individuals, usually former life insurance agents, who, for a fee, have advertised their willingness to assist policyholders in adjusting their insurance programs. One of these individuals, who call themselves insurance counselors, is Mr. Morris H. Siegel, of New York City. Mr. Siegel, a former agent of the Metropolitan, has established a somewhat unique organization for handling policyholders' adjustments. The history of this organization which is known as the Policyholders Advisory Council, illustrates that industrial policyholders have a genuine need for impartial advice on their insurance problems.[178] In 1935 Mr. Siegel began a series of short radio talks on the subject of life insurance using sustaining time once a week on Station WBNX, a station in the Bronx. His first reference to industrial insurance brought an immediate response. Inquiries and pleas for advice began to pour in until as Mr. Siegel stated, "* * * traffic became so heavy that the studio set aside a special office for these interviews.[179]

In fact when these requests for advice continued it was apparent that a counselor service had commercial possibilities. Accordingly, in 1937, Mr. Siegel in partnership with his brother set up an advisory organization for industrial policyholders. This service, which is limited to policyholders not on relief, was given for a fee and limited to advice, no effort being made by anyone connected with the organization to sell insurance. Its main offices are in New York City and most of its clients come from that area. The principal medium of publicity has continued to be the radio. In the beginning the Policyholders Advisory Council broadcasted once every week for 15 minutes over a small station in Brooklyn. After the first broadcast, there were eight calls from policyholders. After the second broadcast there were 15 and following the third week there were 430 calls from policyholders seeking advice. The volume of clients has continued to increase about 100 percent every 6 months until 1939 the Policyholders Advisory Council served about 700 new clients each week. At the present time, it spends about $60,000 annually for radio broadcasts which are given over numerous stations in and around New York and Boston at the rate of 117 periods per week. The gross income of the organization in 1938 was $98,000. When it is realized that the great bulk of the clients of this organization are industrial policyholders there can be no doubt that holders of industrial insurance feel there is compelling reason for seeking the service which is offered.[180]

A regular case procedure is followed for all clients who come in response to radio broadcasts or otherwise to the Policyholders Advisory Council. A flat fee of $1 is paid at the time of the initial interview and if work is undertaken the client is then charged according to a complicated formula based upon the amount of premiums paid at the time he was seeking advice.[181] Originally clients were advised as to

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178 Pt. 12, R. 5799–5829.

179 Pt. 12, R. 5801.

180 Pt. 12, R. 5801–5806.

181 Pt. 12, R. 5807, 5808. Fees charged by the Policyholders Advisory Council are computed in the following manner. Each person who calls at the offices of the Policyholders Advisory Council is charged a flat fee of $1 prior to the first interview. This fee is important in view of the fact that 62 percent of the persons calling at the council receive no service from it either because their problem is not the type requiring the services of an insurance counselor or because the client is unwilling to permit his entire adjustment program to rest in the discretion of the Policyholders Advisory Council. (Pt. 12, R. 5805.) On any case which is

what steps they should take in handling their adjustments and were told to take the matter up with their agents. It was found that although written reports were given such clients they had frequently little success in getting their agents to carry them out. As a result the Policyholders Advisory Council changed its procedure and now handles all correspondence with the companies in working out final adjustments which it recommends. Clients who request assistance must agree to adopt the recommendations which are made.[182]

The adjustments which are advised are not unlike those made by the Life Insurance Adjustment Bureau. Policies are transferred from endowment to whole life plans or placed on a paid-up basis. Often the organization is able to collect surrender values on policies where premium payments have been discontinued and considered worthless. In addition, however, the Policyholders Advisory Council is in a position to recommend changes in the insurance program designed, for example, to increase protection on the breadwinner or to otherwise work out equitable adjustments of insurance protection within a given family by shifting policies from one life to another. Attempt is made to keep the insurance programs in the same company though frequently it is found possible to change the protection from the industrial to the ordinary plan.[183]

Three-hundred-odd-thousand policies have been examined by the Policyholders Advisory Council to date, of which about 50 percent were written by the Prudential, 40 percent by the Metropolitan and the remainder by the John Hancock, Colonial Life, and a few other companies. Of these three-hundred-and-odd-thousand policies examined and made the subject of adjustment approximately one-eighth have remained as they are without change of any sort, another one-eighth have been recommended for cash surrender and the remaining three-quarters have gone through some process of change. The experience of the Policyholders Advisory Council indicates that in a majority of cases, especially on adult lives, a change can be made in the same companies from industrial to ordinary insurance. In the case of children under ten, many companies do not issue ordinary policies and as a result protection must be maintained on the industrial basis.[184]

Life insurance companies have bitterly opposed the activities of insurance counselors.[185] Their opposition to the Policyholders

taken a minimum fee of $7.50 is charged. There is no maximum fee. The fee charged industrial policyholders is in no way based upon the amount of cash recovered for the client. Where the amount of the weekly premium is less than $1, it is computed on an alternative basis; the organization charging whichever is the higher figure of that arrived at by multiplying each policy in force by 4½ or that arrived at by multiplying the total weekly premium by 15. In no instance where the premiums are less than a dollar in their aggregate is more than $15 plus a loading fee of $3 assessed in any case. When weekly premiums are more than $1 the 15 times weekly premium basis is used. In computing fees for ordinary policies a fee of $10 for any policy of $2,000 or less is assessed and a fee of $5 per thousand above $2,000 is charged. In general fees have averaged between $20 and $22 on accepted cases (pt. 12, R. 5807, 5808). No member of the staff of the Policyholders Advisory Council is licensed to sell life insurance (pt. 12, R. 5804).

[182] Pt. 12, R. 5805.

[183] Pt. 12, R. 5805, 5818, 5819. The average family seeking advice has been described by Mr. Siegel as follows. It has an income of about $30 a week and consists of 4 members. The family is paying on the average of $1.90 a week for industrial insurance distributed usually in the form of 50 cents a week on each child for policies written on the endowment plan, 40 cents a week for 20-payment life policies on the mother and 50 cents a week on the head of the family which is usually used to purchase whole life policies (pt. 12, R. 5812, 5813).

[184] Pt. 12, R. 5819.

[185] Pt. 12, R. 5822–5825, 5830–5834. There are numerous other insurance advisers. In New York City, the Policyholders Advisory Council is the largest organization but it is reported that there are from 70 to 100 other insurance counselors operating in that city alone (pt. 12, R. 5825, 5829, 5830).

Advisory Council, for example, illustrates the extent to which they consider insurance counselors detrimental. Almost from the outset the companies have refused to answer correspondence addressed to them by the Policyholders Advisory Council.[186] It also appears that an executive officer of the Metropolitan made an attack against the Policyholders Advisory Council before a legislative committee of the New York State Legislature which was considering the advisability of authorizing an investigation of industrial insurance [187] and that the Metropolitan gave wide distribution to an eight-page leaflet attacking Mr. Siegel.[188] Efforts were also made to stop Mr. Siegel's broadcasts. Certain life insurance groups filed a complaint with the Federal Communications Commission [189] and after this complaint was dismissed, the Metropolitan undertook to warn certain stations that it considered Mr. Siegel's broadcasts defamatory of its officers and agents and when the broadcasts continued, suits were filed on behalf of the Metropolitan against certain of the leading stations which carried Policyholders Advisory Council broadcasts.

Mr. Lincoln explained the objections of the Metropolitan to the activities of the insurance counselors in the following terms:[190]

Policyholders would write and tell us of the unfortunate advice which had been received from this (Policyholders Advisory Council) and other counselors and we felt that it was our bounden duty to take some affirmative steps to protect the policyholders and to protect the agent.

* * * their malign influence on policyholders and on the splendid body of agents in this country, not only the Metropolitan but all other agents, is something that we felt should be combatted.

In further substantiation of his company's position he called attention to its division of changes and surrenders which handles all transactions involving change of policies. In this connection, Mr. Lincoln testified as follows:[191]

Mr. O'Connell. * * * I understand you feel, that the job is being adequately handled by insurance agents and there is no need for having that job done by people outside the insurance companies.

Mr. Lincoln. Decidedly, and I say that not only for Metropolitan but all the companies and all the agents in the country. I should say to you, because the question of our facilities for handling these cases has been brought up, that we have at the home office in the industrial department a division called the change and surrender division, which includes 300 employees whose sole duty it is to

[186] Pt. 12, R. 5822.

[187] Pt. 12, R. 5823.

[188] Id.

[189] Id. A complaint signed by Merle G. Summers, president of the Massachusetts Association of Life Underwriters made to Radio Station WORL in Boston on October 29, 1938, read as follows (pt. 12, exhibit No. 981):

"I am most anxious to submit to you, if you are desirous of further investigating this matter, material which I believe will conclusively demonstrate the fact that Mr. Siegel is operating a very definite racket and one which is most despicable in that it preys upon the savings of the citizens, fine-intentioned and substantial, but unadvised to the extent that they are not competent to judge the advice offered by a clever individual having considerable knowledge of the insurance contracts and their terminology."

[190] Pt. 12, R. 5831, 5832.

[191] Pt. 12, R. 5836. Mr. Lincoln testified, however, that his company, through its agents, has at various times tried to make recommendations for policyholders to those of its policyholders whose premium payments had become out of proportion to the family income as a result of changing economic circumstances. Time and again he said they have been "rebuffed" and he added "we haven't had too good success in persuading them to make the changes" (pt. 12, R. 5868).

adjust policies on account of changed circumstance, and to give advice to policyholders without cost.

Now, those individuals have no dependency on any commission, as was intimated by you or your associate.

Mr. O'CONNELL. How do such cases come to them, through the agency force?

Mr. LINCOLN. Through the agency and directly, both. Last year they handled transactions amounting to 1,987,884 policies, according to the report which I have before me, in which changes were made. That is done at the home office without charge.

Mr. O'CONNELL. How many policyholders have you?

Mr. LINCOLN. Twenty-nine million, roughly.

Opposition to insurance counselors became so intense that the life insurance companies took to the air themselves. Metropolitan, for example, employed Mr. Edwin C. Hill, a commentator, to broadcast five times a week. Mr. Lincoln testified that the Metropolitan took radio time in New York, Boston, and Washington: [192]

* * * and all up and down the coast for the last 4 or 5 months we have been endeavoring to tell over the radio, 5 nights a week, to our policyholders the story of these counselors and their activities and the utter lack of necessity of restoring to any counselor for any thing.

The Prudential has been also active in sponsoring radio broadcasts attacking insurance counselors. The burden of these brodacasts is to the effect that the agents of the Metropolitan and Prudential are thoroughly qualified to give advice to policyholders concerning their insurance program and their insurance needs. Excerpts from the broadcasts of these companies illustrate the general attitude of the companies which sponsor them.

Metropolitan broadcast stated: [193]

You see, the service and advice of Metropolitan agents have always been available to all Metropolitan policyholders * * * promptly, willingly, and without cost. They are given by men trained in life insurance, and in his training, the agent is guided by men who have spent their lives in the insurance business * * * men who are each expert in some particular branch of life insurance. The service of his great company is back of the agent all the time.

Two Prudential broadcasts read as follows: [194]

Your Prudential man is equipped to give you sound advice and counsel on ny life insurance problems which you may have. His training and experience enable him to make constructive suggestions which you might not think of yourself.

Your Prudential man considers this a most important part of his work. So call on him for suggestions whenever you need them. You will find him friendly and able—and his efficient services come to you always without your paying a fee.

* * * * * * *

This Prudential man stands ready to help you and your family to enjoy the benefits of life insurance more fully. He has a thorough understanding of life insurance, and he's more than glad to give you the benefit of his background and experience. * * * He can explain to you in plain, everyday language facts about your policies of which you may not be aware. * * *

[192] Pt. 12, R. 5832.

[193] Pt. 12, exhibit No. 993.

[194] Pt. 12, exhibit No. 1012.

The Prudential hopes that you'll feel free to ask the advice of your Prudential man as you would that of a good friend, for if he can help you with your life insurance problems, he is fulfilling what the Prudential feels to be one of its most important functions * * * to give the maximum benefits of life insurance to every policyholder.

The New York State Insurance Department has also criticized insurance counselors. The following quotation from the Eighty-first Annual Report of the Superintendent of Insurance to the Legislature of the State of New York submitted for the year 1939 sets forth the attitude of the New York department. It is interesting to note in the statements of the department an apparent admission of the necessity of providing some form of service which will assist industrial policyholders in adjusting their insurance program. Apparently, the New York department is not willing to place too much reliance upon the agent's ability to give impartial advice.[195]

During the past few years insurance counselors and advisers have been offering policyholders, particularly industrial policyholders, advice for which a fee is charged, and the question of whether they should be licensed and brought under State supervision has been the subject of considerable discussion. The State of Massachusetts has recently enacted legislation providing for their licensing. It is the department's opinion that the effect of the Massachusetts law should be observed before similar legislation is adopted in the State of New York. This is particularly true in view of the belief that the need for so-called insurance counselors as a permanent institution and the advisability of licensing them has not as yet been definitely established.

The department now handles complaints of policyholders and is in a position to investigate them effectively. Many of the activities for which insurance counselors are receiving a fee are also being performed for policyholders by the department. These activities include securing cash surrender values, obtaining information for and furnishing information to policyholders. No charge whatsoever is made by the department for these services. Policyholders who hesitate to go to their company representatives and who cannot afford to pay a fee, or for other reasons prefer not to visit an insurance counselor, can come to the department confident of receiving every service that its facilities will permit. This is especially true of industrial policyholders. But the department's facilities are limited and whether or not insurance counselors or advisers are licensed, the question remains as to whether provision should be made for expanding the services to be rendered to policyholders by the department. Some time ago the superintendent suggested that the companies establish offices in central places where disinterested advice would be given to policyholders and no insurance would be sold. There seems to be some merit in the idea, but it has aroused little interest or support.

It seems natural for policyholders to look to the State for advice of this kind because the department is in a position to furnish impartial advice. It is affected neither by the influences which might sway insurance agents nor, on the other hand, by those which might affect insurance counselors. One reason advanced against the proposal to expand the activities of the Department is that it represents a questionable extension of its ordinary functions. It gets away from insurance supervision and enters the educational field. It will also add to the expenses of the department.

The question is not an easy one to decide, and the department is not seeking additional responsibilities. But if the Legislature concludes that it is advantageous

[195] Life Insurance, extract from Eighty-first Annual Report of the Superintendent of Insurance to the Legislature of the State of New York, p. 46.

to enlarge the activities of the department, we shall do our utmost to give these additional services to policyholders with zeal and efficiency.

One of the problems which has given rise to the development of organizations set up for the purpose of adjusting policyholders' insurance programs has been the sale of industrial endowment insurance. It will be recalled that the Policyholders Advisory Council and the Life Insurance Adjustment Bureau, as well as certain private and public charitable agencies, uniformly attempt to convert endowment policies to a paid-up or whole-life basis as part of their respective programs for ironing out overloading and maldistribution of industrial insurance holdings. As has already been indicated, there has been an extensive sale of this form of insurance in recent years, particularly to cover the lives of children.

Unquestionably the sale of this type of insurance has been due to some extent to the fact that the industrial agent has received greater compensation for selling endowment policies than for any other form of policy having equal face value. Company representatives, however, have urged that the emphasis upon endowment insurance has resulted from a public demand from persons who desire a type of insurance which will give them opportunity to derive some benefit therefrom during their lifetime. Mr. Lincoln stated: [196]

And our general studies of the whole subject led us to the firm conviction that endowment insurance has its place and that there are people who prefer it to whole life insurance, even with the knowledge that the life insurance would be cheaper. They want to build up a fund for themselves or for the child's education, something of that sort.

A special study made of the 20-year endowment policies issued by the Metropolitan in 1910 disclosed that 28 out each 100 policies matured as premium-paying policies, 4 matured as paid-up endowment policies for reduced amounts, death claims were paid on 4 policies, 4 were converted to extended term insurance which expired, 19 were surrendered for cash and 41 lapsed.[197] Thus by far the greatest number of policies lapsed during the years when the Metropolitan and Prudential were selling the greatest number of endowment policies. A lapse during the first 3 years meant that the policyholder had paid over three times as much for the endowment as for the whole life policy, but was insured for exactly the same period. Even if the commission to the agent so increased the expenses incident to the issuance of the endowment policy that the company could not allow any nonforfeiture benefit before the end of the third year, the greater loss to the policyholder in itself appears to provide an argument against such policies.[198]

In 1938, however, the New York State Legislature refused to accept the companies' arguments in this connection and passed a law effective as of January 1, 1939, in effect prohibiting the sale of industrial endowment policies, thus declaring as a matter of public policy that further

[196] Pt. 12, R. 5891. In another similar study of its endowment experience which covered all 20-year endowment policies issued during the period from 1909 to 1918 the Metropolitan found that it received $151,400,000 in premiums on such policies. It paid dividends and refunds for direct payment of premiums due of $14,300,000, death claims of $10,600,000, cash-surrender values of $53,800,000, sums on maturity of endowment $71,300,000, or total cash payments of approximately $150,000,000; in addition, $2,800,000 was expended on nursing service for this group of policyholders, making a total of $152,800,000 against premiums of $151,400,000. In addition the company spent $4,000,000 in taxes allocated to that portion of the business (pt. 12, R. 5973).

[197] Pt. 12, R. 5973.

[198] Pt. 12, R. 5958, 5959, 5961.

sale of endowment insurance was undesirable.[199] This law was vigorously opposed by the companies and at least one company, the Metropolitan, is now active in urging its repeal. During the time it has been in effect, however, it has had a widespread effect. The Prudential, John Hancock, Metropolitan, and Colonial Life, the four industrial companies admitted to do business in the State of New York ceased issuing industrial endowment policies not only in New York State but throughout the country.[200] The Prudential has found that the law is less harmful than anticipated and is willing to continue without attempting to bring about its repeal.[201] It is certain that the absence of any endowment sales, if continued, will have an important effect in eliminating one of the principal causes for maldistribution of industrial policies in the family group.

J. THE FUTURE OF INDUSTRIAL INSURANCE

There is ample evidence that the heyday of industrial insurance is over.[202] It is clear that industrial insurance has failed to provide

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[199] Sections 83–a, 101, Baldwin's New York Insurance Law, Annotated. Neither Mr. Lincoln nor Mr. Taylor, vice president of the Metropolitan, knew of any reason why endowment policies should be prohibited or why the legislature did so (pt. 12, R. 5893):

"Acting Chairman O'CONNELL. Do you happen to know or could you tell me briefly what the rationale behind the 1938 legislation was, that is the legislation prohibiting the sale of endowment insurance on an industrial basis?

"Mr. LINCOLN. I am afraid I couldn't give you any intelligent reason for it. I never have seen any and I haven't heard any expressed. There was a hue and cry in the State of New York about industrial life insurance business at that time, and the legislature responded to it in this respect and in some other respects."

Mr. Taylor found the reasons equally obscure (pt. 12, R. 5896, 5897):

"Mr. TAYLOR. Well, one side of that can be disposed of quite easily. It was one of those peculiar bills where no arguments were made pro * * *.

"Mr. GESELL. Do I understand from what you say, Mr. Taylor, that there was no real bona fide interest in the bill at all?

"Mr. TAYLOR. Yes, sir * * *.

"I couldn't give you the reasons because nobody ever presented them."

[200] The actuary of the Prudential explained the reasons for the Prudential's action and the effects it of as follows (pt. 12, R. 5903):

"Mr. O'CONNELL. But if I understand you correctly, since the legislation was passed, although it applies only in the State of New York your company is applying that rule throughout the country?

"Mr. GERHARD. That is right. In other words, as long as we are forced to it in New York, we felt that we should take advantage of that by extending it throughout the country and seeing just how it worked.

"Mr. CARDOZO. Do you find that the results are satisfactory?

"Mr. GERHARD. I would say so, yes, as demonstrated by this schedule here which shows a larger amount of intermediate insurance written and a larger amount of ordinary."

[201] Pt. 12, R. 5902, 5903.

[202] In this connection it is interesting to note the testimony of Mr. C. F. Williams, president of the Western & Southern Life Insurance Co., who stated (pt. 12, R. 5939):

"I think it is impossible any longer for an agent to live on industrial insurance."

On June 19, 1939, the Field News, a Western & Southern company paper, carried the following excerpt from a keynote address which Mr. Williams made to the managers of his company, entitled "More Ordinary" (pt. 12, R. 5938):

"You are all aware of the criticism to which industrial insurance has been subjected within the past few years and, strange to say, some industrial agents were among the principal disturbers. In addition to that, we have radio critics and term insurance advocates seeking to destroy the production of industrial and curtail the earning capacity of field men in the industrial branch. Industrial insurance first educated the people of this country to the benefits of life insurance, but to a certain extent it appears to have outlived its usefulness, one reason being that a few hundred dollars is no longer the important money that it used to be; it doesn't go as far or buy as much.

"Another adverse feature was the tendency of the old time industrial agent to make a living off industrial exclusively and to neglect insurance on the breadwinner of the family where the family's life insurance should start.

"So far we have not been greatly affected by restrictions concerning industrial insurance, like the companies that operate in New York, but there is indication that this legislation will spread throughout the

efficient and inexpensive protection for low-income families which is its essential purpose and that it has created unfortunate social problems of serious consequence.

1. Though sold to persons least able to afford life insurance, industrial insurance is the most expensive form of life insurance which companies have devised.

2. Over 95 percent of the industrial policies written terminate before the ultimate purpose is realized.

3. It is frequently sold by high-pressure and overbearing sales methods which result in an uneconomic maldistribution of policies within the family group.

These conditions which exist today have been characteristic of industrial insurance throughout its history. They were recognized as early as 1905 by the Armstrong committee, which reported as follows:[203]

Apart from what has already been suggested, the committee is not prepared to make recommendations with reference to industrial insurance further than to say that the subject is one deserving of special investigation. The most serious evils which have been disclosed by this inquiry, to wit, the excessive premiums, the enormous lapse rate, and the hardships of the agents, seem to be inherent in the system. A great reform could be accomplished if the expense of solicitation and collection could be avoided by the establishment of branch offices where insurance might be obtained by the thrifty poor who desire it. But the opinion of those connected with the companies is that such a plan would be impracticable and the committee is without information which would justify an attempt to compel its introduction. It is insisted that the present method is the most economical that has yet been proved to be adequate to the exigencies of the business. The alternative seems to be presented either of prohibiting altogether industrial insurance by private corporations or of permitting its continuance substantially upon the present basis, subject to those regulations designed to secure economical administration applicable to all companies alike.

The Armstrong committee made no specific recommendations designed to eliminate the more vicious practices of industrial companies. This undoubtedly was partially due to statements of the company representatives that they could correct the situation themselves. During hearings, for example, Mr. Haley Fiske, then a vice president of the Metropolitan and later its president, said:[204]

I do not think legislation is needed at all, sir, in the industrial business. I think if left alone we will work out these problems better than any legislature can. We are in the business and we are studying it, and we have not any other work to do in the world than to work it out, and we will do it if we are left alone.

After 30 years the operations of the larger companies in New York evoked expressions which are significant echoes of the Armstrong report. In 1938 the superintendent, Mr. Louis H. Pink, stated:[205]

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country and that it will become still more restrictive as time goes on. You are familiar with the spread of savings bank insurance, which is conducted without the benefit of agents or agents' commissions, and then there is the Social Security Act and other blanket-insurance legislations.

"I recite these facts so that we may know where we stand and that we may chart our course accordingly.

"In view of the developments of recent years it appears to the company, as it should to every man in the field that the future rests entirely with the development of ordinary * * *."

[203] Armstrong report, vol. X, p. 445.

[204] Armstrong report, vol. VI, p. 5075.

[205] Report on examination of the Metropolitan Life Insurance Co., Special Study of Industrial Insurance (February 11, 1938), p. 1.

Industrial insurance has to some extent at least performed what Government is attempting to do today in the line of social security. During the period when Government was unwilling or unable to help, the poorer people protected themselves through this form of insurance. We should not be too hasty to attempt to tear down what has been built up.

On the other hand, there are serious defects which may to some extent be inherent in the nature of the industrial business and every possible effort must be made to overcome them. These are high cost, the large number of lapses, and pressure of salesmanship and the resulting oversale and uneconomic distribution of policies in the family.

In the same year the superintendent of insurance of New York, in reporting his recommendations to the joint legislative committee for recodification of the insurance law, made the following statement:[206]

Two outstanding causes for criticism of industrial insurance are cost and the large number of lapses. While both of these can be mitigated they are to some extent inherent in the nature of the business. But there is another serious criticism which cannot be entirely eliminated by law and must be met by vigorous effort of management. That is, high-pressure salesmanship. There is no doubt but that this underlies the weaknesses of industrial insurance and is perhaps more subject to just criticism than any of the other matters. Competition and a long course of business experience has undoubtedly brought this about. It will take considerable courage and effort to alter the situation, but this is exactly what the companies are called upon to do. They must exercise their best leadership in an effort to put the sale of industrial insurance on a higher plane. Quality, service to the public, and not mere production must be the goal.

Thus industrial insurance continues to exhibit the same inherent evils: High-pressure salesmanship, excessive lapse, extravagant cost, and, finally, overselling and uneconomic distribution of policies in the family. In fact the situation has not radically changed since 1905 except in one regard, namely, that the operations of the industrial companies can no longer be considered a matter of local concern. With their tremendous growth they have taken on a national importance.

The conclusion is inevitable that industrial insurance has failed to fulfill its essential purpose. Either industrial insurance must be eliminated or the traditional method of conducting it must be drastically changed to eradicate its inherent weaknesses.

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[206] Industrial Life Insurance, Recommendation to Joint Legislative Committee for Recodification of the Insurance Law, Louis H. Pink (October 24, 1938), p. 35.

SECTION XVIII

Savings-Bank Life Insurance

No study of the distribution of life insurance to low-income families would be complete without an examination of savings-bank life insurance. The preceding section undertakes to describe the sale of life insurance to such families by the industrial life insurance companies. This section is concerned with the sale of life insurance to residents of Massachusetts and New York [1] through mutual savings banks.

Savings-bank life insurance has flourished in Massachusetts for 30 years operating under a plan devised by Justice Louis D. Brandeis, then a practicing lawyer in Boston. Justice Brandeis became interested in insurance problems at the time of the Armstrong investigation. He was convinced that there was a great need for safe, low-cost insurance, and set out to find a way by which it could be supplied. Having observed the efficient operation of the Massachusetts mutual savings banks, he concluded that they could handle insurance economically and with equal efficiency. The plan which Justice Brandeis perfected was one by which, with a very slight enlargement of their powers, these banks might be authorized to sell low-cost insurance without the use of soliciting agents or any sales organization. The plan was approved by the Massachusetts Legislature,[2] and in 1908, 1 year after the enabling legislation had been passed, the first bank began issuing life insurance.

Since 1908 savings-bank life insurance has experienced a steady growth. Starting with a premium income in the first year of only

[1] This discussion of savings-bank life insurance will be confined almost entirely to the operations of the Massachusetts system. The New York law, creating a savings-bank life insurance system in that State, is, in most essential respects, comparable to the Massachusetts law though there are some slight differences (pt. 10, R. 4500–4503). The New York system did not commence business until January 1, 1939. At the present time there are 6 issuing banks and 7 agency banks (pt. 10, R.4500). A representative of the largest bank in the system testified (pt. 10, R. 4504):

"The banks that have gone in are very well pleased with the results so far. In fact, the results have been far beyond anything that we had planned on when we thought of going into this the first of the year."

In this connection it should be noted that national banking associations organized under the laws of the United States which are "located and doing business in any place the population of which does not exceed 5,000 inhabitants, as shown by the last preceding decennial census, may, under such rules and regulations, as may be prescribed by the Comptroller of the Currency, act as the agent for any fire, life or other insurance company authorized by the authorities of the State in which such bank is located to do business in said State, by soliciting and selling insurance and collecting premiums on policies issued by such company; and may receive for services so rendered such fees or commissions as may be agreed upon between the said association and the insurance company for which it may act as agent" (12 U. S. C. A. par. 92; ch. 7, 1916, c. 461, 39 Stat. 753).

This provision was discussed in the course of testimony by Mr. Thomas I. Parkinson, president of Equitable. (See pt. 13, R. 6514.)

[2] Ch. 178, General Laws of Massachusetts.

$368.21 it passed the one-half million-dollar premium income mark in 1922 and by the end of 1938 had accounted, during that year alone, for premiums totaling $4,787,123.[3] The number of banks belonging to the system has also increased until at the time of the hearings a total of 26 issuing banks are members.[4] These banks now have insurance in force totaling $154,788,376, which is held by over 82,000 policyholders.[5] An analysis of the amounts of insurance written and the amounts terminated in Massachusetts during the year 1938 showed that although four companies wrote more insurance than the banks, none made as great a gain as did the banks. Savings banks accounted for 6.81 percent of the total new issues for the year and for 45.66 percent of the total net increase in insurance in force.[6] This record is even more astonishing when it is realized that during 1938 and in fact throughout its entire history, savings-bank life insurance has operated without utilizing soliciting agents of any kind.[7]

The savings-bank life insurance system is under the control of the General Insurance Guaranty Fund, a corporate body created by the savings-bank life insurance law and consisting of seven unpaid trustees appointed by the Governor of Massachusetts. This board of trustees appoints a deputy commissioner, an actuary, and a medical director. These three officers serve as executive officers for the whole savings-bank life insurance system and are each separately responsible to the trustees. The deputy commissioner is the active administrative officer, the State actuary determines the rates and policy forms to be used by the banks, and the medical director passes on all applications for insurance. All three officers are appointed for life, subject to good behavior.[8] These officials are State officers responsible solely to the trustees, and they are entirely free from control by the banks in the system. Similarly, they are safeguarded from political pressure.[9]

Until 1929 the expenses of the division of savings-bank life insurance were paid out of State funds. These expenses, which went entirely toward the running of the State department and never to the direct benefit of the banks themselves, totaled about $492,000 for the period 1908–29.[10] In 1929 a reimbursement act was passed which

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[3] Pt. 10, exhibit No. 737.

[4] Pt. 10, R. 4455. The first bank to enter the system was the Whitman Savings Bank (then known as the Peoples Bank of Boston) which came in in June of 1908. Mr. William Douglas, an ex-Governor of Massachusetts and prominent shoe manufacturer, was president of the bank and was instrumental in encouraging it to join the system for the reason that as a shoe manufacturer he wanted savings-bank life insurance made available to the workers in his factory (pt. 10, R. 4454). There are now 193 mutual savings banks in Massachusetts. Two-thirds of these banks are identified with savings-bank life insurance, either as issuing banks or as banks which act as premium collecting agencies for the issuing banks (pt. 10, R. 4492–4493).

[5] Pt. 10, exhibit Nos. 737, 739. The savings banks sell ordinary insurance, group insurance, and annuities. (Id.) The following standard plans are available: Straight life, 20-year endowment, 20-payment life, and term. All insurance is sold on a strictly participating basis (pt. 10, R. 4472).

[6] Pt. 10, exhibit No. 740.

[7] Pt. 10, R. 4463–4465.

[8] Pt. 10, R. 4450–4455. The deputy commissioner receives a salary of $4,200 a year; the actuary, $3,800 a year; and the medical director, who gives part-time service only, receives a salary of $2,000 a year (pt. 10, R. 4450, 4452, 4453).

[9] Pt. 10, R. 4450–4453. Each member of the board of trustees is appointed on a rotating basis for a term of 7 years. The board can institute proceedings to remove the deputy commissioner, the actuary, or the medical officer. Such proceedings cannot be instituted by the Governor or the legislature. On the other hand if the board of trustees recommends the removal of one or more officials, the Governor and the Governor's council must concur in this recommendation (pt. 10, R. 4452, 4453).

[10] Pt. 10, R. 4460.

provided that at the end of every fiscal year thereafter the entire State appropriation for the division, which now amounts to about $64,000 per annum, should be repaid to the State treasury by the member banks of the system. As a result of this act, the privileges of savings-bank life insurance are now available without cost to the State.[11]

As has been stated there were 26 issuing banks in the system at the time of the hearings.[12] Each bank issues the same types of policies, uses the same policy forms and adopts the same gross premium rates. In addition, every prospective policyholder is required to take a physical examination and his acceptability is passed upon by the medical director of the division. The banks issue policies ranging in face amount from $100 to $1,000. It is possible for a single policyholder to obtain $25,000 of insurance by taking out a $1,000 policy in each of 25 issuing banks.[13] The great bulk of the policies issued by the savings banks are small policies taken out by members of low-income families. Of the 82,221 persons insured in the savings-bank-life-insurance system as of August 31, 1938, 26.79 percent were insured for $500 or less and 76.41 percent were insured for $1,000 or less. Only 0.09 percent, or 73 persons, had taken out the then maximum amount of insurance, namely, $24,000,[14] which could be taken out under the system at that time and over 90 percent of the persons insured were insured for amounts of $3,500 or less.[15]

Methods used by the banks to sell insurance and collect premiums are both novel and practical. In cooperation with public agencies, employers and others, stations have been established at settlement houses, manufacturing plants, credit unions, and other banking houses located in areas not immediately serviced by the issuing banks themselves. At these stations or agencies, as they are called, of which there are now some 517, premiums may be paid and insurance purchased. In addition to facilities offered by the issuing banks or their

[11] Pt. 10, R. 4459,4460. In this connection, Mr. Judd Dewey, the present deputy commissioner of savings-bank life insurance, testified (pt. 10, R. 4460):

"The people in the division of State savings bank life insurance are State officers, performing a State function just the same as any other State officer. There is no reason why their salaries shouldn't be paid as they were by the Commonwealth of Massachusetts. The reason we finally proposed reimbursement wasn't because it wasn't proper for the State to pay State officers. It was because the life insurance men were using the fact that there was a State appropriation. They were saying that accounted for the low cost of savings bank life insurance and that the taxpayers were paying for it. Of course, they weren't; the savings banks, everyone of them from the day it established its insurance department, everyone of them has paid the expenses of running the insurance department. The State has never subsidized the insurance department of any savings bank."

[12] Any savings bank in Massachusetts is eligible to become an issuing bank provided approval of the commissioner of banks is obtained. It is a relatively simple matter for a bank to become a member of the Massachusetts savings-bank life insurance system. No substantial outlay of funds is necessary. Under the statute, the directors of the bank must call a special meeting of its board of incorporators and trustees for the sole purpose of considering the establishment of an insurance department. A vote of three-fourths of the directors is required, and this vote may be ratified by the incorporators. The bank must provide a sum of $25,000, $5,000 of which is earmarked for a special expense guarantee fund and $20,000 of which is earmarked as a special insurance fund. This money must come from sources outside the bank and cannot be taken from deposits (pt. 10, R. 4456, 4457).

[13] Pt. 10, R. 4453, 4454, 4466, 4467, 4481. Although there were 26 issuing banks at the time of hearings, the maximum insurance which the banks will issue on any one person is $25,000. This can be taken out by filling out applications in any issuing bank or agency and it is not necessary for the prospective policyholder to go to the offices of each bank in order to obtain the 25 policies (pt. 10, R. 4466, 4467).

[14] Pt. 10, R. 4466. As of August 31, 1938, there were 24 issuing banks in the system (pt. 10, R. 4455).

[15] Pt. 10, exhibit No. 739.

10 branches, there are 5 public agencies, such as settlement houses, 267 employer agencies, and 50 credit unions at which insurance may be purchased and premiums paid.[16] To facilitate further the collection of premiums, most banks connected with the savings-bank system have made arrangements whereby premiums can be paid out of savings deposits; the bank paying the premium when it becomes due and debiting the policyholder's account a corresponding amount. The employer agencies follow a substantially similar practice by automatically deducting the monthly premiums of the employee from his pay envelope and transmitting the premium to the issuing bank.[17]

In order to familiarize the people of Massachusetts with savings-bank life insurance two field instructors are employed by the State to explain the operations of the system to factory workers and other groups. These instructors do not take applications for insurance. They are paid a straight salary, and their income is in no way dependent on the amount of insurance written as a result of their work. All salaries and expenses of these instructors are included in the reimbursement which is made to the State treasurer at the end of the year.[18]

Unquestionably, the most striking feature of savings-bank life insurance is its low cost. Not only do its smaller policies cost much less than the usual industrial weekly premium policy of the same face amount, but its policies generally, when compared with similar policies on the ordinary plan issued by well-known old-line legal reserve companies, are cheaper regardless of the age of issue or the form of the policy. A study of the actual experience of 27 representative companies over the last 10 years discloses that an ordinary straight-life $1,000 policy issued at age 35 in any of these companies was substantially more expensive than a similar policy issued through the banks. Taking the issue of 1929 as an example and computing net cost for the 10-year period, 1929 to 1939, the average yearly net cost of such a $1,000 policy for the savings banks was $2.74, as compared with the lowest net cost reached by any of the 27 representative companies, namely, the Northwestern Mutual, of $4.60. As may be seen from the following table, the net cost of such a $1,000 policy ranged in the representative companies from $4.60 in the Northwestern Mutual to $8.73 in the Berkshire Life. Similar relationships are apparent from an analysis of policies issued in 1938.[19]

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[16] Pt. 10, exhibit No. 738. A collection fee of 3 percent of premiums collected is paid to the collection agency (pt. 10, R. 4461, 4462).

[17] Pt. 10, R. 4461, 4462.

[18] Pt. 10, R. 4463, 4464.

[19] Pt. 10, R. 4482–4486. Although all the banks employ the same gross-premium scale, their dividend scales are not necessarily identical. The mortality experience of all the banks is pooled, but the individual administration expenses and interest earnings can affect the amount of dividends that they pay.

Illustration of 10 years' experience—issues of 1929 and 1938 $1,000 straight-life insurance—age 35 [1]

Company	Issues of 1929 average yearly net cost [2]	Issues of 1938 average yearly net cost [3]	Company	Issues of 1929 average yearly net cost	Issues of 1938 average yearly net cost
Banks [4]	$2.74	$2.72	Connecticut Mutual	$6.71	$6.89
Northwestern Mutual	4.60	5.20	Phoenix Mutual	6.72	8.10
Provident Mutual	5.36	5.64	Equitable, Iowa	6.78	7.71
New England Mutual	5.39	6.45	Travelers	6.81	10.29
Penn Mutual	5.59	6.25	Mutual Life, New York	6.87	8.56
Metropolitan	6.05	7.44	Prudential	7.00	7.15
State Mutual	6.06	6.81	Home Life, New York	7.03	8.15
Mutual Benefit	6.14	6.81	John Hancock	7.17	7.17
Connecticut General (nonpar)	6.21	8.53	Aetna (nonpar)	7.21	10.32
Massachusetts Mutual	6.29	7.11	Union Central	7.56	7.57
Equitable, New York	6.30	8.02	Connecticut General (par)	7.58	10.32
National Life	6.37	5.78	Fidelity Mutual	7.64	7.16
Guardian	6.45	7.04	Aetna (par)	7.85	8.18
New York Life	6.65	8.77	Berkshire Life	8.73	9.09

[1] Pt. 10, exhibit Nos. 745, 746.
[2] Actual dividend history.
[3] Based on 1938 dividend scale.
[4] 10 banks' experience for 1929 issues; 24 banks for 1938 issues.

The preeminent net cost position of savings-bank life insurance is even more noteworthy when it is realized that the insurance departments of the savings banks are subject to the same regulations as legal reserve companies; that they are taxed on a comparable basis and are subject to even stricter investment requirements.[20] These control factors would all tend to put savings-bank life insurance on an equal footing with other forms of insurance.[21]

The principal reason for the low cost of savings-bank life insurance is, of course, that the savings banks do not incur agency expenses.[22] With no commissions paid to agents and without any of the overhead which necessarily arises coincident with the development of a well-organized agency system, the banks can function far more economically. It is not infrequent that in an old-line legal reserve company from 45 to 75 percent of the first-year permiums go to agents' commissions or other selling expenses. Without these heavy charges, the savings banks can naturally achieve a better record.

There are, however, other factors which account for the low cost of this form of insurance. First of all, the banks incur a very small

[20] Pt. 10, R. 4476, 4477, 4478. Until 1939 the investments of the insurance departments of savings banks were taxed on the same basis as the investments of the savings departments. This tax was a property tax, whereas life insurance companies were taxed an excise tax based on the amount of reserve. In 1938 this resulted in the savings banks paying in the aggregate about $10,000 more taxes than they would have had to pay had they been taxed on the same basis as the insurance companies. It is true that under this mode of taxation some insurance departments of savings banks were taxed less than they would have been if subject to the same as life insurance companies. In 1939 the law was changed so that the insurance companies and the insurance departments of savings banks are now taxed on the same basis (Id.).

[21] The ratio of surplus to reserves is even greater in the savings banks than in the old-line companies (pt. 10, exhibit No. 747).

[22] Pt. 10, R. 4485.

overhead expense in setting up insurance departments. To date only one bank has been obliged to increase its office space, and the more customary procedure has been for the banks simply to open a teller's window on the banking floor for savings bank premiums and to set aside a small office for clerical work.[23] Though the accounts of the insurance departments and savings departments of the bank are kept strictly separate,[24] the officers of the two departments are frequently the same, and as a result, savings in salary and other operating expenses are naturally effected.

Furthermore, the savings banks have experienced a better mortality than other companies doing business in Massachusetts, and this experience has had a favorable influence on its net cost showing.[25] The fact that all applicants for insurance in the savings bank system are examined by a medical officer of the State, who is not subject to underwriting pressure of any sort, is partly responsible for the favorable mortality experience.[26]

The insurance departments of savings banks have earned a higher return on their investments than have legal reserve companies.[27] There can be no doubt that the rate of return reflects the efficiency of the managements of the savings bank life insurance departments. The testimony of Mr. Judd Dewey in this connection is interesting:[28]

Mr. DEWEY. * * * the life insurance departments of these savings banks in Massachusetts earned higher net rate of return on their invested funds than the average of the life insurance companies were able to do during any of that period (1920–38).

Mr. GESELL. To what factors do you consider that attributable?

Mr. DEWEY. I should suppose, in the first place, a perfectly natural reason why it should be true is that the trustees of savings banks, say, the little Whitman Savings Bank with assets of five or six million and with premiums income of a few hundred thousand, can do a better job investing that sum of money than anybody can do with two or three or four million dollars a day; I should suppose just reasonably that that would be so.

Mr. GESELL. You mean you feel they don't have as much money to place out in investments from day to day and therefore it is possible for them to have a greater range in which to exercise their discretion?

Mr. DEWEY. Well, no; not that; not greater range, but they can devote more time and attention to the particular investments; they can make sure of the quality of them. When you go to a savings bank in Massachusetts to get money on a mortgage, it is not a $20,000,000 mortgage, it is probably a $1,500 or $3,000 mortgage. The persons in that savings bank who would consider the application, in a great majority of cases, will know the man applying for the mortgage, they will know what kind of person he is, they will go and look at his house, they know whether he pays his bills or keeps his cellar clean, they know what kind of person they are dealing with.

Also of importance is the fact that the savings banks experience a very low lapse rate. The policy form used by the savings banks contains many provisions more liberal than those offered by the legal

[23] Pt. 10, R. 4477, 4481.
[24] Pt. 10, R. 4481.
[25] Pt. 10, exhibit No. 742.
[26] Pt. 10, R. 4475, 4481.
[27] Pt. 10, exhibit No. 743
[28] Pt. 10, R. 4475, 4476.

reserve companies.[29] Among these provisions, is a provision which eliminates any surrender charge and makes the full reserve available to the policyholder after the policy has been in force 6 months. Thus it is impossible for a savings bank policy to lapse except during the first 6 months that it is in force, and upon surrender of his policy the policyholder loses none of his accumulated savings. As a result, the banks have had a far greater proportion of surrenders than lapses in their voluntary terminations. In 1937, for example, of the total insurance terminated by lapse or surrender, 89 percent was surrendered and 11 percent lapsed in the savings banks, whereas in the industrial departments of other Massachusetts companies only 36 percent was surrendered and 64 percent lapsed. A comparable relationship has existed at all times since 1911.[30] In 1932, for example, companies writing industrial insurance lapsed more business than they wrote, and an amount of ordinary insurance was lapsed which constituted 42 percent of the business written that year. As opposed to these figures, the savings banks lapsed but 2.63 percent of the business they wrote in that year. In 1936, industrial lapsed 34.52 percent; ordinary, 29.9 percent; and savings banks, 1.25 percent.[31] It must be recognized that this record is partly attributable to the payment of early surrender values by the banks but in large part is accountable to the fact that the insurance placed on the books of the banks is placed without high-pressure methods and written for persons who have a bona fide interest and intention of keeping the insurance in force.

Savings bank life insurance was designed to furnish residents of Massachusetts with safe, low-cost insurance. It has been preeminently successful in serving its purpose.

Since savings bank life insurance can be sold more cheaply than other forms of ordinary life insurance and is, therefore, sold in direct competition with the legal reserve companies, representatives of such companies have attempted to prevent an extension of this form of insurance. In Massachusetts, savings bank life insurance has met constant opposition from insurance agents. Derogatory pamphlets have been distributed and misrepresentations by the agents with respect to the nature of savings bank life insurance are frequent.[32] Mr. Judd Dewey testified that the agents have engaged in a campaign to create fear and terror in the minds of the holders of savings bank policies by representing that the banks were likely to fail, that the State was going to withdraw its support, and that new taxes on banks were forthcoming which would increase the price of insurance.[33] Insurance interests in Massachusetts have also made repeated efforts to block appropriations for the administration of the savings bank system and to reduce the maximum amount of such insurance which can be sold to one person.[34]

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[29] Pt. 10, R. 4471. Among other provisions are those which give the same benefits to a holder of a $250 policy as are available to policies in face amount of $1,000 or more and provisions permitting policy loans at any time after the first year's premium is paid (pt. 10, R. 4495).

[30] Pt. 10, R. 4471, exhibit No. 741.

[31] Pt. 10, R. 4469.

[32] The licenses of 2 agents in Massachusetts have actually been revoked by the Commissioner because of misrepresentation of this character (pt. 10, R. 4498).

[33] Pt. 10, R. 4498.

[34] Pt. 10. R. 4499.

Both the Association of Life Insurance Presidents and the Life Underwriters Association have vigorously combated savings bank life insurance bills when introduced in other States. Since 1909 numerous bills to establish savings bank life insurance have appeared regularly in one State or another.[35] These bills have all been defeated except in New York State, where a savings bank life insurance bill was enacted in 1939 following many legislative attempts stretching over a period of 20 years.[36]

The Association of Life Insurance Presidents adopted a resolution in 1931 to oppose savings-bank life insurance, "wherever any form of State subsidy is provided and wherever such savings banks engaged in the life-insurance business are not subjected to the same restrictions and burdens as are imposed upon legal-reserve life insurance companies." [37] Since that date the association has combated all bills introduced with the single exception of the New York bill enacted in 1939.[38]

For example, during the 1935 and 1937 State legislative sessions, a total of 15 bills was introduced unsuccessfully in 12 different States. The association, in its confidential report to its members, took credit for each defeat.[39]

The stated basis for the association's opposition is that it does not wish to compete with any type of insurance supported by State "subsidy" regardless of the amount or character of that "subsidy." [40] Not only has the association fought savings-bank life insurance where no subsidy was proposed [41] but it has developed elaborate objections wholly unrelated to the question of subsidy and has vigorously presented these objections in support of its efforts to prevent savings-bank life insurance from spreading.[42] There can be no question that the association's activities in this connection have been based upon a

[35] Bills have been introduced in may States, including Colorado, Connecticut, Missouri, Ohio, Pennsylvania, Rhode Island, New Hampshire, and North Carolina (pt. 10, R. 4419, 4421).

[36] Pt. 10. R. 4419–4421.

[37] Pt. 10, R. 4419.

[38] Pt. 10, R. 4420. Insurance agents vigorously opposed enactment of the New York legislation. The committee on law and legislation of the New York State Underwriters Association urged members to bring "all forces to bear" to defeat the bill. A circular was sent out by the committee enclosing 16 suggestions for telegrams or letters of protest to be mailed to members of the legislature. This circular read in part as follows (pt. 10, exhibit No. 734):

"FLASH

"Word from Albany indicates pressure from New York and vicinity against savings-bank life insurance bill is still not strong enough. Please have all your agents wire again making sure every senator and assemblyman gets at least 1 telegram from your office regardless of constituency.

"They are weakening.

"Keep up the good work."

[39] Pt. 10, R. 4419.

[40] Pt. 10, R. 4420, 4438. A representative of the association admitted that the interest of policyholders was not as great in the association's opposition to savings-bank life insurance as in the case of other bills (pt. 10, R. 4437).

[41] See opposition to Missouri constitutional amendment which without State subsidy authorized savings banks to write life insurance. Pt. 10, R. 4423, 4424.

[42] Typical of its activities in this connection has been the wholesale distribution of the so-called De Groat pamphlet (pt. 10, R. 4425, exhibit No. 722), an attack on savings-bank insurance prepared by an insurance agent. This pamphlet, though adopted by the association, was shown to contain serious misrepresentations. Pt. 10, R. 4493–4497. See also pt. 10, exhibit No. 731.

fear of competition from savings banks rather than the niceties of phraseology in any particular bill.[43]

[43] The manager of the association, himself, characterized savings-bank life insurance as "an assault on the established companies" (pt. 10, R. 4437). It is clear that agents are fearful that savings-bank insurance will take away business (pt. 10, R. 4440). This is perhaps best illustrated by form telegrams used by agents in opposing the New York savings-bank life insurance bill. Two such telegrams read as follows (pt.10, exhibit No. 734):

"Thousands of life-insurance agents of this State will lose their means of earning a living unless the 1,000 limit per person is placed in savings-bank life insurance bill. Please use your efforts to protect life-insurance agents who are your constituents."

"Sixty-one thousand four hundred and twenty-two licenses issued in this State to 'nonindustrial' life insurance salesmen whose livelihood will be seriously threatened if savings banks are permitted to write life insurance in needless competition."

The association has taken pains to plant this fear in the minds of agents of member companies in order to elicit their support in opposing savings-bank legislation. Pt. 10, exhibit Nos. 720, 721.

SECTION XIX

Reports to Policyholders and Accounting

The complete annual statement prepared by life insurance companies in accordance with the requirements of the various States is a volume of folio size, in some instances containing over 300 pages.[1] Only a limited number of copies of these statements is prepared and for all practical purposes they are available for inspection only at the home office of the company or the offices of the insurance regulatory officials of the States in which the company does business.

Because of the inaccessibility of the full annual statement, a policyholder's chief source of information about the company in which he has insurance is the company's annual report to policyholders.[2] An examination was made of the distribution of annual reports for 1937 operations sent to their policyholders by 323 life insurance companies. Of these only 126, or 39 percent, sent regular reports to their policyholders, while 42 additional companies sent reports to policyholders on request. Another group of 53 companies stated that annual reports were issued but did not indicate how they were distributed. As many as 64 companies, or 20 percent of all companies studied, issued no formal report. Thirty-eight percent of the mutual companies included in the group failed to send regular reports to policyholders, while 67 percent of stock companies carrying some participating insurance and 72 percent of the nonparticipating stock companies neglected to send such reports.[3] The distribution of annual reports by type of company is indicated in greater detail in the following table:[4]

	78 mutual companies		52 stock companies carrying some participating insurance		193 straight stock companies	
	Number	Percent	Number	Percent	Number	Percent
1. Regular annual reports sent to both stockholders and policyholders			17	32.7	48	24.9
2. Regular annual reports sent to stockholders only			6	11.5	30	15.5
3. Regular annual reports sent to policyholders only	56	71.8			5	2.6
4. Regular annual reports sent to stockholders only and policyholders on request			7	13.5	22	11.4
5. Regular annual reports sent to stockholders on request					2	1.0
6. Regular annual reports sent to both stockholders or policyholders on request	5	6.4	2	3.8	6	3.1
7. Companies issuing annual reports but not indicating to whom sent			17	32.7	36	18.7
8. No formal report	17	21.8	3	5.8	44	22.8
	78	100.0	52	100.0	193	100.0

[1] This is designated as the "Convention Form Annual Statement" and the form will be found printed in appendix B.

[2] Some States require the publication in local newspapers of annual statements of companies doing business in the State.

[3] Replies to Commission's preliminary questionnaire.

[4] Id.

A policyholder is entitled to a complete report on the operations of his company regardless of the form under which it conducts its business. The policyholder of a mutual is the proprietor and as such should be constantly and accurately advised of the manner in which the directors who theoretically represent him are conducting the affairs of his company. The fact that a company is organized as a stock company does not materially change the situation. If the stock company sells participating insurance the policyholder, who in such cases may sometimes even have the power to vote, is vitally affected by the operating decisions made and results achieved. Even in the instance of a straight stock company it must be recognized that the policyholder's funds are greater than those contributed by the stockholders and give the policyholder an interest in the management far greater than that of the ordinary consumer.[5]

The analysis of company practice in reporting to policyholders discloses not only that many companies fail to report at all, but also that the reports issued are often incomplete and entirely inadequate.

The reports distributed to policyholders are of a great variety in size and quality. Some of the reports are well prepared, giving a fairly comprehensive statement of the company's business and condition. Others are merely elaborate sales literature devoting much space to expansive self advertisement but giving very little concrete information. Many companies still issue single sheet folders which contain only a condensed balance sheet and a very general letter from the president.

The precise outlines of a satisfactory annual report to policyholders cannot be established for companies generally or indeed even for a single company since conditions differ from year to year and company management problems vary widely. A policyholder would appear entitled, however, to get enough information to enable him to make an intelligent judgment of his company's financial position, of the quality of its management, and of the results achieved, good or bad, for the year's operations. Some of the items on which it would seem he should have information are the nature of the dealings, if any, between the company and its officers and directors, the extent to which directors attended board meetings, any substantial salary increases, bonuses or other special perquisites voted officers or directors and other information of a general character which might be lumped under the heading of management, such as notice of forthcoming meetings for the election of directors and the manner in which policyholders may vote for or nominate directors.

An analysis of the contents of a typical group of 35 reports sent to policyholders by representative companies during 1939 disclosed that information of this character is not given policyholders except in a few rare instances and then but sketchily.[6] Furthermore it

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[5] See pp. 27 and 28, supra.

[6] For example, no report discussed dealings between companies and their officers and directors, though such dealings were known to exist in the case of some companies whose reports were analyzed. No report discussed salary increases or changes. Attendance of directors at meetings was likewise not considered in any report. Only 5 of the 23 mutual companies in the group examined advised their policyholders of their right to vote. The manner in which the policyholders were to vote and the right of the policyholders in some cases to make independent nominations to the board were not discussed except by one company, Bankers Life (Iowa), which distributed to all policyholders a full-page notice of the election with statements concerning and recommendations for the reelection of directors whose terms were expiring. The company enclosed with the statement a business reply card ballot on which postage was to be paid by the company.

appeared that financial and operating data contained in the reports was also often incomplete and inadequate.

All of the reports examined carried a balance sheet, although some balance sheets were so condensed as to be practically meaningless. Only four companies showed comparative balance sheets which permitted the policyholder to see at a glance the principal changes in assets and liabilities as a result of the year's operations. The majority of companies limited presentation of financial information to the balance sheet and gave no explanatory or qualifying discussion. In the light of the totally inadequate accounting methods employed in the preparation of the life insurance company balance sheet [7] and the tendency toward condensation of such facts as are presented this approach is practically meaningless. Some examples will serve to qualify this statement.

Because of the many variations in valuation and accounting procedures, a more complete discussion of the assets owned by the company than is contained in the statement of the balance sheet figures is necessary to enable an intelligent analysis of the company's financial position to be made. A segregation of the assets by types with the percentage which each type is of the whole, a description of the methods by which they are valued, a statement of their market value, and a statement of the amounts of investments in default though desirable are frequently not found in reports to policyholders. Of the reports examined, for example, only 21 showed assets owned by percentage of each type. In the other companies, the amount of asset diversification or the company's policy of diversification was very difficult if not impossible to determine.

The reports examined were also inadequate in terms of valuation information. This is particularly important with respect to real estate; yet little or no information on real-estate values was given. The 1939 annual statement of the Union Central, for example, whose real estate in 1938 was valued at 119.17 percent of the unpaid principal amount of the foreclosed mortgages and whose real estate in 1939 constituted 20 percent of all of its assets (including policy loans), contained no discussion of the basis of valuation. only the total book value being stated.[8]

No report of the 35 companies stated the principal amount of mortgages in default, while only 6 (mostly companies which had no bonds in default) made any statement regarding defaults in the bond account.

Thirteen reports included lists of securities owned, while 13 more offered to furnish such lists on request. None of the 35 companies gave complete investment ratings of the bonds owned; only 3 gave market values.[9]

This ballot provided the policyholder with an opportunity to vote for the directors recommended by the company or to make independent nominations. A letter from Mr. D. N. Warters, associate actuary, to the Commission advised that in the last election 12.6 percent of the company's policyholders voted by means of this card and that 410 votes were cast for individuals other than those recommended by the management.

[7] See pp. 319 to 322 infra and appendix B.

[8] Pt. 10A, R. 191, 102. Replies to Commission Questionnaires disclosed that Union Central's urban real estate was carried at a book value 18.23 times gross income and that since 1932 it capitalized an aggregate amount of $10,954,000 in interest (pt. 10A, R. 243, 177. See also pt. 28, supplementary data.)

[9] The Pacific Mutual reported that "86.93 percent of the company's bonds are rated 'A' or better by one of the leading bond-rating services."

Only 2 companies gave operating figures which gave more than the barest intimation of the actual operating results for the year. Twenty-nine of the companies gave income and disbursement figures for the last year, but these were usually so condensed and vague that they were useless. None of the 35 companies gave their operating results by lines of business, thus making it impossible for a policyholder reading the report to know whether one or more branches of the business were being supported by other lines. In fact, only three of the reports stated what lines of business the company was engaged in.

Nineteen of the reports stated the amount of new business done during the year, but none stated the cost of acquiring the new business. A very few companies stated the total termination rate, but no company stated the lapse rate separately or gave adequate information on the company's experience with voluntary terminations.

Only one company stated the rate of interest earned on each type of security owned, while two gave the rate earned on each type of asset. Thirteen companies gave the net rate earned on all assets. The remaining companies, a clear majority, gave absolutely no information in this respect. No company related the interest earned to the interest required to maintain reserves.

A policyholder should be informed not only as to what his company has done but what it intends to do and the policies which it is following. He is interested in knowing the extent to which the company is increasing its size at his expense.[10] He is interested in knowing whether the company is favoring any line of business, such as industrial or annuity, or if it is withdrawing from these fields. He is interested in knowing what the company's investment policies are and what changes are being made in them. He is interested in knowing whether the company is strengthening reserves or whether it is setting up minimum reserves. The company's dividend policy is of vital importance to him.

The questions which must arise in a policyholder's mind on these subjects are seldom answered by the annual reports. Only a few companies make any attempt to define investment policies and when any such attempt is made it is usually in such general terms as to be practically meaningless. In only a few cases was a definite statement made. As to dividends, in none of the reports was any statement found as to the method of allocating dividends as between lines of business or as to the factors taken into consideration in declaring dividends.

One of the difficulties encountered in approaching a critical analysis of company reports to their policyholders lies in the fact that in most cases the companies do not have annual audits. Such companies rely upon the convention form annual statement which is both antiquated in its form and frequently misleading in its presentation of information.

Of the 26 principal companies 11 do not employ an auditor for any purpose, even to count the securities. The remaining companies do

[10] For example, nowhere in the report of the Equitable of New York can one find any intimation of the policy of that company's management to grow larger even if that growth results in higher costs to policyholders. Yet, Mr. Parkinson, president of that company, testified (pt. 13, R. 6539): "I could immediately, even with my little knowledge of the life-insurance business, so restrict our activities territorially, occupationally, and otherwise that we could easily score a much lower net cost. What we are trying to do is to give the widest possible and the fullest possible coverage to the greatest number of people at a cost which they will stand."

employ an auditor but this is frequently for the sole purpose of verifying the assets; the audit does not involve an actual examination of all the accounts or any substantiation of liabilities. There are only a few companies which are adequately examined by independent auditors once a year.[11]

It is also the amorphous nature of the accounts themselves which results in obscuring much information from the policyholders. These accounts are such that even the most conscientious summary of them in a report to policyholders would leave much to be desired.[12] In few businesses is adequate accounting as important as it is in the life insurance business. Life insurance and annuity contracts are by their terms payable at some time in the future, often 50 or more years in the future, and the money which is paid in today must be set up as a reserve to meet those future obligations. Because of the steady flow of incoming cash and the regular excess of income over disbursements, it is never difficult for a company which is growing, as all of our American companies are, to meet current expenses, and irregularities or mismanagement of reserve funds can be concealed until many years after the event unless accounting controls currently reveal such situations. If the accounting controls are not adequate, bad management policies may continue unobserved, and appear only under the stress of economic depression, or because of the ultimate degeneration of the company to the point where it is no longer able to meet its obligations as they mature. Because of these considerations and because of the fact that the companies stand in a fiduciary relationship to those whose funds they hold, it is vitally important that life insurance companies give adequate accounts of their stewardship of these funds.

In the face of this imperative necessity, life insurance company operation is characterized by an utter lack of modern accounting methods.[13] The companies do not maintain their accounts on an accrual basis, nor do they make use of a full double-entry system of bookkeeping, such as is usually necessary to the orderly conduct of a business of any size. The bulk of the liabilities of the companies do not appear in the books of account of the companies at all and are only inventoried for statement purposes at the end of the year. The financial statements of the companies may be distorted and frequently give an unrealistic portrayal of financial position and operating results.

The essentials of the convention form annual statement which establishes the company accounting procedure were adopted in 1875, at a time when statements were generally made on a purely cash basis and life insurance company transactions were relatively simple to record. In the ensuing years the companies have made little effort to have the form adapted to modern accounting methods, and the State regulatory bodies which sponsor the form have been apathetic to change. The form now in use is still basically that of 1875.

In 1914 a recommendation for the adoption of the accrual method of accounting was made to the National Convention of Insurance Commissioners. The proposal was rejected, not because of lack of merit in the recommendation, but because, as the committee con-

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[11] Pt. 28, testimony of Ernest J. Howe, Mar. 1, 1940.

[12] See testimony of Mr. George S. Van Schaick, vice president of New York Life and former superintendent of insurance for the State of New York (pt. 28, testimony of February 29, 1940).

[13] For a full discussion of life insurance company accounting, see Appendix B.

sidering the matter stated:[14] "The present life blank has been accepted as satisfactory for a series of years. There has been, and there is now, no pressing demand or necessity for a radical change. Department statistics and reports which have been based upon the present form for some time would have to be materially changed. This would render the statistics now in existence of much less value for comparative purposes than heretofore."

Briefly stated, the convention form contains the following financial statements, which are prepared as at the close of the calendar year:

1. Assets, liabilities, surplus, and other funds.
2. Income and disbursements.
3. Gain and loss exhibit.
4. Changes in surplus for the year, according to class or lines of business.
5. Supporting schedules, etc.

Although the convention form itself is standardized in form, statements of various companies are not necessarily comparable because the companies have no uniform method of preparing the items which go to make up the statement. The given designation in the statement may have one meaning in regard to one company's statements and a somewhat different meaning for another company. Furthermore, because the form is designed to set only minimum requirements, companies whose conservative policy exceeds requirements appear at a disadvantage when their statements are compared with those of their less conservative competitors. The form now used is not designed to permit a ready analysis of such differences.

The balance sheet as used in the convention form (which is the balance sheet presented to policyholders in the annual report when one is issued) is not the balance sheet familiar to ordinary accounting practice. The form does not provide for full classification and proper definition of accounts, nor does it present the accounts in summarized and related form. Due to the failure of the companies to maintain a full double-entry record of all of their transactions, most of the figures shown in the balance sheet originate from sources outside of the books of account or from single-entry records of a subsidiary nature; the final figures, except for the so-called ledger assets, are determined by the inventory method. The balance sheet as finally constructed is not supported by the books of the company and is not supported by the statement of income and disbursements or related statements involving operations.[15]

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[14] Proceedings of National Convention of Insurance Commissioners, 1914, at p. 38.

[15] The asset side of the balance sheet is divided into 3 parts. The first of these is "ledger assets" and the second "nonledger assets" and the third is headed "deduct assets not admitted."

Ledger assets, generally speaking, represent the cash and investments on hand at the date of the statement. Nonledger assets are those assets not taken into the accounts of the companies but simply inventoried at the end of the period and added to the total of ledger assets in the balance sheet. Nonledger assets are principally due and deferred net premiums due and accrued interest on bonds, mortgages, etc. Assets not admitted are the assets which are deducted from the total of the ledger and nonledger assets not arriving at the final total on the balance sheet. They include any of the company's stock, owned or loaned, all supplies, furniture, and fixtures, balances due from agents, and they also include valuation accounts by means of which the companies deduct the excess of book value (the value at which the assets appear in the ledger) of the bonds over investment values (the final value at which bonds appear in the balance sheet after all adjustments), the excess of the book value of stocks over market, and overdue interest considered uncollectible.

The liabilities of life insurance companies are principally policy reserves. These are computed by the actuaries whenever a statement is to be made up. They represent a composite of the most stringent of the minimum legal standards prescribed by the various States in which the given company does business, plus

The statement of income and disbursements as used by insurance companies today was designed to meet the requirements of a simple cash-transaction business. Its parallel will not be found in any other business. The income and disbursement statement of life insurance companies takes into account only the changes in the accounts which are handled by double-entry bookkeeping; that is, the so-called ledger assets (including suspense accounts) and takes no account whatsoever of nonledger assets, not-admitted assets, or the most important liabilities. Although it is supposed to be a cash statement, it does not even give a full statement of cash receipts and cash disbursements, for funds disbursed in connection with policy loans, for example, and funds received as a result of the repayment of such loans do not appear on the statement, and neither do sums disbursed for the acquisition of bonds or other assets.

As a cash statement, therefore, the schedule of income and disbursements is almost valueless. Even as a statement of changes in total assets from year to year, it is subject to the serious limitation that it does not include all assets nor does it include those assets and valuation accounts which the balance sheet classifies as "not admitted." Taking practically no account whatsoever of liabilities (except such liabilities as borrowed money, the receipt of which affects ledger assets), it has no value whatsoever as an ordinary income account showing the annual gains or losses of the business.

About 1895 some need was felt for an account which took into consideration not only the changes of a part of the assets, but the changes in all of the assets and the changes in all of the liabilities and surplus. This appeared in the form of an exhibit which is now known as the "gain and loss exhibit." After about 10 years, and after the Armstrong investigation in New York, the gain and loss exhibit was generally adopted. The gain and loss exhibit was the first official attempt in insurance accounting to provide a rough substitute for an ordinary profit-and-loss statement.

Instead of setting up a statement, however, patterned on commercial accounting procedure, the gain-and-loss exhibit was built around an actuarial analysis of the business. A large part of its usefulness has been lost because the classification of items is not as detailed as the income and disbursements statement, and because the actuarial analysis requires much information nowhere available in the annual statement.

One of the great shortcomings of the gain-and-loss exhibit is that it gives only the haziest impression of the operating results of the

such additions as the management may deem necessary or desirable. They may reflect, therefore, the opinion of management within wide latitude. Other liabilities for the most part are also inventoried at annual statement time and are not necessarily subjected, as are the liabilities of commercial enterprises, to accounting control. After the liabilities have been thus computed, the balance which remains is surplus (or capital and surplus in the case of a stock company) or it is sometimes characterized in whole or in part as general or special contingency reserves. The meaning of these latter characterizations is not apparent.

The "ledger assets" are in general the only items which come into the double-entry accounts. Nonledger assets and policyholders' reserves are specifically omitted. This is a serious accounting defect. C. O. Shepherd, associate actuary of the Travelers Insurance Co., in an address in May 1937 before the American Institute of Actuaries, stated regarding this situation: "Transactions that go into the ledger are recorded with a certain degree of formality and a certain standard of accuracy and precision in the science of accounting and are recorded under the supervision of an official trained in accounting practices. Before an item can appear in a double-entry record the evidence must be produced and the facts vouched for in writing. There is no assumption that this formality or these standards have been applied to nonledger items. Whether this is sound practice is worthy of consideration" (Record, American Institute of Actuaries, vol. XXIV, Nos. 53, 54, 1937, p. 188).

various lines of business in which life insurance companies are engaged. The need for information of this type was apparently not sufficiently felt until 1925, when the exhibit of changes in surplus was inserted in the convention form. This exhibit was the result of an obvious need, but was very poorly constructed.

The main part of the exhibit is simply a division by lines of business of the information itemized in much greater detail in the statement of income and disbursements. After arriving at a figure of excess of income over disbursements for each line of business, the exhibit classifies all other items under the headings: "Increase in Non-Ledger Assets," "Increase in Not Admitted Assets," and "Increase in Liabilities." This results in an estimate of operating earnings but gives no information as to the method of allocation which has been adopted as between lines of business in regard to asset losses and in regard to the important matter of the strengthening of reserves by change in basis.

This exhibit produces the interesting effect of a statement most of the items of which are on a cash basis and the end product of which is stated on a revenue or accrual basis. Analysis of it by a nonexpert is impossible.[16]

As a result of haphazard accounting methods, much essential information about the operations of the companies is lacking. In the matter of lapses and surrenders of policies—one of the most important problems of the business—the companies are not able to tell either the number of such terminations, whether they profit or lose on them, or how long a policy must be in force before it results in a profit to the company. No adequate cost accounting has been developed, so the cost of new business and the cost of servicing old business are unknown, and cost allocations as between lines of business are made on a very rough basis. The company's total cash income and outgo is frequently unknown, and many companies cannot determine the excess of their assets over liabilities, even from their balance sheets, without making extensive adjustments and calculations.

The effects of poor accounting are several: The State in its regulatory activities and the policyholders in their purchase of insurance and in their judgment of the integrity and efficiency of the management are hampered by the lack of usable accounting, without which the controls normally exercised by these parties become nonoperative. The company managements themselves, in their determination and evaluation of their own management policies and in their attempt to solve the problems of the business, are handicapped by the lack of operating analyses which the use of practical accounting methods would provide.

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[16] In 1939 a new gain-and-loss exhibit was adopted by the National Association of Insurance Commissioners, but it has not been adopted by New York and other important insurance States. It is patterned more or less on the exhibit of changes in surplus, and all items are put on a revenue or accrual basis. While it purports to show the net increase or decrease in surplus, it does not set forth the items in such a manner that true net income available for dividends can be properly determined without exhaustive analysis. This statement has the important disadvantage that it is impossible under ordinary circumstances to reconcile the figures contained therein with the elaborate, if inconsistent, classification of accounts shown in the income and disbursements statement. Furthermore, the statement omits data with reference to the allocation of asset losses by lines of business, leaving the reader confused as to the method of allocation of this important item, which, however difficult, is inescapably necessary in order to properly analyze the company's dividend policy and to evaluate the company's management policies with respect to its various lines of business.

SECTION XX

Operating Results

In order to analyze the operating results and general underwriting experience of the life insurance companies, the Commission made detailed studies of 26 principal legal reserve companies. These companies included all companies with assets in excess of $125,000,000 and accounted for approximately 87 percent of the total admitted assets of all legal reserve life insurance companies as of December 31, 1938. The study covered the 10-year period 1929–38. Figures were obtained showing the operating results of the various lines of business conducted by each company, including the amount of insurance in force, the total premium income, total income from all sources, dividends paid to policyholders, and net changes in surplus.[1]

A. INCOME AND DISBURSEMENTS

From the analysis made, it appeared that 25 of the companies[2] had a total income of $42,679,883,000 during the period from 1929 to 1938, inclusive, and that they disbursed to policyholders or for operating expenses a total of $32,094,901,000 during the same period. This excess of income over disbursements is a notable feature of the life insurance companies. Not only has it persisted, as the figures indicate, for the 10-year period under review, but it has been a phenomenon found typical throughout the history of the companies. Studies made for each year commencing in 1865 demonstrate that the combined total income for all legal reserve companies in each year has been in excess of total expenditures, and, in fact, it appears that since 1890 there have been but 4 years in which total premium income alone for such companies was not in excess of all disbursements, including both those made to policyholders and those required in the administration of the business itself.[3]

This excess of income over disbursement, is one of the outstanding characteristics of the life insurance business. In a normal year this excess of income over disbursement runs well over a billion dollars for the 25 companies; only 3 times during the last 10-year period did it fall below that sum—in 1932, 1933, and, by a narrow margin, in 1934. In 1936, 1937, and 1938 the sums thus withdrawn from general circula-

[1] The complete tabulations, covering not only operating results but investments and cost comparisons as well, appear in pt. 10A.

The purpose of these tabulations is to show in summarized form the most significant financial information about each company in order that its operations may be studied in the light of the experience of other companies replying to the questionnaires. The information has been classified by lines of business and types of investment wherever feasible and is designed to reveal the relative degree of success of the various departments of each company.

[2] Pt. 28, exhibit No. 2258. Figures for the Pacific Mutual were not available for the full 10-year period, so the income and disbursement figures in this section do not include figures for that company.

[3] Pt. 4, R. 1175–1178, exhibit No. 218. In 1918, 1932, 1933, and 1934 premium income was slightly less than total expenditures, although in each case total income was considerably in excess of total expenditures.

tion by these 25 companies were $1,384,114,000, $1,328,911,000, and $1,200,461,000, respectively.[4]

The principal sources of income and the principal disbursements for the 10-year period are indicated in the following schedule:[5]

	Amount	Percentage of total
Income:		
Premium income	$31,384,356,000	73.54
Investment income	8,473,264,000	19.85
All other income	2,822,263,000	6.61
Total income	42,679,883,000	100.00
Disbursements:		
Dividends to policyholders	4,576,819,000	14.26
Death claims	7,784,283,000	24.25
Disability claims	935,299,000	2.91
Matured endowments	1,204,919,000	3.75
Annuities	573,0v9,000	1.79
Other payments to policyholders	762,572,000	2.38
Surrender values paid	7,384,823,000	23.01
Commissions to agents	2,662,513,000	8.30
Other agency compensation	890,338,000	2.77
Other operating expenses	2,146,162,000	6.69
Investment expenses	1,162,302,000	3.62
All other disbursements	2,011,862,000	6.27
Total disbursements	32,094,901,000	100.00

From the foregoing it will be observed that the principal source of income or 73.54 percent of the total came from policyholder premiums. Of the disbursements made, the chief item was payments made on death claims. It should be noted, however, that dividends to policyholders which, as has been indicated, are principally a refund to the policyholder of a portion of his premium and surrender values, together accounted for 37.27 percent of total disbursements. It is also of interest to observe that commissions to agents and other agency operating and investment expenses accounted for 21.38 percent of all disbursements. If the experience for 1938 alone is considered it will be found that these same general ratios prevail. In that year the total income was $4,700,535,000, a sum equal to more than 7 percent of the 1938 national income, and total disbursements amounted to $3,500,072,000. Death claims amounted to 23.29 percent, dividends to policyholders and surrender values paid accounted for 30.11 percent and agency commissions and other expenses accounted for 21.28 percent.[6]

Since most insurance companies are offering insurance of several different types, and indeed engaged in some activities which may have only a remote kinship to life insurance, it is important to consider proportionate amounts contributed by each of the various lines

[4] Pt. 10A, R. 11.
[5] Pt. 28, exhibit No. 2258.
[6] Replies to Commission's investment questionnaire, tables 8 and 9.

of business in which the companies are engaged. Ordinary and industrial insurance are but two lines of business written by legal reserve companies. There are six others worthy of special note. Four of these, annuities, group life, group annuities, and accident and health insurance, are written in separate policies and are to be considered, like ordinary and industrial, as separate departments of the company, and two, disability and accidental death, are primarily lines of business offered as additional benefits in connection with the writing of ordinary and industrial insurance.

It was found that of the 25 companies annuities were handled by 24 companies, group insurance by 8 companies,[7] group annuities by 7 companies, accident and health insurance by 7 companies, disability by 25 companies and accidental death by 23.[8] Of the premium income received by the 25 companies during the 10-year period over $25,000,000,000 was received from ordinary and industrial insurance, which accounted for 82.40 percent of the entire premium income. The lines of business mentioned above accounted for the following percentages of the total premium income.[9]

	Premium	Percent
Ordinary	$18,782,202,000	59.84
Industrial	7,078,769,000	22.56
Disability	540,248,000	1.72
Accidental death	273,649,000	.87
Group	1,038,724,000	3.31
Annuities (individual)	2,142,695,000	6.83
Annuities (group)	543,666,000	1.73
Accident and health	984,403,000	3.14
Total	31,384,356,000	100.00

First year premium income for the 25 companies from ordinary insurance was $275,261,000 in 1929. During 1933–35 sales of ordinary insurance fluctuated widely, first year premium income totaling $188,395,000 in 1933 and $286,400,000, the highest in the 10-year period, in 1935. By 1938 first year income for ordinary had fallen to $223,431,000.[10] First year premium income from group life insurance shows a more decided decline going from $11,782,000 in 1929 to $4,893,000 in 1938,[11] while sales of individual annuities have ranged from $40,157,000 in 1929 to $323,920,000 in 1935 and down again to $172,919,000 in 1938.[12]

Total disbursements made have been broken down to indicate the amount disbursed for each line of business, and it is thus possible to determine for each line amounts disbursed for each of the purposes indicated on the general schedule of disbursements. These disbursement figures given do not take into consideration that portion of income which is not immediately disbursed but is held as reserve.

[7] Western & Southern is not included, because it has written only one group contract, which covers its own employees (pt. 10A, R. 45).

[8] Pt. 28, exhibit No. 2252.

[9] Pt. 10A, R. 20, 28, 34, 40, 48, 55, 62, 67.

[10] Pt. 10A, R. 27.

[11] Pt. 10A, R. 47.

[12] Pt. 10A, R. 54.

Since the figures are those of well-established companies, whose rate of expansion is fairly even from year to year, however, the disbursement percentages for a given year, in this case 1938, may be regarded as typical. The following schedule expresses in percentages the total income and disbursements by each line of business for the various indicated categories in 1938:[13]

	Ordinary insurance	Disability benefits	Accidental death benefits	Group life insurance	Individual annuities	Group annuities	Industrial insurance	Accident and health insurance	Total
INCOME									
Premium income	65.57	54.16	86.05	96.80	67.40	81.53	79.77	93.83	70.40
Investment income	22.95	37.06	13.35	2.26	22.42	17.85	19.11	5.[illegible]0	21.23
All other income	11.48	8.78	.60	.94	10.18	.62	1.12	.27	8.37
Total income	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
DISBURSEMENTS									
Dividends to policyholders	13.85	(1)	1.56	14.47	1.45	.02	12.05	5.71	11.97
Death claims	27.77		62.66	65.95			16.76		23.31
Disability claims		78.68		7.85		2.92	.33	28.65	3.30
Matured endowments	5.59			.02	.07		5.00		4.56
Annuities					53.66	39.32	(1)		3.29
Other payments to policyholders	2.50	.47		.05	.80		.94	22.08	2.44
Surrender values paid	18.14			.06	11.71	24.43	30.93		19.18
Commissions to agents	5.56	.40	2.76	1.92	5.52	1.72	[2]16.20	13.27	8.04
Other agency compensation	1.90	.34	.75	.85	1.24	.65		5.06	1.40
Other operating expenses	6.14	7.00	21.34	6.33	4.77	5.81	6.29	19.87	6.62
Investment expenses	5.53	6.03	5.04	.42	7.72	14.25	4.42	.52	5.14
All other disbursements	13.02	7.08	5.89	2.08	13.06	10.88	7.08	4.84	10.75
Total disbursements	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	[3]100.00

[1] 0.001.
[2] Includes agency compensation and expense.
[3] Replies to Commission's investment questionnaire, tables 8–25.

It will be observed that the percentage of total income of the various lines arising from premium payments ranges from 54.16 percent in the case of disability benefits to 96.80 percent in the case of group life. Conversely, group life was dependent on investment income for only 2.26 percent of its total income, while disability benefits took 37.06 percent of its total income from investments.

Close scrutiny of the above table reveals some significant facts about the operations of the various lines of business conducted by the insurance companies and the relative results achieved by each line in returning to policyholders or their beneficiaries the money which they pay in. The group life business has been the most expeditious in returning money paid in to policyholders or their beneficiaries, 65.95 percent of total disbursements being on death claims, 7.85 percent on disability claims, and 14.47 percent being refunded to policyholders as dividends. A total of 88.40 percent of disbursements made in this line was disbursed to the benefit of those for whose protection the business was operated. Contrasted with this is the result obtained

[13] From replies of 25 companies to Commission's investment questionnaire, tables 8–25.

in other lines of business. In industrial, for example, only 16.76 percent was paid on death claims and 5 percent on matured endowments, while 30.93 percent went as surrender values to persons surrendering their insurance. In ordinary 27.77 percent of disbursements went for death claims and 5.59 percent for matured endowments.

Commissions to agents accounted for 16.20 percent of industrial and 13.27 percent of accident and health disbursements. Investment expenses were highest in group annuities, for that business taking 14.25 percent of all disbursements.

The following table, derived from the preceding one, gives some measure of the relative operating efficiency of the various lines of business by showing the percentage of total disbursements of each line returned to policyholders as surrenders and dividends, the percentage paid to policyholders or their beneficiaries on insurance claims, and the percentage spent for selling and administration:

	Percent returned to policyholders as dividends and surrenders	Percent returned to policyholders or beneficiaries on insurance claims	Percent used for operating expenses and other disbursements
Ordinary	31.99	35.86	32.15
Disability benefits	0	79.15	20.85
Accidental death benefits	0	64.22	35.78
Group life insurance	14.53	73.87	11.60
Individual annuities	13.16	54.53	32.31
Group annuities	24.45	42.24	33.31
Industrial insurance	42.98	23.03	33.99
Accident and health insurance	5.71	50.73	43.56

The foregoing analysis does not of course indicate the degree of success with which the companies have handled each line of business. In fact there have been great discrepancies in this respect, the companies having made total additions to surplus for the 10-year period of over one-half billion dollars in the case of ordinary [13a] on the one hand while having suffered deductions in surplus of over $400,000,000 in the case of disability on the other. The following schedule shows for each of the eight lines of business the net changes in total surplus after deductions of dividends for the period 1929–38.[14]

[13a] All 25 companies write ordinary insurance while only 4 companies write industrial insurance. Premium income from ordinary insurance amounted to $18,782,202,000 during this 10-year period (pt. 10A, R. 28). The 25 companies as of December 31, 1938, had 27,516,000 ordinary policies in force which represented $62,649,297,000 of insurance in force. During 1938 premium income for ordinary policies totaled $1,903,719,000. Dividends to policyholders for the 10-year period 1929 to 1938, inclusive, amounted to $3,440,954,000 and the companies, after payment of such dividends, achieved a total net change in surplus of $544,395,000 for the period (pt. 10A, R. 25–32).

[14] Pt. 10A, R. 24, 32, 38, 44, 52, 59, 66, 71. Figures included for Pacific Mutual where such figures were available. The total changes in surplus before deduction of dividends were as follows (pt. 10A, R. 22, 30, 36, 42, 50, 57, 64, 69):

Ordinary	$3,992,327,000
Industrial	1,160,152,000
Annuities (individual)	42,452,000
Group life	114,220,000
Group annuities	7,708,000
Accident and health	39,962,000
Disability	408,516,000
Accidental death	58,367,000

Net changes in total surplus after deduction of dividends for period 1929–38:

Ordinary	+$546, 796, 000
Industrial	+163, 967, 000
Annuities (individual)	−65, 738, 000
Group life	+34, 212, 000
Group annuities	+4, 872, 000
Accident and health	+6, 731, 000
Disability	−408, 721, 000
Accidental death	+58, 015, 000
Net total	340, 134, 000

It will be noted that the net total result of these operations was a gain in total surplus of $340,134,000 and that losses were experienced in only two lines of business; namely, individual annuities and disability. The experience of the companies in handling these two lines deserves special consideration.

B. ANNUITIES

Stated in the simplest terms, an annuity is a contract under which a company agrees in return for a sum of money, paid in lump or installments, to provide a person with a stated amount of money at regular intervals for the rest of his life. The payments may be arranged to begin immediately or at some future date.[15]

The importance of the annuity business is demonstrated by the fact that the rapid increase of insurance company assets in recent years has been attributable to a large extent to the great increase in the sale of annuities. In 1929 life reserves for the 26 largest companies [16] were $11,868,476,000 and annuity reserves were $400,641,000. By 1938 life reserves were $16,829,661,000 while annuity reserves had risen to $2,665,052,000.[17]

As the reserve figures indicate, the extensive development of the annuity business as a branch of the legal reserve life insurance companies in the United States has taken place in comparatively recent times. While the amount of annuity premiums received by the companies has shown, in general, a consistent increase from year to year since 1866, the first year for which the amount of annuity premiums is available, it was not until about 15 years ago that the volume of annuity premiums began to attain significant proportions. Moreover, the real mushroom growth has taken place only during the latter half of the 15-year period.

Starting with an aggregate of only $41,000 in annuity premiums in 1866, the volume rose to a temporary high of approximately $11,000,000 in 1904. But during the period 1905–15 it dropped off substantially, with the result that it did not pass the 1904 high until about 1916.[18] Following more or less steadily a rapid growth until

[15] For a further definition of individual annuities see p. 177, supra, at note 1. Individual annuities are to be distinguished from group annuities which are of relatively lesser importance (pt. 28, testimony of Ernest J. Howe, February 12, 1940. Pt. 10A, R. 61–66). Group annuities are carried by eight companies, there being $102,659,340 payable to group annuitants annually under contracts in force December 31, 1938. The sale of group annuities from 1929 to 1938, inclusive, resulted in an increase in surplus after dividends of $4,872,000 (pt. 10A, R. 60, 66).

[16] All figures given in the annuity and disability discussion include those of the Pacific Mutual when figures for that company were available.

[17] Pt. 10A, R. 99.

[18] Pt. 28, testimony of Ernest J. Howe, March 1, 1940.

1930, during which year approximately $90,000,000 of annuity premiums were received by the companies, it began to skyrocket in an unprecedented manner, reaching the level of almost $454,000,000 in 1935. Since then it has tapered off somewhat to approximately $363,000,000 in 1938.[19]

Annuity premiums of the one year 1935 approximated—in fact, slightly exceeded—the total annuity premiums of the period 1866 to 1927, inclusive, while the aggregate annuity premiums of the 11-year period 1928 to 1938, inclusive, were more than six times as large as the aggregate annuity premiums during the 62-year period, 1866–1927.[20]

The immense importance which the sale of individual annuities assumed during the 1930's may be seen from the following comparison of the total first-year premium income on ordinary insurance and individual annuities for the 26 largest companies as a whole: [21]

	Ordinary insurance	Individual annuities
1934	$227,636,000	$288,218,000
1935	286,400,000	323,920,000
1936	243,177,000	250,986,000
1937	247,481,000	182,506,000
1938	224,646,000	173,327,000

As of December 31, 1938, there were outstanding in the 26 largest legal reserve life insurance companies in the United States 868,206 individual annuity contracts providing for annual payments to annuitants of $431,619,850 and 599,732 group annuity contracts which provided for annual payments to annuitants of $102,859,340.[22]

Of the amount of individual annuities in force December 31, 1938, 36.5 percent had been issued by the Equitable of New York; 11.6 percent by the New York Life; 5 percent by the Mutual of New York; 4.8 percent by the Prudential; and 4.7 percent by the Travelers. Other companies accounting for more than 4 percent of the total amount of individual annuities in force were the Penn Mutual and the Massachusetts Mutual. In the field of group annuities the Metropolitan alone held 56.8 percent of the annual amount payable

[19] Pt. 10A, R. 55, 62.

[20] Pt. 28, testimony of Ernest J. Howe, March 1, 1940. Statistics for life insurance premiums show a quite different history. While the amount of life insurance premiums increased steadily and almost uninterruptedly throughout the entire period 1866–1938, the period of greatest growth was the 1920 decade. In 1866, annuity premiums were only about one-tenth of 1 percent of the amount of insurance premiums. During the next 50 years annuity premiums averaged about 1½ percent of life insurance premiums and in no year amounted to as much as 5 percent of the life insurance premiums. In 1920 annuity premiums had fallen to less than 1 percent of life insurance premiums. But in 1935 they rose to the point where they amounted to over 15 percent of the life insurance premiums. Since 1935 annuity premiums have declined (id.).

[21] Pt. 10A, R. 27, 54.

[22] Pt. 10A, R. 53, 60. The individual annuity contracts outstanding include $103,216,205 per year now payable under contracts fully paid for by annuitants, $54,040,981 per year payable after future dates under deferred annuity contracts fully paid for by annuitants, and $274,362,664 per year payable after future dates under deferred annuity contracts which had not been fully paid for by annuitants. The group annuity contracts include $11,747,455 per year now payable under contracts fully paid for by annuitants, $73,150,721 per year payable after future dates under deferred annuity contracts fully paid for by annuitants, and $17,961,165 per year payable after future dates under deferred annuity contracts which had not been fully paid for by annuitants.

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to annuitants, the Prudential, 24.3 percent, and these two companies and the Equitable together held 92.9 percent of the group annuities outstanding.[23]

A great deal of difficulty has been experienced by the companies in estimating mortality for the purpose of determining annuity rates. By 1920 it was generally recognized that there was need for a new table of annuitants' mortality to replace the McClintock's table (1896) which up to that point, had been used more or less generally by American companies. Consequently a study of the annuity mortality experienced up to 1918 was made by Dr. Arthur Hunter, actuary of the New York Life, and the result was the publication of the American annuitants' table. Compared with the earlier McClintock's table, the new table indicated increases of 6 to 12 percent in the present value of annuities issued to males at the older ages and up to 20 percent increase in the female values but only at the very old ages. The new experience had included only immediate single life annuities without any guaranty or refund provision—the type of annuity which had largely predominated up to that time—and since this kind of annuity was almost always issued at the older ages, the results of the 1920 study demonstrated that the companies were offering annuities at rates which were low.

Many interesting facts emerged in the discussion of the 1920 mortality study and the resultant tables. It was noted that the mortality had been more favorable to companies when considered in terms of amount of annuity income rather than the number of annuitants. This phenomenon, which was to be repeated in later annuity investigations, indicated an important divergence from life insurance which had consistently shown a less favorable result—from the standpoint of the company, namely, higher mortality—by amounts of insurance than by lives.

It was also noted that since up to 1920 there had been little active solicitation of annuity business most of the annuities had been purchased by, rather than sold to, the annuitants. This had resulted in a definite selection against the companies, the tendency being for only persons in good health to take out an annuity contract.

Following the publication of the American annuitants' table, it served as the basis for new rates that were adopted. The interest rate guaranteed was usually 4 percent, it being assumed that with new investments then returning at least 5 percent there would be a margin of excess interest to serve as a backlog against further unfavorable mortality which might arise. This was not a very satisfactory method for companies did not know definitely how much they would ultimately gain or lose because of unfavorable mortality on past underwritings and it was especially unsatisfactory in the light of the revelation that the Sun Life's experience with British female annuitants showed even then significantly lower mortality (which, of course, is unfavorable to the company in the case of annuity contracts)[24] than that indicated by the new American annuitants' table.[25]

[23] Pt. 10A, R. 53, 62.

[24] The opposite effects of mortality on life insurance and annuities was illustrated by the testimony of John Stevenson, president of the Penn Mutual who was asked if his company would sell an annuity to a person who had applied for life insurance and had been rejected on the basis of a medical examination. Mr. Stevenson stated that it would (pt. 28, testimony of John H. Stevenson, February 13, 1940). In such a case, of course, the company would have reason to believe that it had a chance to profit on the annuity contract because of the greater possibility of the early death of the applicant.

[25] Record, American Institute of Actuaries, June 1921, p. 135 et seq.

The American Annuitants' Table understated the mortality at the younger ages substantially and had been derived from the experience on immediate annuities issued primarily at the older ages. By 1930 recognition that this mortality table did not adequately cover the experience of annuitants at the younger ages led to the adoption of a new mortality table, known as the combined annuity table, which had been constructed by combining insured lives' mortality at the younger ages with annuitants' mortality at the older ages. It was the sale of deferred annuities which was developing to a significant degree both through group contracts and on the individual basis that pointed up the need for a better mortality guide on the new type of annuity business and resulted in the preparation and adoption of the combined annuity table. Even at this stage, because of the absence of information, this table had to be constructed largely on the basis of estimates.

This trend toward increased sales of deferred annuities was only one manifestation of the general trend toward efforts to establish personal financial security which was given impetus by the economic collapse. There began a boom in the sale of annuities of all types—not only the old standard form of single premium immediate annuity but also annual and single premium deferred annuity and endowment insurance combining substantial life coverage to a specified age and retirement annuity thereafter.

One company, the Penn Mutual,[26] reported that in comparing 1931 with 1930 it found that single premium retirement annuities had increased 3 times and annual premium retirement annuities 10 times. The retirement annuity had replaced the old-style deferred annuity and had proved much more attractive because it involved merely a sinking fund accumulation of net premiums (after deduction of loading) during the deferred period with cash values and participation in dividends and various forms of optional annuities offered at the retirement age (also optional), whereas the old deferred annuity had included none of these features designed to attract investments and had been a much more rigid contract. As a consequence of these changes, the Prudential was able to report that whereas for each 1,000 quotations given on the old-style deferred annuity contract, only one or two sales had resulted, in 1934 it was issuing 100 retirement annuities per week.[27]

With this development came many complications. Companies were divided in their opinions as to whether it was a healthy development and should be encouraged or, on the other hand, whether it would ultimately prove disastrous and should be restrained. Though it was felt that the trend reflected at least partially a real growth of a desire for old-age security, all companies were agreed that there was a peculiar outgrowth of the depressed state of the investment market and that many of the retirement annuities were being purchased merely for the purpose of providing a haven for additional money and without the purchaser having any real intention of ultimately procuring an annuity. In other words, the retirement annuity and other forms of deferred annuities were being used as a savings account.

[26] Record, American Institute of Actuaries, June 1932, p. 105, discussion on "Investment Forms of Policies."

[27] Record, American Institute of Actuaries, June 1934, pp. 125, 128, 129, discussion of "Retirement Annuities."

Other aspects of the problem added to the difficulties. The companies were passing through a period of strain occasioned by the unprecedented volume of cash withdrawals and loans. The premiums on retirement and other annuities provided a ready source of liquid funds which no company wished to pass up, even though the growth of annuity business might create a difficult situation at a later date when, if higher interest rates and more favorable investment opportunities return, heavy withdrawals of cash values under the retirement annuities should be made.

The companies were also swayed by agency considerations.[28] The depression had materially reduced the volume of new life insurance [29] and they were concerned with the problem of maintaining the income of their agents insofar as possible. Hence the companies had emphasized the sale of annuities, had developed elaborate sales material and granted liberal production credits for annuity business. Ultimately the agents became so "annuity conscious" that the companies acted to restrain their sales activities. Tax advantages of annuities were no longer stressed. Production credits were reduced. Limitations were imposed on the amount of annuities issued to any one person and the conversion of retirement annuities to life insurance policies was encouraged. While these restrictions acted somewhat as a brake on annuity sales, the volume of new issues remained on a relatively high level.[30]

The depression and heavy annuity sales brought into focus two important aspects of the annuity problem, one of which had always existed and another which had become important because of the new developments. First, it became necessary to reappraise the interest assumption in the light of decreasing investment yields, mounting investment losses and large volumes of refunding. The wisdom of basing the rate for single-premium annuities on the long-term interest rate prevailing at the time of issuance could be seriously questioned in the light of experience. A special problem was posed in the determination of the proper interest assumption for the annual premium retirement annuity involving as it did the investment of small sums over a long period of time as in the case of the life insurance contract. In an effort to solve the difficulties more conservative interest assumptions were adopted. Some companies substituted participating retirement annuities for the nonparticipating contracts which had been based on higher guaranteed rates and, in a few instances, the nonparticipating single premium immediate annuities were replaced by similar contracts on a participating basis. There was considerable reluctance to place immediate annuities on a participating basis since it was felt that they would then be less salable because the annuitant is interested in obtaining the largest possible guaranteed return but a few companies—including the two largest in point of individual annuity business, the New York Life and the Equitable of New York—adopted the participating forms.

The other important phase of the annuity problem was again the matter of annuity mortality. Even before the onset of the boom in annuity sales the earlier mortality experiences were out of date due to continual lightening of annuitants' mortality. During the 1920's

[28] See, e. g., discussion cited in note 30, supra.

[29] Pt. 10A, R. 27, 47.

[30] Pt. 28, testimony of Ernest J. Howe, March 1, 1940.

studies made by the individual companies had indicated a lighter mortality than that indicated by the American annuitants' table, the improvement being more pronounced in the case of females. As a result, consideration was again given to the adequacy of annuity reserves.

A study of annuitants' mortality made in 1933 and representing an extension of an earlier study made in 1928 confirmed the general feeling as to improvement of both male and female mortality. Apparently as a result of this study rates were revised upward through the general adoption of a 3¾ percent interest rate and the use of a modification in respect to the American annuitants' table whereby male annuitants were rated 1 year younger than true age. On July 1, 1933, the principal companies adopted the American annuitants' select table with interest at 3¾ percent. Rates charged for men were those indicated by the table for 1 year less than attained age and rates charged for women were based on 5 years less than attained age. The loading charge was 4½ percent which was accounted for mainly by commissions allowed soliciting agents plus over-riding commissions allowed general agents. These rates constituted an increase of approximately 6.9 percent of previous rates for men and 7.7 percent for women. Under this method a male annuitant aged 35 would pay the rate of age 34, which of course would be higher. This in itself had the effect of increasing rates about 7½ to 8 percent.[31]

After the 1933 change in annuity rates, additional changes were made in 1935 and in 1936.[32] On January 1, 1935, the principal companies increased annuity rates by raising loading from 4½ to 6½ percent and by adopting a 3½ percent interest table in comparison with the 3¾ percent table which had previously been used. The same American annuitants' table was still followed and men were still rated 1 year younger and women 5 years younger than attained age. Commissions on the sale of annuities were reduced so that after January 1, 1935, soliciting agents received only 2 percent and general agents an over-riding commission of one-half of 1 percent. Up to this time practically all companies had been writing individual annuities on a nonparticipating basis. On January 1, 1935, however, the New York Life and the Equitable began the sale of participating immediate annuities. These were based on gross rates slightly higher than the rates for nonparticipating annuities which were generally adopted by other companies in the business. As interest rates continued to decline and mortality showed up even lighter than expected, the American annuitants' table continued to be used but with further modifications and a lower rate of interest was assumed.

In 1937 a further investigation was made of the experience on over 100,000 annuitants. It revealed again a continued trend toward lower mortality especially in the case of females. It was found that the experience under the immediate annuities involving a guaranty (refund or cash refund) in event of early death—a form which had sprung up comparatively recently and had enjoyed a rapidly increasing popularity probably because of its investment appeal—was more favorable than under the immediate annuities without refund.

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[31] Female annuitants were rated 5 years younger than true age, 4 years being deemed to be the measure of differential between male and female annuitants.

[32] See pp. 154 to 157, supra, regarding intercompany activities in raising these rates.

In 1938 a new annuity table made its appearance. It was the 1937 standard annuity table which had been constructed by merging the experience on certain group life policies at the younger ages with the modified American annuitants' table at the older ages. As finally adopted generally by the large companies, it was further modified by rating males 1 year and females 6 years. That is, a 5-year differential was assumed to reflect the difference in annuity mortaility between males and females. The new table was adopted by most large companies as the mortality basis for all types of annuities—annual premium or single premium, immediate or deferred, with refund or without refund, group or individual.

It must be recognized that individual annuities are in several respects very different from life insurance policies and from an underwriting point of view are affected adversely by factors quite different from those which may be injurious to life insurance. The business of granting annuities has in fact no necessary connection with the selling of life insurance. Life insurance and annuities are exact opposites, in that a contract of life insurance is an agreement to pay a certain sum when a person dies while an annuity contract is an agreement to make payments to him during his life. The annuity contract is primarily an investment contract. The life insurance company takes money from the annuitant either in lump sum or installments and in return guarantees that it will pay him a specified amount for a definite number of years or until his death. If the annuitant lives longer than is expected on the basis of actuarial tables or if the rate of interest assumed in the company's guarantee is not earned losses may be suffered. As has been indicated both the mortality experience and the interest earned have been adverse from the company point of view. Since substantial portions of the annuities are offered on a non-participating basis, the losses suffered have to a large extent been assessed against policyholders carrying life insurance policies. In the case of mutual companies the assessment of this loss against the policyholder means a reduction in his dividends and accordingly to the extent of these losses it may be said that the policyholders in mutual companies have subsidized the companies' annuity business. Through the operations of the annuity business, these mutual policyholders have been placed in a proprietary position and are in some respects placed in the position of operating investment trusts which guarantee a specified rate of earnings. It is the life policyholders who must pay for the annuity losses.

The extent of this subsidy may be demonstrated through an examination of the losses which have been experienced as a result of falling interest rates and mistaken estimates of mortality. During the years 1929 to 1938 the operation of the individual annuity business of the 26 largest companies resulted in a deduction from surplus of $42,452,-000 before payment of dividends.[33] These losses were increased by the fact that during the period the companies paid dividends amounting to $23,290,000 on individual annuities [34] thus making the total deduction from surplus which had to be met by the life insurance

[33] Pt. 10A, R. 57.

[34] Pt. 10A, R. 58.

policyholders equal to the substantial sum of $65,738,000.[35] This loss, large as it is, does not, however, measure accurately the results of the companies' mistaken management policies, since in addition to the deductions in surplus already made the companies are certain to suffer much greater losses on policies written on the now admittedly inadequate basis and still in effect. Many of these contracts were made on the basis of mortality tables which subsequently failed to reflect actual experience and with high interest assumptions. As a result the reserves which have been set up on these old annuity contracts are far below those which are being set up on contracts currently sold. Unless interest rates increase very much within the next few years (enough to cover both the high interest assumptions and the error of the estimated mortality) only a reversal in the mortality trend or an avalanche of annuity surrenders, neither very likely, can even hope to save the companies from much greater losses in annuities than those which they have experienced to date.

An estimate of the amount required to set up reserves on existing contracts on the basis of contracts currently being sold (generally, 1937 standard annuity table, modified, at 3 percent) was submitted by 22 of the larger companies and these estimates revealed that about $181,358,000 would be required for that purpose. These companies carry only about 55 percent of the annuity business in force, however, since estimates requested from the Metropolitan, Equitable,[36] Pacific

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[35] Net change in total surplus resulting from individual annuity business after deduction of dividends by companies was as follows (pt. 10A, R. 59):

Company	Amount	Company	Amount
Metropolitan	2, 195	Providence Mutual	837
Prudential	3, 746	Connecticut Mutual	1, 026
New York Life	36, 882	Connecticut General	440
Equitable New York	14, 138	Phoenix Mutual	735
Mutual New York	4, 647	Bankers Life	194
Northwestern	274	National Life	1, 225
Travelers	206	Pacific Mutual	[a] 773
John Hancock	70	State Mutual	686
Penn Mutual	438	Equitable Iowa	1, 095
Mutual Benefit	961	Western & Southern	96
Massachusetts Mutual	686	Lincoln National	936
Aetna	2, 056	Guardian Life	369
New England Mutual	404		
Union Central	3, 323	Total	65, 738

[a] From July 1936.

[36] The following statement of annuity reserves from the convention form annual statement of the Equitable as of Dec. 31, 1938, shows the basis on which reserves were carried at that time:

Basis	Amount
American experience table, at 3½ percent	$649, 873
American experience table, at 3 percent	24, 742, 389
McClintock's table, at 3½ percent	54, 330, 697
McClintock's table, at 3 percent	2, 036, 117
Combined annuity table, at 3½ percent	63, 579, 148
Combined annuity table, at 3¼ percent	14, 482, 608
Combined annuity table (first modification), at 3½ percent	56, 810, 962
Combined annuity table (second modification), at 3¼ percent	13, 613, 806
Combined annuity table (second modification), at 3 percent	109, 365, 461
American annuitants' select table, at 3½ percent	240, 445, 802
American annuitants' select table, at 3 percent	67, 225, 397
American annuitants' select table (first modification), at 3 percent	269, 241
1937 standard annuity table, at 3½ percent	10, 928, 971
1937 standard annuity table, at 3 percent	27, 883
1937 standard annuity table (second modification), at 3 percent	823, 360
Total	659, 331, 714

From this it will be seen that of the $659,331,714 annuity reserve liability shown on the balance sheet, only $11,780,214, or less than 2 percent, is on the 1937 standard annuity table and only $851,243, or about 0.13 percent, are on the standard annuity table at 3 percent. The Equitable has more annuity business than any other one company. Its premium from annuities was $90,351,000 in 1938 (pt. 10A, R. 55, 62), representing 24.9 percent of the total premium income from annuities in that year.

Mutual, and Western & Southern were not submitted in response to the Commission's request. These companies, particularly the first two, carry substantial portions of the annuity business. On the basis of the information at hand, however, it is possible to estimate that future losses from annuities approaching $300,000,000 can be anticipated before the companies succeed in placing this department of their business on a basis justified by current conditions.

C. DISABILITY BENEFITS

Disability benefits are contained in the policies of all principal life insurance companies.[37] Though originally these benefits simply enabled the policyholder to waive premiums in the event of disability, they have been greatly expanded over the years until in some cases they now provide in addition to the waiver of premium that the policyholder shall receive a stated amount monthly or annually in the event of total and permanent disability.[38]

During the period from 1929 to 1938 they have received a total premium income for these benefits amounting to $542,053,000.[39] First-year premium income has consistently declined since 1930, until in 1938 it amounted to only $1,866,000.[40] Dividends paid to policyholders on these benefits have been negligible, there being but 2 companies, the Mutual Benefit [41] and the New England Mutual, which have paid any dividends during the entire 10 years.[42] Indeed, except in the case of the Northwestern Mutual [43] and the Mutual Benefit, each of the 26 companies has uniformly lost money from the handling of disability benefits during the 10-year period. In fact, in this short period the 26 companies lost an aggregate sum of $408,516,000 on

[37] Although total and permanent disability benefits are usually provisions in industrial as well as ordinary life-insurance policies, figures given in annual statements on total and permanent disability usually refer only to provisions in ordinary policies. The convention form annual statements issued by the Equitable, the Penn Mutual, and the New York Life, however, include figures covering disabilities in annuities. Figures in this section are subject to qualifications indicated in pt. 10A, R. 33, 38.

[38] "Total and permanent disability," if strictly construed, implies a condition which completely prevents the affected individual from engaging in any occupation whatsoever for compensation, gain, or profit and does not permit any possibility of recovery from the condition. In these respects it differs from the usual form of accident and sickness policy, issued principally by casualty companies, which generally grant indemnities for other conditions that disable the insured only partially (i. e., do not stop his income completely) or merely disable him temporarily. If the phrase "total and permanent disability" were construed literally, there would be relatively few conditions that would fall within the scope of its meaning, but it has acquired, with the passage of time, a far broader meaning—partly through the action of the companies themselves, which at first interpreted the language liberally and later extended its meaning in the wording of the contracts, and partly through decisions of the courts, which, in the opinion of many observers, went far beyond the intent of the contracts in their constructions of the language.

[39] Pt. 10A, R. 34.

[40] Pt. 10A, R. 33.

[41] The Mutual Benefit did not issue any disability benefits whatever until 1929, and when it did enter the field at that time it adopted provisions which, while permitting both income and premium waiver benefits, differed substantially in terms from the clauses offered by other companies. The most important departures from the practices of other companies are: (1) The definition of total disability in terms of loss of earned income rather than mere inability to work, and (2) the "prorate clause," which enables the company to reduce the disability benefits payable under the contract if, and to the extent that, the disability coverage carried in all companies exceeds the earned income of the insured during a stipulated period immediately prior to the occurrence of the disability. Through the use of these 2 provisions, the Mutual Benefit apparently has been successful in eliminating a substantial part of the moral hazard involved in the writing of the income disability coverage and thus has avoided the serious losses incurred by other large companies.

[42] Pt. 10A, R. 37.

[43] The Northwestern Mutual has confined itself to disability benefits providing for waiver of premium and has never issued income disability insurance.

total and permanent disability benefits, while the losses during 1938 alone aggregated $32,738,000. The experience of the various companies during 1938 and for the 10-year period from 1929 through 1938 is indicated below.[44]

The development of the disability benefit provisions and the resultant losses presents a significant picture of bad underwriting practice in the operations of the life insurance companies.[45] It was in 1896, almost 20 years after the total and permanent disability clause had first been adopted by the fraternal societies, that it was first used in this country by a legal reserve life insurance company, the Fidelity Mutual. The benefit was a nominal one, consisting merely of the waiver of the premiums under the policy in the event of disability, or in lieu of such waiver, at the option of the insured, payment of the face amount of the policy in the form of an annuity based upon the mortality of disabled lives.

No other company adopted a disability benefit until almost 10 years later, when the Travelers began to issue a clause that provided merely for waiver of premiums. In 1910 other companies began to adopt the same disability benefit provision being issued by the Travelers.

It was 2 or 3 years later that the trend toward liberalization of disability benefits first manifested itself. A few companies began to provide what is known as the "installment" disability benefit. There were several variations of the plan, but basically it provided that upon disablement the insured would become entitled to annual

[44] Pt. 10A, R. 36. See the following table:

	1938	Total
Metropolitan	−$1,437,000	−$20,934,000
Prudential	−2,068,000	−31,521,000
New York Life	−13,463,000	−133,110,000
Equitable, New York	−3,767,000	−55,079,000
Mutual, New York	−4,669,000	−80,356,000
Northwestern	137,000	854,000
Travelers	−2,701,000	−42,309,000
John Hancock	−999,000	−9,065,000
Penn Mutual	−133,000	−5,638,000
Mutual Benefit	46,000	608,000
Massachusetts Mutual	−818,000	−2,021,000
Aetna	−452,000	−7,747,000
New England Mutual	−116,000	−376,000
Union Central	−307,000	−2,821,000
Provident Mutual	−68,000	−44,000
Connecticut Mutual	−251,000	−3,070,000
Connecticut General	−182,000	−3,335,000
Phoenix Mutual	45,000	−452,000
Bankers Life	−247,000	−3,411,000
National Life	−65,000	−1,115,000
Pacific Mutual	−626,000	−947,000
State Mutual	−92,000	−445,000
Equitable, Iowa	−92,000	−2,181,000
Western and Southern	24,000	−279,000
Lincoln National	−136,000	−1,025,000
Guardian Life	−301,000	−2,697,000
Total	−32,738,000	−408,516,000

[45] See discussion of disability benefits, pt. 28, testimony of Ernest J. Howe, March 1, 1940.

payments, each in the amount of 5 or 10 percent of the face amount of the policy, such disability payments being deducted from the benefit payable at death or upon maturity of the policy. Hence if the disability continued for 20 years (if 5 percent annually were being paid) or for 10 years (if 10 percent annually were being paid), the entire face amount would be paid out and there would be no further disability payments nor would there be a death or maturity benefit. In one variation of the plan the disability payments were continued even though they aggregated more than the face amount. This further extension of the benefit indicated the form of disability coverage which, after greater elaboration, was to be adopted generally.

The first income disability benefit that did not reduce the amount payable at death or maturity was introduced in 1915, by the Penn Mutual. It constituted a radical innovation. The income disability payment was an annual payment of 10 percent of the face amount, the first payment to be made a year or more after proof of disability was filed with the company.

In 1920 the benefit was extended materially when the income disability payment was changed to 1 percent per month and the payments made to begin 1 month after proof was filed.

Further liberalizations followed quickly. In 1921 companies began to use what is known as the 90-day clause. This was the point at which large losses began to be incurred. The 90-day clause provided in effect that the insured would be deemed permanently disabled if total disability had continued for 90 days, even if it were evident that the total disability were only temporary and there was little or no possibility of its being truly permanent. The value of the income disability benefit thus was increased considerably. Soon thereafter it also became customary to provide that the first income disability payment be made immediately when proof was filed.

The year 1922 saw the introduction of a disability clause in which the income disability payments were increased as duration of the disability claim increased. One type of increasing indemnity clause provided that the payments would be increased 10 percent for each of the first 5 years of disability, remaining constant thereafter during the continuance of the total disability. Another type, adopted by the New York Life and the Mutual Life, provided that the payments would be increased 50 percent after 5 years of disability and another 50 percent after 10 years of disability, so that payments made in the eleventh year of disability and thereafter were double the amount initially paid. These clauses proved very costly to the companies.

Later a number of companies began to issue a disability provision which provided for payments covering the 90-day waiting period.

Throughout the entire period prior to 1922, rates for disability benefits had in general been based on Hunter's disability table derived from the experience of the fraternal societies. As long as the benefits provided were payable only in the event of true "total and permanent disability," the net premiums based on Hunter's table were generally sufficient. But with the adoption of the 90-day clause followed by liberal interpretations of "total and permanent disability," premiums based on Hunter's table became clearly inadequate. Premiums were increased occasionally, but the additional premiums were usually more than offset by the extension of benefit. This became evident when

in 1926 a group of companies made a study of their combined disability experience.

As a result of the 1926 study, premiums were generally increased. Nevertheless, the losses on disability continued to mount, and further changes were clearly necessary. A committee of actuaries appointed in part by the superintendent of the New York Insurance Department and in part by the National Convention of Insurance Commissioners, after studying the problem of disability, recommended standard provisions which would result in more uniform practice and make it possible to assemble statistics which would be suitable for premium and reserve calculations.

This committee made a series of recommendations, which were adopted in 1930 by most of the large companies. The principal changes made were: (1) Increase in the waiting period from 90 to 180 days; (2) elimination of disability payments for the first 3 months of disability; (3) reduction of the limiting age, before which disability must occur, from 65 to 60; (4) limitation of disability income benefits to 1 percent per month without any increase by duration of claim; (5) adoption of stringent election rules in regard to women, such as elimination of income disability and restriction in amount of coverage granted; (6) withdrawal of disability clause providing indemnity merely if the insured was unable to perform the duties of his own occupation. This had proved particularly costly when issued to professional men.

Along with these changes in benefits, increases in disability premiums were also made. The basis for the rate change was the 1926 intercompany study. This study was not an altogether satisfactory guide, since it had been based on both limited and rather heterogeneous data. The companies which contributed their experience to the study had offered widely different types of coverage and, in addition, had differed substantially in interpreting the disability clause, selecting risks, and administering claims. As a consequence, the data had been divided into three broad classifications, one of which, called class (3), showed the experience under the 90-day clause of those companies which had been most liberal in administering the disability coverage. Premium rates adopted in 1930 were based upon this class (3) experience. Furthermore, most of the companies began to charge female risks either one and one-half or two times the disability premium charged male risks, since the experience on women had been particularly bad.

The drastic changes made in 1930 did not bring the desired results. Losses continued to mount, with the result that in 1932 many further changes were made. A number of companies eliminated the income disability benefits altogether and thereafter restricted their disability coverage to the premium waiver benefit of those that continued to write income disability, many reduced the benefit to one-half of 1 percent per month, some provided for the payment of 1 percent for only a limited time and one-half of 1 percent thereafter, while some provided that the monthly income should cease altogether after a limited period. In addition, other provisions of the disability clause were restricted generally. The waiting period was increased from 4 to 6 months, the limiting age of the coverage was reduced from 60 to 55 if income disability was granted, and virtually all companies stopped issuing income disability benefits to women. Finally

new premium rates were adopted. They were based on the "class (3)" experience increased by 65 percent or more in the case of the income benefit, and increased by 50 percent or more in the case of the premium waiver benefit. Also, the charge adopted for premium waiver issued to women was generally double the rate for men.

Along with the drastic changes in coverage and rates which had resulted from the companies' study of their costly disability experience, there has been a growing realization of the special underwriting problem inherent in the writing of disability benefits. This had manifested itself in many ways. It had become evident that the issuance of disability benefits to women had been especially costly; overinsurance of risks had been common and especially costly when excessive income disability benefits had been issued; and, as the companies' own disability experience accumulated and was analyzed, it became apparent that the writing of disability benefits involved certain occupational and moral hazards which were either lacking or operated with less effect in the underwriting of death benefits alone. In addition the basic moral hazard involved in the issuance of insurance benefits to dishonest or untrustworthy persons was much more pronounced when disability benefits were involved, especially income disability.

The advent of the depression accentuated the underwriting hazards implicit in disability insurance and no doubt was an important factor in the substantial increase in disability claims which occurred during the 1930's. As earned incomes shrank or completely vanished, companies found that in many instances the potential monthly benefit of an individual in event of disablement exceeded his actual monthly earnings. Meanwhile, the public had become more insurancewise and aware of the potential benefits of the disability coverage. As a result an increasing number of claims began to be filed, many of them of doubtful validity.

The decisions of the courts also were of great influence.[46] Their interpretations of the contracts were liberal, exhibiting a tendency to give the claimant the benefit of any doubt wherever possible. As a consequence, the companies found themselves liable on claims which they probably had had no intention of covering in their disability contracts. Even where they were able to defend dubious claims, the costs of such defense were not inconsiderable, and, together with the mounting costs of administering claims under which payments were being made—with the necessity of regular check-up and review in order to verify the continuance of the total disability—they added to the substantial disability losses incurred. The depression had not only increased the incidence of claims but also their duration. There was a tendency for claimants to malinger and extend their claims as long as possible, all of which required more thorough and hence more costly investigations on the part of the companies.

Many of the increased benefits and liberalized clauses which proved so disastrous were adopted because of severe competition, and were in response to sales needs rather than the result of any cost calculations. So freely were the disability benefits used in competition that in many instances it was probably the disability benefit, rather than the death benefit, which the insured was purchasing. The

[46] Actuarial Studies No. 5, Disability Benefits in Life Insurance Policies, by Hunter and Phillips, ch.XI.

effects of this unwise competition were greatly reduced in 1930, when the standard provisions for disability coverage which had been promulgated by the National Association of Insurance Commissioners were adopted generally by the companies, but the errors in judgment which had been made previously resulted in a continuation of the unfavorable disability experience which in 1932 caused most of the companies to eliminate the income benefits altogether and to modify further those disability benefits which they continued to offer. Since then, some of the large companies which discontinued issuance of income disability in 1932 have resumed the issuance of the benefit in a modified form. Today 10 of the 26 largest companies are issuing income disability benefits on a restricted basis.

With the 1932 changes in coverage, changes in rates were made also. These changes have placed the issuance of disability benefits on a basis on which the rates are apparently adequate for the coverage. The companies continue to show large losses, however, because of the substantial number of contracts still outstanding at inadequate rates.[47] It will not be possible to determine the total losses for many years.

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[47] Among the companies showing loss on disability provisions during 1929–38, there are wide differences in the ratios of loss sustained. These variations in experience are to be expected, of course, in view of the wide diversity in coverage, especially in the period prior to 1930.

By comparing the various disability clauses and published rules which were being used on January 1, 1929, by the different companies, it is possible to get some indication of factors that have contributed toward minimizing or augmenting the losses sustained. The New York Life and Mutual Life, the only companies of the group that issued an income disability clause providing for benefits which increased with the duration of the claim, show the greatest loss ratio over the period 1929–38. Undoubtedly the incentive of greater ultimate disability benefits attracted especially unfavorable risks and has resulted in the accentuation of the hazard of malingering; 2 of the companies which show moderate loss ratios—the Massachusetts Mutual and the New England Mutual—were virtually the only companies of the group that as late as 1929 had not yet adopted the "90-day clause" but were still using the earlier, more literal clause requiring "total and permanent disability" and were commencing the disability payments as of the date of proof rather than the date of the beginning of disability. These 2 companies also limited the maximum amount of disability coverage below that granted by the larger companies. Those companies which imposed the lower limits of coverage show substantially lower loss ratios as a group than the larger more liberal companies. Among the latter group were the 5 largest companies, and Travelers and Aetna, all of which show high loss ratios in the aggregate.

The most favorable loss ratio of these larger companies is shown by the Prudential, and a possible explanation may be found in the fact that in 1929 this company was the only one of the group that was not dating back the income payments to the inception of the disability. The Prudential was also including the premium waiver and "installment" disability benefit in all policies issued at that time, and has since continued to include a restricted disability benefit in all policies issued. This practice has apparently operated to reduce to some extent the force of selection against the company, which is likely to be more pronounced when the choice is left with the insured. Another of the larger companies, the John Hancock, shows a high loss ratio even though the limit of coverage was restricted. A possible explanation is suggested by the fact that in 1929 it was the only company among those using the "90-day clause" that continued the income disability coverage to age 65. The others terminated it at age 60. The difference in age limit possibly affected the John Hancock experience to an appreciable extent, since the incidence of claims rises very steeply at the older ages. This is especially true when the "90-day clause" is used, providing as it does that the insured is deemed to be permanently disabled if total disability continues for 90 days or more (pt. 28, testimony of Ernest J. Howe, March 1, 1940).

SECTION XXI

Assets and Investment Practices

The investment policies and practices of the legal reserve life insurance companies admittedly influence practically every phase of this country's economic life. It is for this reason that a more detailed review than has been possible in previous sections of this report of the composition of their assets and the nature of their investment management is desirable.

The Commission's analysis of life insurance company investments was confined to a study of the investments of the 26 largest life insurance companies for the period from 1929 to 1938 and is based upon replies submitted by these companies to the Commission's two investment questionnaires.[1] The analysis is published in statistical form as part 10A of the hearings before the committee and contains detailed information on funds available for investment and investments made, assets and liabilities, cash, policy loans, collateral loans, bonds and stock, farm mortgages and real estate, urban mortgages and real estate, and contingency or other special reserves. The holdings and an investment analysis of each company are set forth separately to enable comparison to be made. Among other information presented is material showing the amount of bonds owned, acquired, redeemed, and sold; the investment ratings and maturities of such bonds; and the income received therefrom. The ownership and acquisition of farm and urban mortgages and real estate is also set forth and analyzed according to size, delinquencies, geographical location, and functional types. The discussion of life insurance investments contained in this section of the report is of necessity a summary of this more voluminous material. The reader who desires a more comprehensive picture of investment operations and practices should read the section with constant reference to the supporting tables in part 10A.

During the period from 1929 to 1938 the 26 principal companies had available for investment over $28,000,000,000.[2] This tremendous sum represented the excess of income over disbursements and receipts from sale, redemption, or exchange of securities. Of the entire amount, the companies succeeded in investing slightly over $26,000,000,000.[3] An indication of the channels through which this sum was invested may be seen from an examination of the combined assets of these 26 companies. It will be seen from the 10-year statement of admitted assets printed on the opposite page [4] that by far the largest sum is invested in bonds and stocks, the second largest amount in mortgages, the third in policy loans, and the fourth in real estate. The statement of admitted assets also gives some indication of the shifting

[1] The 2 questionnaires were sent to all United States legal reserve life insurance companies which had, at the end of 1938, $125,000,000 or more of assets. There were 26 such companies. They are the first 26 companies listed in appendix A.

[2] Pt. 10A, R. 92.

[3] Pt. 10A, R. 94.

[4] Pt. 10A, R. 98.

trends in life insurance company investments which have taken place since 1929. Some of the most conspicuous changes revealed are the increase in Government bond holdings, the decrease in mortgages, and the increase in real estate.

The following table reflects the relative percentage of admitted assets in the principal asset classifications as of December 31, 1929, compared with holdings as of December 31, 1938.[5] It will be observed

Admitted assets—Combined statement—26 largest legal reserve life insurance companies as of Dec. 31 for each year 1929 to 1938, inclusive

[In thousands of dollars]

	1929	1930	1931	1932	1933
Cash	102, 188	109, 734	134, 329	271, 413	388, 364
Policy loans and premium notes	1, 923, 231	2, 264, 370	2, 717, 654	3, 099, 344	3, 117, 465
Bonds and stocks:					
Bonds:					
United States Government's	302, 834	296, 532	347, 182	412, 450	783, 042
Canadian Government's	130, 008	119, 722	130, 695	134, 872	138, 666
Other government's	31, 161	31, 258	29, 743	23, 865	16, 393
United States political subsidies	477, 048	516, 398	616, 151	661, 403	745, 395
Canadian Provinces	238, 028	275, 889	304, 578	306, 902	294, 849
Railroad equipment's	368, 234	355, 971	322, 745	288, 979	256, 042
Railroad bonds	2, 349, 426	2, 431, 770	2, 487, 999	2, 453, 777	2, 385, 042
Public utilities	1, 299, 276	1, 475, 888	1, 572, 315	1, 565, 328	1, 584, 341
Industrial and miscellaneous	213, 586	275, 871	301, 153	304, 624	295, 428
Total bonds	5, 409, 600	5, 779, 299	6, 112, 559	6, 152, 201	6, 499, 201
Stocks	368, 991	451, 669	496, 680	517, 928	443, 576
Total bonds and stocks	5, 778, 591	6, 230, 968	6, 609, 239	6, 670, 129	6, 942, 777
Collateral loans	4, 865	4, 533	3, 350	2, 072	1, 730
Mortgages [1]	6, 209, 893	6, 472, 518	6, 567, 082	6, 331, 255	5, 891, 549
Real estate	277, 744	335, 750	430, 113	640, 616	964, 438
All other assets	595, 818	652, 151	704, 429	736, 811	781, 553
Total admitted assets	14, 892, 334	16, 070, 025	17, 166, 196	17, 751, 645	18, 087, 117

	1934	1935	1936	1937	1938
Cash	523, 578	715, 540	742, 035	626, 411	665, 329
Policy loans and premium notes	3, 026, 570	2, 923, 371	2, 839, 637	2, 829, 235	2, 822, 410
Bonds and stocks:					
Bonds:					
United States Government's	1, 699, 053	2, 645, 463	3, 608, 723	4, 264, 159	4, 525, 174
Canadian Government's	147, 161	169, 106	180, 615	191, 469	208, 707
Other government's	14, 243	12, 549	8, 778	5, 030	5, 898
United States political subsidies	939, 998	1, 077, 311	1, 183, 805	1, 282, 877	1, 367, 744
Canadian Provinces	287, 247	293, 219	284, 410	279, 134	277, 168
Railroad equipment's	225, 673	204, 341	217, 960	304, 322	283, 989
Railroad bonds	2, 360, 253	2, 273, 490	2, 359, 678	2, 276, 233	2, 277, 406
Public utilities	1, 673, 680	1, 898, 468	2, 285, 765	2, 531, 559	2, 967, 410
Industrial and miscellaneous	351, 707	487, 497	632, 299	908, 382	1, 196, 276
Total bonds	7, 699, 016	9, 061, 441	10, 762, 030	12, 043, 167	13, 109, 768
Stocks	438, 670	530, 806	555, 695	500, 875	525, 566
Total bonds and stocks	8, 137, 686	9, 592, 247	11, 317, 725	12, 544, 045	13, 635, 334
Collateral loans	1, 153	1, 221	3, 278	2, 858	2, 324
Mortgages [1]	5, 134, 158	4, 625, 603	4, 447, 429	4, 488, 616	4, 655, 387
Real estate	1, 358, 444	1, 593, 898	1, 739, 349	1, 776, 730	1, 775, 181
All other assets	753, 395	705, 081	719, 784	729, 117	734, 163
Total admitted assets	18, 934, 986	20, 156, 959	21, 809, 237	22, 997, 004	24, 290, 135

[1] Includes ground rents.

NOTE.—Data for Pacific Mutual Life Insurance Co. included since Dec. 31, 1936. Data for Dec. 31, 1929 to 1935, inclusive, 25 companies only.

[5] Pt. 28, exhibit No. 2264. For a review of investment trends as disclosed by the experience of the New York Life from 1897 to 1930 see pt. 28, testimony of Thomas A. Buckner, Feb. 12, 1940. That company emphasized the investments in the following order: Railroads, municipal bonds, farm mortgages, Government bonds, urban mortgages, policy loans. Id.

that United States Government holdings have increased from 2.03 percent in 1929 to 18.63 percent in 1938 while mortgages have decreased from 41.7 to 19.17 percent and real estate increased from 1.87 to 7.30 percent.

Admitted asset value in percentage of total admitted assets as of Dec. 31, 1929, and Dec. 31, 1938

	Dec. 31, 1929	Dec. 31, 1938		Dec. 31, 1929	Dec. 31, 1938
Cash	0.69	2.74	Mortgages	41.70	19.17
United States Government bonds	2.03	18.63	Real estate	1.87	7.30
Other Government bonds	1.08	.83	Policy loans	12.91	11.62
United States political subdivisions	3.20	5.63	Collateral loans	.03	.01
Other political subdivisions	1.60	1.14	Other assets	4.00	3.02
Railroad bonds	15.78	9.38		100.00	100.00
Railroad equipment trust	2.47	1.17			
Public utility bonds	8.73	12.22			
Industrial and miscellaneous bonds	1.43	4.92			
Total bonds	36.32	53.97			
Total stocks	2.48	2.17			

The above averages do not, of course, indicate the wide variation which exists in the investment policies of individual companies. The proportion of admitted assets invested in bonds at the close of 1938, for example, varied widely with different companies. The Mutual Life and Travelers carried 60.46 percent and 63.10 percent respectively, of their assets in bonds while the Union Central and Guardian Life had but 26.14 percent and 29.19 percent,[6] respectively, so invested. Similarly, investments in mortgages measured in terms of the companies' total assets varied widely from as low as 7.09 percent in the case of the Travelers to as high as 43.72 percent in the case of the Western & Southern.[7]

A. MORTGAGES AND REAL ESTATE

One of the principal channels of investments which life insurance companies have utilized for many years has been first mortgages on farm and city real estate. These mortgage loans are authorized by the laws of all States and have been made by the companies throughout the country. As indicated above, 19.17 percent [8] of the assets of the principal companies was invested in such mortgages as of the end of 1938 and an additional 7.30 percent was invested in real estate most of which was acquired through foreclosure or in satisfaction of debt. The total investment in farm and urban real estate acquired in satisfaction of debt, and in mortgages as of December 31, 1938 totaled $6,067,035,000 and was divided as follows: [9]

[6] Pt. 10A, R. 102.
[7] Ibid.
[8] See table.
[9] Pt. 10A, R. 161, 180, 194, 217.

	Percent of total mortgages and real estate	Percent of total assets
Farm mortgages, $743,961,000	12.3	3.1
Farm real estate, $529,392,000	8.7	2.2
Urban mortgages, $3,888,045,000	64.1	16.0
Urban real estate, $905,637,000	14.9	3.7
	100.0	25.0

Of this amount the five largest companies own $3,662,618,000 or 60.4 percent of the total.[10]

1. Farm Mortgages and Real Estate

Because of their huge investments in farm mortgages life insurance companies are an important factor in the agricultural economics of the country. The period from 1910 to 1939 was characterized by a steady diminution in the percentage of farm debt held by individuals and a correspondingly substantial increase in the percentage held by insurance companies and other lending institutions.[11] During this period the farm mortgage debt of the United States increased from $3,208,000,000 to $7,071,000,000.[12] The percent of the debt held by life insurance companies did not remain static. In 1910 life insurance companies held 12.1 percent of the total. By 1928 this amount had gradually increased to a high of 22.3 percent while by 1939 it had receded to 12.6 percent. In 1939 farm mortgages held by life insurance companies exceeded those held by land bank commissioners or the commercial banks but were less than the amounts held by individuals and the Federal land banks.

In some areas of the country, life insurance companies have been heavily interested in the farm mortgage situation. Their holdings have been heaviest in the West North Central States, where in 1939 they amounted to 19.2 percent of the farm mortgage debt.[13] In this region during the period from 1926 to 1934 life insurance company farm mortgages were always in excess of 30 percent of the total farm debt, reaching a high point of 34.9 percent in 1928. The companies have been particularly active in the State of Iowa, one of the richest of the farm States. Since 1920 they have held the largest volume of farm mortgages in this State held by any institutional lenders, the investments of the 26 companies totaling in 1938 $195,170,000 in Iowa farm mortgages alone. Other States in which large amounts of farm

[10] Pt. 10A, R. 104.
[11] Pt. 28, exhibit No. 2274.
[12] Ibid.
[13] Pt. 28, exhibit No. 2275.

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mortgages are held by these companies include Illinois, Indiana, Kansas, Missouri, and Nebraska.[14]

The Prudential is the most active company in the farm-mortgage field. Its holdings of $167,298,000 of farm mortgages are over twice that of any of the other 25 principal companies.[15] In the case of all but 5 of these companies (which 5 do not own farm mortgages) farm-mortgage investments represent a substantial portion of the portfolios, ranging as high as 17.21 percent in the case of the Equitable of Iowa.[16]

The amount of farm mortgages held by the 26 companies as of December 31, 1938, and the percentage such holdings constituted of each company's total assets are indicated in the following table:[17]

Company	Amount	Percentage of total assets	Company	Amount	Percentage of total assets
Metropolitan	$70,986,000	1.44	Union Central	$50,426,000	13.47
Prudential	167,298,000	4.40	Provident Mutual	2,579,000	.74
New York Life	6,336,000	.24	Connecticut Mutual	15,498,000	4.61
Equitable of New York	71,593,000	3.17	Connecticut General	9,752,000	3.95
Mutual of New York	6,000	0	Phoenix Mutual	15,284,000	6.44
Northwestern	81,248,000	6.59	Bankers Life	30,681,000	13.44
Travelers	29,775,000	3.05	National Life	11,787,000	5.74
John Hancock	67,002,000	7.28	Pacific Mutual	2,176,000	.70
Penn Mutual	4,153,000	.59	State Mutual	0	0
Mutual Benefit	45,366,000	6.70	Equitable Iowa	31,352,000	17.21
Massachusetts Mutual	0	0	Western & Southern	1,988,000	1.16
Aetna	25,450,000	4.10	Lincoln National	3,225,000	2.18
New England Mutual	0	0	Guardian Life	0	0

The farm mortgage accounts of these companies as a whole has been steadily contracting since 1929 at which time they totaled $1,787,-799,000, which is over a billion dollars in excess of the present figures. The account of the Prudential has increased since 1935, however,

[14] The State in which the largest farm mortgages investments were made, with the investment in each, were as follows:

State	Mortgage investment	Percent of total farm mortgages owned by 26 companies
Iowa	$195,170,000	25.84
Illinois	91,663,000	12.13
Indiana	47,843,000	6.33
Missouri	45,871,000	6.07
Texas	46,866,000	6.20
Kansas	45,367,000	6.01
Minnesota	46,640,000	6.17
Nebraska	35,465,000	4.69

The 26 life insurance companies had no farm loan investments in the following States: Delaware, Maine, Massachusetts, Nevada, New Hampshire, Rhode Island, and insignificant amounts in Connecticut, Florida, New Jersey, New Mexico, New York, Utah, Vermont, and Wyoming (pt. 10A, R. 167–171).

[15] Pt. 10A, R. 161.

[16] Pt. 10A, R. 104, 161.

[17] Ibid.

while the comparable accounts of the Metropolitan and Equitable have declined.[18] Reduction in the farm mortgage account has resulted to a considerable extent from foreclosures, the companies having foreclosed $669,559,000 of farm mortgages (measured in terms of the unpaid principal amount) during the period from 1932–38.[19]

The average contract rate on the companies' farm mortgages ranged in the case of individual companies from a high of 5.54 percent to a low of 4.70 percent during 1938. These average contract rates are appreciably lower than those obtained in 1932.[20] The $743,961,000 farm mortgages owned December 31, 1938, earned a gross interest for the companies of over $31,000,000 during that year.[21]

The companies' farm mortgages are principally in the $10,000 to $25,000 category. A relatively small number may be found in the less-than-$2,000 group.[22]

A large number of the farm mortgages outstanding are delinquent as to both taxes and interest. As of the end of 1938 14.75 percent of the total mortgages were delinquent over 1 year in this regard, and the number so delinquent was found to range as high as 28.55 percent in the case of the Union Central.[23] Delinquencies for interest alone were also large, there being 9.26 percent of the mortgages delinquent as to interest 1 year or more and 14.71 percent of the mortgages delinquent 3 months or more.[24]

Delinquencies are but a first indication of more serious farm-mortgage investment difficulties. In recent years the insurance companies have been obliged to foreclose heavily on their mortgage loans in order to protect the interest of their policyholders. Foreclosures come about for many reasons, some of which were enumerated by Mr. R. R. Rogers, vice president of the Prudential: The abandonment of the farms, the inability and lack of desire on the part of the farmer to attempt to salvage a heavily encumbered farm, delinquent taxes and judgments, absentee ownership which has relied on farm renters to pay living expenses and to pay taxes and mortgage requirements, the burdening of the borrower with chattel and crop loans until subordinate creditors receive the entire income of the farm and senior creditors such as life insurance companies receive nothing, and finally because of the direct request of the farmer himself who may desire foreclosure as a means of relieving himself from debt.[25] Foreclosures of farm properties have been heavy, amounting to $669,559,000 in the period from 1932 to 1938 for the 26 companies alone.[26]

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[18] Pt. 10A, R. 161.

[19] Pt. 10A, R. 165.

[20] Pt. 10A, R. 163.

[21] Pt. 10A, R. 178.

[22] Pt. 10A, R. 172.

[23] Pt. 10A, R. 175.

[24] Pt. 10A, R. 174.

[25] Pt. 28, testimony of R. R. Rogers, February 19, 1940.

[26] Life insurance companies have received substantial help through Federal land bank and Land Bank Commissioner loans, without which loans their delinquencies and foreclosures would have been considerably higher. From May 1, 1933, to January 1, 1937, the amount of such loans used to refinance first and junior mortgages held by life insurance companies amounted to $305,818,000. In several instances the amounts loaned to assist the insurance companies amounted to over 30 percent of the total loans made; 32.7 percent of Federal land bank and Land Bank Commissioner loans in Iowa, for example, were made to insurance companies while in Kansas, South Dakota, and Tennessee they equaled 35.2 percent, 34.6 percent, and 32.6 percent, respectively (pt. 28, exhibit No. 2279).

With the decline in new farm mortgage investments and the rise in farm land ownership resulting from foreclosure during the period of depression, the insurance companies have become active as farm managers and now rank among the largest owners and operators of farmland in the country. Information assembled by the Department of Agriculture reveals that during the period from 1929 to 1939 the life companies acquired more farm real estate than any other type of lending agency.[27] During this period there was a decided shift in life insurance company farm investments. In 1929 about 96 percent of their total farm investment was in mortgages. By 1939 such mortgages accounted for only 55.8 percent of their interest in farm properties. With the decreasing proportion of farm mortgages held, there was of course a corresponding increase in the proportionate importance of farm real estate owned, which now constitutes 44.2 percent of the companies' total farm investment.[28]

As a result of foreclosure the 26 companies held at the end of 1938 $529,392,000 of farm real estate and an additional $81,755,000 of farm real estate under contract of sale.[29] The figures indicate that almost half of this real estate had been acquired prior to 1934 and indeed the companies have succeeded in selling only 32.14 percent of the farm real estate which they acquired during 1931 or thereafter.[30] This farm real estate is not profitable to the companies, returning an average income during 1938 of only 0.93 percent of mean admitted asset value without taking depreciation into consideration.[31] Two companies have lost money, before depreciation, in the operations of their farm real-estate account, and in no instance has the farm real estate been sufficient to return income adequate to meet the amount guaranteed under insurance policy contracts.[32]

Some indication of the extensive farming operations of the principal life companies may be found in a review of the activities of the Metropolitan. This company is the biggest farmer in the Central States, operating at the present time over 7,000 separate farms. The company's farms, which average 200 acres in size and may range as high as 2,000 acres, represent an investment of close to $80,000,000. Metropolitan operates farms in 25 States and employs over 350 people to act as farm managers, appraisers, and agricultural experts of various types. In the State of Iowa alone it sold over $5,000,000 worth of farms during 1939.[33] The company's farming program includes working out with the farmer detailed crop-rotation schedules and erosion-prevention plans. It carries out extensive undertakings for the rehabilitation of farm property, repairing barns and homes, building fences, and so forth.[34] Tremendous quantities of grain and livestock are handled each year and the company is a large dealer in farming mplements. During 1937 alone Metropolitan harvested 50,000 bales of cotton, 10,000,000 bushels of corn, 5,000,000 bushels of wheat, 6,000,000 pounds of peanuts, and 1,000,000 pounds of tobacco.[35]

[27] Pt. 28, exhibit No. 2280.
[28] Pt. 28, exhibit No. 2281.
[29] Pt. 10A, R. 180, 181.
[30] Pt. 10A, R. 182, 185.
[31] Pt. 10A, R. 189.
[32] Ibid.
[33] Pt. 28, testimony of Glen E. Rogers, February 16, 1940.
[34] Pt. 28, testimony of Glen E. Rogers, February 19, 1940.
[35] Pt. 28, testimony of Glen E. Rogers, February 19, 1940.

The importance of life insurance company farm operations may also be demonstrated by further reference to the companies' experience in the State of Iowa. As of January 1, 1939, the companies held 2,752,000 acres of farm land in this State, an amount representing 8.1 percent of the land.[36] The next largest corporate lender, the deposit banks, owned but 1 percent.[37] In 1933 the insurance companies had owned only 3.9 percent of the farm land in Iowa. The rapid increase in their holdings during the period resulted from their heavy foreclosures; being the owners of first mortgages they foreclosed somewhat later than other institutional lenders.[38] In 1930 they were responsible for 27 percent of the foreclosures and by 1934 they were responsible for 67 percent of the foreclosures. At this time they held but 40 percent of the Iowa farm debt.[39] A brief review of the life insurance company operations in this State will focus attention on the extent to which life insurance companies are dependent upon the stability and productivity of the farming community.

In the State of Iowa the insurance companies during the period of acquisition (1901–28) loaned money primarily through farm correspondents. These correspondents made loans on a commission basis and this fact, in addition to the influence of the general farm land boom which was in progress, resulted in many companies lending amounts on farm properties in excess of their true value. Loans made on a valuation as high as $100 per acre were frequent in the State and there are indications that these loans were made without distinction between the low-value and high-value farm properties.[40] As a result when it became necessary for the companies to foreclose they found themselves the owners of substantial quantities of farm property which were of low value and which could not possibly be sold for a price equal to the book value at which they were carried. A special study of five high- and five low-value counties in southern Iowa disclosed that in 1939 the insurance companies owned 9 percent of the land in the high-value counties and 20 percent in the low-value counties.[41] The economic effect of this ownership of low-value properties cannot be overestimated. Since the insurance companies are required to dispose of their properties they are constantly on sale and managed by tenants who frequently have no permanency of tenure. As a result they are inclined to "mine" the land and the property deteriorates from erosion and neglect. As one farm expert stated: [42]

> * * * the difficulty is that the insurance companies have those farms for sale. Every year the tenant on one of those farms is subject to termination of the agreement.

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[36] Pt. 28, exhibit No. 2284.

[37] Ibid.

[38] Pt. 28, testimony of William G. Murray, February 15, 1940. An interesting indication of the foreclosure policies of the life insurance companies is disclosed in an analysis of foreclosures in southern Iowa for the period 1915 to 1936. For this total period private individuals foreclosed 36.3 percent of the total and life insurance companies 30.7 percent. Foreclosures by private individuals remained greater than foreclosures by life insurance companies until 1930 and in fact it was not until this date that foreclosures by insurance companies, considering the amount of holdings, became substantial. During much of the earlier period insurance foreclosures were exceeded not only by private individuals but by the banks though ultimately foreclosures by banks amounted to but 15.7 percent of the total foreclosures (pt. 28, exhibit No. 2283).

[39] Pt. 28, testimony of William G. Murray, February 15, 1940.

[40] Pt. 28, testimony of William G. Murray, February 15, 1940.

[41] Pt. 28, exhibit No. 2285.

[42] Pt. 28, testimony of William G. Murray, February 15, 1940.

The farm may be visited by anybody at any time to determine whether or not it is to be sold, and the farmer who is operating that farm is constantly under possibility of having to move the next year, and that means that land where there is erosion, and where there are difficulties in handling it, is not under stable ownership in terms of a long-term program.

In an effort to meet this situation some companies have attempted to work out arrangements which will give the tenant a stake in the land and encourage him to cultivate it by giving him some reasonable expectation that he will become its ultimate owner.[43]

The management of farm land by proxy is not socially desirable and the tendency in recent years for an increasing amount of this land to fall into the hands of large institutional holders has far-reaching economic consequences. There are indications that the companies have not in all cases adopted a realistic attitude toward the valuation of their farming properties and remain as owners in the hope that they will eventually realize from the properties the amount invested therein.[44] It is far better from a long-range point of view that these properties be returned to owner-operators toward the end that tenancy may decrease and the farmer may continue to have a stake in his farm.

2. Urban Mortgages and Real Estate

As of December 31, 1938, the companies owned $3,888,045,000 worth of urban mortgages.[45] These mortgages were on many different types of properties including one- to four-family houses, apartments, commercial hotels, office buildings, and stores.[46] Like the farm-mortgage account the urban-mortgage account has been contracted during the period since 1929. The contraction was not, however, nearly as great and in fact since 1936 when the low point was reached, there has been some expansion in the aggregate amount of such loans outstanding.[47] Some of the reduction in the account is the result of foreclosure, the companies having foreclosed $1,229,849,000 of urban mortgages during the period 1932–38.[48]

In 1938 the companies realized an income of $1,301,532 or 4.69 percent of mean adjusted asset value from the urban mortgages owned.[49] Contract rates on these mortgages owned ranged from 3.95

[43] Pt. 28, testimony of William G. Murray, February 15, 1940. See also pt. 28, testimony of Mr. R. R. Rogers, February 19, 1940.

[44] Pt. 28, testimony of William G. Murray, February 15, 1940; exhibit No. 2286; testimony of Glen E. Rogers, February 19, 1940.

[45] Pt. 10A, R. 194.

[46] Pt. 10A, R. 208–209. The amounts invested in the principal categories and the percent of the total are as follows (id.):

	Mortgages owned	Percent of total urban mortgages owned
1- to 4-family houses	$1,040,201,000	26.76
Apartment houses	811,600,000	20.88
Office buildings	356,221,000	9.17
Stores and offices	249,303,000	6.41
Hotels	177,482,000	4.57

[47] Pt. 10A, R. 194.

[48] Pt. 10A, R. 199.

[49] Pt. 10A, R. 215, 216.

percent in the case of the Mutual of New York to 5.39 percent for the Guardian Life.[50] The urban mortgages were on properties in every State with the largest amounts in New York, Pennsylvania, California, Ohio, and Illinois; [51] 60.77 percent of all urban mortgages owned are located in 10 metropolitan areas; $1,227,290,000 are located in or around New York City and $316,262,000 in or around Chicago.[52] Many of these mortgages are of large size, 56.09 percent of them being over $100,000 in amount with the largest amount, $502,904,000, in the $100,000 to $250,000 size.[53] Of the urban mortgages owned as of December 31, 1938, 10.52 percent were delinquent as to interest 3 months or more. As between individual companies the percentage of mortgages, on which the interest was delinquent 3 months or more, ranged as high as 33.68 percent in the case of the Guardian Life and 21.48 percent in the New England Mutual.[54]

A few companies have been particularly active in the field of residential loans and housing development. For example, two of the five largest companies, Prudential and New York Life, have purchased a total of over $85,000,000 of Federal Housing Administration mortgages, that is, mortgages insured under title 2 of the National Housing Act; the 26 companies have an aggregate of over 155,000,000 of such mortgages.[55] These investments have been found to have some distinct advantages, such as expediting the rapid turn-over of property and preventing the real-estate account of the company from becoming overburdened with large business properties which could not be readily moved. Only 2 of the 26 companies, Metropolitan and Prudential,[56] have made any investment in the field of housing development. The Metropolitan has been a pioneer in the development of this field of urban investment, which is still in the experimental stage. The Federal Housing Administration mortgages and housing development projects offer new outlets for investment funds and may even prove to be acceptable investment devices which can eventually be extended to other fields.

As in the case of the farm account, the urban account has shown a substantial increase in real estate owned during recent years. In 1929 the companies owned but $11,208,000 of such real estate whereas by the end of 1938 they owned $905,637,000 and had an additional $78,767,000 under contract of sale.[57] By and large these real-estate properties are held in 10 large metropolitan areas which account for 62.97 percent of the total and as much as 96.93 percent in the case of

[50] Pt. 10A, R. 197.

[51] Pt. 10A, R. 202–206. The companies have very small or no urban-mortgage investments in Maine, New Hampshire, and some of the Western States.

[52] Pt. 10A, R. 201.

[53] Pt. 10A, R. 207.

[54] Pt 10A, R. 211.

[55] Pt. 10A, R. 195.

[56] Pt. 10A, R. 258.

[57] Pt. 10A, R. 217, 218. The 5 largest companies owned 67 percent of the urban real estate acquired in satisfaction of debt by the 26 companies. The holdings of these 5 companies at the end of 1938 were as follows:

Metropolitan	$237,496,000
Prudential	129,781,000
New York Life	108,105,000
Equitable (New York)	81,015,000
Mutual	50,899,000
Total	607,296,000

the Mutual of New York.[58] The companies have succeeded in selling 27.11 percent of urban real estate owned December 31, 1931, plus subsequent additions.[59] There has been great variation as between individual companies, however, the largest amount of real estate being sold by the Prudential and the smallest by the New England Mutual. The 26 companies earned an average of 1.37 percent of mean admitted asset value on the 1938 operation of the real-estate account, many companies operating at a loss even without considering depreciation.[60] The bulk of the real estate owned is to be found in the $100,000 to $250,000 size classification though a relatively large amount is in the $5,000 to $10,000 class.[61]

Many companies have indulged in excessive valuation of their urban real estate. At least 8 companies of the 26 carry their real estate at a book value in excess of the unpaid principal amount of foreclosed mortgage less cash received. The valuations range as high as 120.66 percent of this figure for the New England Mutual and 111.83 percent for the Lincoln National.[62] In terms of the percentage ratio of book value to gross income the range was from a low of 5.8 percent in the case of the New York Life to a high of 18.23 percent in the case of the Union Central. The Mutual Life, the New England Mutual, the Union Central, and the Connecticut Mutual all carry their real estate at a valuation in excess of 12 times gross earnings.[63]

Two companies which have had particular difficulty in the handling of their real estate are the Mutual Life and the New England Mutual. The experience of these companies demonstrates the investment difficulties encountered as a result of a restricted mortgage lending policy coupled with a somewhat unrealistic attitude toward the disposition of real estate. The Mutual Life has confined its mortgage loans to loans on urban properties in the large metropolitan areas. Over 89 percent of its loans are in the New York City metropolitan area and the acting manager of the company's real-estate department acknowledged that his company did not have adequate facilities

[58] Pt. 10A, R. 219.

[59] Pt. 10A, R. 223.

[60] Pt. 10A, R. 227.

[61] Pt. 10A, R. 228.

[62] Pt. 10A, R. 229.

[63] Pt. 10A, R. 230–254. The soundest real-estate valuation evidenced by determining the ratio of book value to gross income occurred in the cases of the New York Life, the Prudential, and National Life. Urban real estate of the New York Life was carried at 5.80 times gross income; that of the National Life at 6.20 times gross income; and that of the Prudential at 6.96 times gross income. In view of the fact that the foreclosed real estate owned by the New York Life included only 14 percent 1- to 4-family houses while that of the National Life contained over 29 percent and that of the Prudential over 49 percent, these values may be considered about equally strong.

The real estate of many companies is carried at a book value of from 9 to 18 times gross earnings. Such high valuations are unsupportable. The following is a list of companies whose real estate appears on their books at more than 9 times gross:

	Ratio of book value to gross earnings		*Ratio of book value to gross earnings*
Metropolitan	9.45	Union Central	18.23
Mutual Life	14.40	Provident Mutual	9.48
John Hancock	9.09	Connecticut General	9.01
Travelers	10.37	Connecticut Mutual	12.37
Penn Mutual	9.56	Phoenix Mutual	9.81
Mutual Benefit	10.25	Bankers Life	9.33
Massachusetts Mutual	10.94	State Mutual	9.77
Aetna Life	9.14	Lincoln National	9.27
New England Mutual	12.25		

which would enable it to place its money around the country.[64] Not only has there been this heavy geographical concentration but the company has not seen fit to diversify its mortgage loans within the area. Most of its loans range from $250,000 upward.[65] It has few residential loans, that is loans on one to four family houses, and no Federal Housing Administration loans on residential properties.[66] In the main its loans are concentrated on business buildings, apartment houses and office or other commercial properties. The company representatives stated:[67]

> * * * we have not made residential or farm loans since the latter nineties, and the reason for that is because of the losses we sustained in farm loans and residences that were made in the eighties and latter seventies.

As a result of this lending policy 96.93 percent or $49,336,000 of the company's urban real estate is located in New York, Chicago, Philadelphia, and Buffalo, with $48,000,000 in New York City alone.[68] These properties include in addition to large office buildings and apartments, auto salesrooms, loft buildings, and warehouses; 14 percent of the account is in old law tenement houses.[69] The properties are carried at a ratio of book value to gross income of 14.4, the second highest ratio of all the 26 companies. Stores and apartments are carried as high as 20.32 times gross income.[70] These high valuations and the nature of the properties have resulted in the company's being unable to dispose of much real estate in recent years, and in fact the company has preferred to speculate on the future market value of the property rather than sell it as expeditiously as possible.[71]

The experience of the New England Mutual in the field of mortgage loans and real estate is to the same effect. The company has confined its lending operations entirely to business properties. It has made no farm loans or loans on apartment houses or residences.[72] Mr. George Willard Smith, president of the company, explained its narrow real-estate investment policy. He said that the New England Mutual had no farm investments because:[73]

> * * * we started many years ago to lend on mortgages on business properties and we have not gone to another field extensively as yet.

When pressed for a fuller explanation he stated that it was because the field was very well covered and because entry would require a larger organization and change in office control. Similar explanation was

[64] Pt. 10A, R. 201; pt. 28, testimony of John D. McLaughlin, February 19, 1940.

[65] Pt. 10A, R. 228.

[66] Pt. 10A, R. 195, 208, 209. Mr. Polk, a trustee of Mutual, testified that the board of trustees had never taken formal action on the matter of purchasing Federal Housing Administration loans (pt. 28, testimony of February 19, 1940).

[67] Pt. 28, testimony of John D. McLaughlin, February 19, 1940.

[68] Pt. 10A, R. 219.

[69] Pt. 28, testimony of John D. McLaughlin, February 19, 1940.

[70] Pt. 10A, R. 234.

[71] The records of the company disclosed instances where offers to purchase the property in prices in excess of book value had been refused. The company had presumably taken this position in view of the fact that the properties were earning income and it was hoped that eventually sales could be made at higher prices and at a profit sufficient to wipe out certain losses experienced in other properties. See pt. 28, testimony of John D. McLaughlin, February 19, 1940.

[72] Pt. 10A, R. 208.

[73] Pt. 28, testimony of George Willard Smith, February 20, 1940.

given for the company's failure to loan on residential properties. Mr. Smith stated:[74]

> * * * the field is so well covered.

In explaining the company's failure to invest in apartment houses he said:[75]

> The general statement holds true that we have had a very narrow mortgage field and we have not extended it.

Though indicating that his company would like to invest $5,000,000 to $10,000,000 in the real-estate field he indicated that it had been unwilling to undertake investments outside of the narrow field of business properties partly because his staff was not trained to handle such other types of investment.[76] Regarding business properties, it was not possible to secure an adequate explanation as to why the company made loans in some areas and failed to do so in others. Out of a total of $43,273,000 in urban mortgages, the company has $18,328,000, or 42.35 percent, on property located in four cities. Of the entire account $10,473,000, or approximately 25 percent, is on property in Chicago.[77] This heavy concentration of the company's money in Chicago was explained as due to the fact that it had there an energetic correspondent while its complete failure to loan in such areas as Cleveland, Philadelphia, and New York was said to be due to the fact that the company felt the mortgage field was covered by the local banks and accordingly had no correspondent in those areas.[78] That the New England Mutual has proceeded in a somewhat hit-and-miss fashion is indicated by a further examination of its lending system. It employs correspondents but has no written contracts with them.[79] It will make a loan on the basis of an appraisal made by the correspondent, who may offer a loan for his own account. This appraisal is paid for by the borrower. It will sometimes undertake to loan without checking earning statements on the properties submitted by its correspondents.[80] The results of its somewhat haphazard lending policy may be found in the status of its account as of December 31, 1938; 16.29 percent of its mortgages were found to be delinquent as to interest 1 year or more, and 29.63 percent were found to be delinquent for the same period as to interest and taxes.[81] It has $29,371,000 worth of urban real estate, of which over 50 percent is concentrated in five metropolitan areas.[82] The bulk of these properties are in the $250,000 to $500,000 class.[83] Only 2.27 percent of the real estate has been sold in the period since 1931.[84] The properties are carried at an excessive book value, having been written up 20.66 percent above the unpaid principal of the foreclosed mortgages.[85] This write-up is due in part to heavy capitalization of interest and

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[74] Pt. 28, testimony of George Willard Smith, February 20, 1940.
[75] Pt. 28, testimony of George Willard Smith, February 20, 1940.
[76] Ibid.
[77] Pt. 10A, R. 201.
[78] Pt. 28, testimony of George Willard Smith, February 20, 1940.
[79] Ibid.
[80] Ibid.
[81] Pt. 10A, R. 211, 212.
[82] Pt. 10A, R. 219.
[83] Pt. 10A, R. 228.
[84] Pt. 10A, R. 223.
[85] Pt. 10A, R. 229.

results in the entire account being carried at a book value equal to 12.25 times gross income.[86] Mr. Smith stated:[87]

> * * * the values are higher probably than would be recognized by a sale in today's market.

The company has made no realistic effort to dispose of its properties. No sales prices have been set and in spite of operating deficits the company is unwilling to sell the property at less than its investment therein.[88] It is apparent that this company, like the Mutual, is holding its real estate in the hope that values may rise sufficiently to enable it to recapture its investment. This procedure is of course contrary to that expressed by most State laws, and it is certain that it results in placing the company in the position of a manager of real estate and permits the carrying of property long beyond a desirable period of time.

B. CASH

In recent years the amount of cash held by the 26 principal legal-reserve life insurance companies has become an increasingly important item. As of the end of 1938 it represented on an average 2.7 percent of the assets of the companies and ranged as high as 5.02 percent for the Penn Mutual.[89] The total cash amounted to $665,329,000, representing an increase of $563,141,000 over the year-end balance of 1929. The peak amount of cash carried by these companies was in 1936 when the year-end figures reached the total of $742,035,000.[90] Largest balances are carried by Equitable and Metropolitan, each of which held over $100,000,000 in its bank accounts at the end of 1938.[91] The amount of interest which has been earned on these free cash balances is insignificant, totaling only $273,219 for the year 1938. The largest amount of interest was earned by Metropolitan while as many as seven companies showed no interest earned for the year.[92]

Company representatives were questioned concerning their policies in handling free cash balances. It appears that in general the largest companies chose to deposit their funds in New York City banks on a demand basis.[93] The use of New York depositaries is apparently prompted by a desire to have the funds close at hand and by the companies' belief in the outstanding stability of these banking institutions. As has been indicated in a previous section it also results to varying degrees from the influence of interlocking directorships in different

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[86] Pt. 10A, R. 242. Pt. 28, testimony of George W. Smith, February 20, 1940.

[87] Ibid.

[88] Ibid. In contrast the real-estate operations of the New York Life are illuminating. This company's urban properties are carried at a 5.8 ratio of book value to gross income. This is the result of a realistic and energetic revaluation and write-down program. Since 1931 the company has written down the book value of its urban real estate by $50,378,663.12. In carrying out its sales program it has classified its properties and made a special effort to sell or dispose of poor-grade holdings. In addition the company has set up substantial reserves to cover losses which may be realized in the mortgage account. Pt. 28, testimony of George S. Van Schaick and Ernest J. Howe, February 20, 1940, and February 29, 1940.

[89] Pt. 10A, R. 102.

[90] Pt. 10A, R. 106.

[91] Id. Equitable's balance amounted to $112,794,000 and Metropolitan's to $108,802,000.

[92] Pt. 10A, R. 107.

[93] Under the provisions of the Glass-Steagall Act, 49 Stat. 714, ch. 614, sec. 324 (c) interest can now be paid only on time deposits where such deposits are with member banks of the Federal Reserve System. Pt. 28, testimony of Winthrop Aldrich, February 26, 1940.

companies.[94] Most companies do, however, carry some home office accounts in banks located away from their main place of business. These accounts are usually maintained in large cities where the company has offices and are designed in part to facilitate payments to policyholders and the conduct of normal banking transactions.[95] In the case of the New York Life which was shown to have received several requests to deposit its funds at interest in banks scattered throughout the country, its treasurer stated that it was not the company's policy to place money in banks located in cities where it did not have a branch office and that these requests for deposits, though coupled with a statement of the soliciting banks that they were willing to pay interest, were uniformly refused because it was felt the banks were simply seeking prestige which would result from securing the insurance company's deposit and because of the difficulties inherent in handling a large number of relatively small accounts.[96] Some evidence was offered, however, that in the case of the Equitable and other companies as well bank deposits were made in strategic places to assist the sale of insurance or to favor a bank which had placed its group policy with the particular insurance company involved.[97]

The life insurance accounts are carried on a demand basis to provide a greater degree of liquidity and to enable the release of funds whenever necessary in order to meet opportunities for substantial investments which may arise. Many of the bank balances, however, are static and the records of the companies show that identical sums have been on deposit month after month and year after year in the same institutions. These inactive accounts are demand accounts and their existence was not entirely explained.[98]

Most of the large companies have one and sometimes two principal active accounts and the relationship between the insurance company and its chief depositary is usually cemented by interlocking directorships and a long history of business association. Indication of the close community of interest which exists in such a situation was found in an examination of the relationship between the Chase National Bank and Metropolitan. For many years, there has been a close association of these two financial institutions. Not only have there been common directors [99] but the Chase places a portion of its group insurance with the Metropolitan [100] and has been that company's principal depositary, carrying balances at times ranging over $100,000,000.[101] Since 1921, the Chase has maintained an office

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[94] See pp. 32 to 38, *supra*.

[95] Pt. 28, testimony of Henry Greaves and Alfred H. Meyers, February 26, 1940.

[96] Pt. 28, testimony of Alfred H. Meyers, February 26, 1940. See also testimony of Henry Greaves, February 26, 1940.

[97] Pt. 28, testimony of Lawrence Washington and Henry Greaves, February 26, 1940, and exhibit No. 2321.

[98] Pt. 28, testimony of Lawrence Washington, Henry Greaves, and Alfred H. Meyers, February 26, 1940, and schedule E, Convention Form Annual Statements.

[99] Pt. 28, exhibit No. 2316.

[100] Pt. 28, testimony of Winthrop W. Aldrich, February 26. 1940.

[101] Pt. 28, testimony of Winthrop W. Aldrich and Lawrence Washington, February 26, 1940. District offices of the Metropolitan carry the accounts of the company's local managers. An analysis discloses that the Metropolitan, out of 597 such accounts, has 268 in correspondent banks of the Chase (45 percent; i. e., banks which have established a relationship with the Chase by depositing money with it. If allowance is made, however, for the 106 localities where Metropolitan has an account but the Chase has no correspondent, 54 percent of Metropolitan accounts in the remaining localities are with Chase correspondents (pt. 28, exhibit No. 2314). Counsel for the Metropolitan pointed out that of the 268 banks shown as correspondents of the Chase in which the Metropolitan had accounts 168 were also correspondents of banks in New York City which are competitors of the Chase and with which Metropolitan is also doing business.

known as the Metropolitan branch.[102] This branch, which is located in the Metropolitan Life Insurance Co.'s building, carries that company's principal checking account through which around 10,000,000 transactions clear each year. Metropolitan's account with Chase has varied in recent years from $4,000,000 to $104,000,000.[103]

Quite frequently the Chase receives requests from its business associates to solicit the Metropolitan on their behalf. These requests may be for almost any conceivable form of business patronage or, if the request comes from a bank, for a Metropolitan account. Chase representatives relay these requests to officers of the Metropolitan, either by personal call or interoffice memoranda, sometimes indicating the manner in which the Chase may benefit through the Metropolitan adopting the requested course of action.[104] One such situation, which will serve to illustrate, arose in 1938 in connection with a 28-story office building Metropolitan was constructing in New York City. Three cement companies, which carried accounts with the Chase were anxious to obtain the cement contract for the building, and each asked the Chase to intercede on its behalf. One company, Pennsylvania-Dixie Cement Corporation, the last to make this request, wrote an officer of the Chase as follows:[105]

> We are very anxious indeed to secure this cement order. Three of your directors, namely, Messrs. F. H. Ecker, N. Carlton, and J. O'Brien, are on the board of directors of the Metropolitan. I presume because of this you are probably in position to have the owners speak a word in our behalf to the contractors who will buy the cement. Of course, we do not expect them to pay a premium; but our price and everything else being equal we certainly trust you can get your three directors to prevail upon the proper officials of the Metropolitan Life Insurance Co. to say a word to these contractors in our behalf.

When a vice president of the Chase approached the Metropolitan, he was advised the company would receive consideration. In a confirming letter, the Chase official wrote the Metropolitan as follows:[106]

> I have now written you three letters along this line in connection with cement. I do not know that it will make any difference but in the order of their importance to us the Lehigh-Portland Cement Co. maintains the largest balances, Lone Star Cement Corporation next, and the Pennsylvania-Dixie Cement Corporation last. I do not know offhand whether we have accounts from other cement companies, but if this will be of any use to you in reaching your decision later on, I shall be glad to supply additional information.

This particular request was not granted. Other instances were presented, however, where Metropolitan officials indicated their willingness to permit the Chase to make capital of an action of the Metropolitan and memoranda were introduced in the record giving evidence of the variety of opportunities presented for the bank to advantage itself from its close insurance connection.[107] For example, it appeared that the Metropolitan agreed at the suggestion of the Chase to request courts to designate the Chase for bank accounts of receivers appointed by the courts to administer properties on which the Metropolitan

[102] Pt. 28, testimony of George H. Saylor, February 26, 1940.

[103] Pt. 28, testimony of George H. Saylor, February 26, 1940. This account is profitable to the Chase. Id.

[104] Ibid.

[105] Pt. 28, exhibit No. 2309; also pt. 28, testimony of George H. Saylor, February 26, 1940.

[106] Pt. 28, exhibit No. 2309.

[107] Pt. 28, testimony of George H. Saylor, February 26, 1940; exhibit Nos. 2312, 2313.

holds a mortgage in default.[108] The Chase wanted to be appointed trustee under a mortgage indenture to be issued in connection with a railroad consolidation and asked the Metropolitan, which was represented on a protective committee in connection with the reorganization, to put in a good word on its behalf.[109] In another instance, Chase got the account of a hotel manager for a particular hotel owned by the Metropolitan because the Metropolitan had requested the manager to place his account in the Chase.[110]

Another situation was particularly striking. The Chase desired the Union Trust Co. of East St. Louis, Ill., as its correspondent and the Union Trust agreed to make Chase its correspondent provided Chase could help it obtain some commercial business. A memorandum in the files indicates that an officer of the Chase who stated: "I am calling for help" felt sure the acquisition of the Metropolitan account would bring the desired relationship to the Chase. The Metropolitan was solicited for this change and the manager of its district office switched his account to the Union Trust Co.[111]

Another indication of close cooperation between a bank and an insurance company which carried a deposit with it was found in an exchange of correspondence which took place in 1938 between representatives of the Metropolitan and the Bank of the Manhattan Co. It appeared that an agent of the Metropolitan had sought to arrange a policy loan for a policyholder at the bank for a rate of interest less than that which the insurance company demanded in making the loan itself. A vice president of the bank wrote an officer of the Metropolitan in part as follows:[112]

> You asked me to send you the name of your agent who had endeavored to arrange a loan at one of our branches against the policies of your company.
>
> I have explained to you the policy of our bank in the matter of loans on life insurance policies, particularly when the companies are friendly to us. As you know we find it difficult to obtain good loans today but nevertheless do not feel that we should take policy loans away from the insurance companies where the business rightfully belongs.

An agency manager of the Metropolitan wrote the agent in question to the same effect stating:[113]

> This company has very close relations with many of the large banks in New York City and elsewhere. Some of these banks for reasons of their own do not look with favor upon life insurance policies as collateral, and some of them out of regard for the life insurance business decline at least to solicit this type of business.

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108 Pt. 28, exhibit No. 2307.

109 Pt. 28, exhibit No. 2308.

110 Pt. 28, testimony of George H. Saylor, February 26, 1940.

111 Pt. 28, testimony of George H. Saylor and Lawrence Washington, February 26, 1940, and exhibit No. 2310. Mr. Winthrop Aldrich, chairman of the board of the Chase, stated that the banking connections which Chase had with the Metropolitan resulted in only "trival" advantages. He stated he supposed that there have been some occasions where the close relationship of the Chase to the Metropolitan had had some effect (pt. 28, testimony of Winthrop W. Aldrich, February 26, 1940). It should be pointed out that though Mr. Aldrich had been a director of the Metropolitan since 1930 and a member of its finance committee, he stated that he had never investigated the manner in which the Metropolitan determined where it should keep its accounts and that he had no information concerning the management of these accounts. He said (pt. 28, testimony of February 26, 1940):

"I literally don't know one thing about where or how the Metropolitan keeps its bank balances."

112 Pt. 28, exhibit No. 2320; see testimony of Lawrence Washington, February 26, 1940.

113 Pt. 28, exhibit No. 2320.

It is clear that the company bank balances are higher than is necessary to meet day to day expenses or to provide in addition some margin of safety against an unusual cash demand. The companies apparently prefer to maintain these large pools of free cash in lieu of purchasing government securities in order to have ready cash available in the event of a favorable investment opportunity. As long as the bank balances remain as large as they are today they may be considered as a partial measure of the companies' inability to invest.

C. BONDS

A description of the bond account requires discussion of the type of bonds owned, the quality of the bond portfolio, the basis upon which it is valued, maturities and marketability, methods of acquisition and disposal of bonds and the operating profits derived from the handling of the account in its entirety. During 1938 the 26 companies invested more money in bonds and stocks than they did in any other type of investments.[114] As of December 31, 1938, bonds of the various categories indicated below were held by these companies and these holdings accounted for the indicated percentages of the companies' total admitted assets:[115]

	Amount held by 26 companies, Dec. 31, 1938	Percent of total admitted assets of 26 companies
U. S. Government bonds	$4, 525, 174, 000	18. 63
Canadian and other government bonds	214, 605, 000	. 88
Bonds of United States political subdivisions	1, 367, 744, 000	5. 63
Bonds of Canada and other political subdivisions	277, 168, 000	1. 14
Railroad bonds	2, 277, 405, 000	9. 38
Railroad equipment trust certificates	283, 989, 000	1. 17
Public utility bonds	2, 967, 410, 000	12. 22
Industrial and miscellaneous bonds	1, 196, 276. 000	4. 92

The above percentages are averages for all companies indicated. The individual investment practices of the different companies vary considerably in regard to the percent of their assets invested in the various classifications listed. The following schedule shows for the 26 companies the greatest amount invested in each category in any of the 26 companies and the smallest amount so invested:[116]

	Greatest	Smallest
	Percent	*Percent*
U. S. Government bonds	39. 62	6. 11
Bonds of United States political subdivisions	21. 50	. 01
Railroad bonds	16. 08	0
Railroad equipment trust certificates	3. 87	0
Public utility bonds	22. 12	0
Industrial and miscellaneous bonds	13. 21	0

[114] Pt. 10A, R. 95.
[115] Pt. 10A, R. 98, 103.
[116] Pt. 10A, R. 103.

It will be noted that for all intents and purposes there is at least one company (actually there are frequently more than one) which has failed to invest any money in a given classification except in the case of United States Government bonds, companies having universally recognized this type of bond as a proper field for investment.

During the period from 1932 to 1938 the principal companies have acquired $15,246,617,000 of bonds including United States governments, which alone totaled over half this amount or $8,343,309,000.[117] Several different channels have been used in making bond investments, the following amounts having been purchased in the manner indicated:[118]

Purchased at public bidding	$81, 025, 000
Purchased from bankers	2, 537, 740, 000
Purchased in open market	2, 149, 405, 000
Purchased privately from issuers	1, 850, 766, 000

Though private purchases have not been the most important channel measured in terms of aggregate amount as the above table indicates, this method of bond acquisition has become increasingly important in recent years, particularly in the larger companies. Such purchases accounted for the following percentages of total corporate bond purchases for the years indicated.[119]

	Percent		*Percent*
1932	24. 5	1936	24. 1
1933	6. 8	1937	30. 6
1934	24. 5	1938	50. 6
1935	39. 4		

Bonds purchased privately have been principally industrial and miscellaneous corporate securities, the total purchases being as follows:[120]

Railroads	$93, 176, 000
Public utilities	744, 390, 000
Industrial and miscellaneous	978, 055, 000
Total	1, 815, 621, 000

During 1938 the five largest companies purchased 86.65 percent of the total bonds purchased privately. Equitable was the largest buyer, accounting for 34.17 percent of the total for the 26 companies and Metropolitan was second largest buyer, accounting for 27.94 percent.[121]

The quality of the bond portfolio may be measured either in terms of the percentage of defaulted securities contained therein or in terms of the investment ratings given such bonds by a recognized rating service. A very small percentage of the bonds owned by the 26 companies was in default at the close of 1938. Such bonds amounted to approximately $165,000,000 or 1.23 percent of the admitted asset value of all bonds owned.[122] Railroad issues alone accounted for

117 Pt. 10A, R. 122.

118 Pt. 10A, R. 126, 127, 128, 129.

119 Pt. 10A, R. 131.

120 Pt. 10A, R. 132.

121 Pt. 10A, R. 130.

122 From schedule D, convention form statements, and company replies to Commission's investment questionnaire, table 32.

$141,000,000 of this total. From the point of view of investment ratings, analysis of the bond portfolio on the basis of the ratings used by Moody's Investors' Service showed that 75.69 percent of all bonds were rated "Aaa," "Aa," or "A" and that as much as 86.35 percent of the entire portfolio was rated Baa and higher.[123] On the other hand, 8.56 percent of the bonds were shown to be in the "not rated" classification. The amount of bonds so rated equaled $1,123,154,000.[124] Not all bonds in this category are of poor quality since to a considerable extent the not rated issues include issues purchased privately by the insurance companies which are not rated by Moody's because of lack of public participation or inadequate information. Approximately 4 percent of the bonds held were in the Ba category, about which Moody's says:[125]

> Bonds which are rated "Ba" are judged to have speculative elements; their future cannot be considered as well assured.

Many of the bonds in this group were not purchased at "Ba" quality but have fallen into that group as a result of changing economic conditions. This is particularly true in the case of railroad bonds in this category which no longer have prime investment status due to the declining trend of railroad traffic and earnings in recent years. By far the largest amount of "Ba" bonds are held by the Metropolitan.[126]

For the 26 companies the market value for United States Governments and "Aaa," "Aa," or "A" bonds was in almost all cases in excess of the admitted asset value. Taking the holdings of the companies individually, the "A" bonds of three companies had a market value less than admitted asset value, but the amounts in each case were relatively insignificant.[127] In the "Baa" and "Ba" group, however, the market value was in both cases substantially less than the admitted asset value, "Ba" bonds being carried by 45 percent over their market value on the average, and in some cases, notably in the Aetna and the Mutual, being carried at more than 60 percent above the market.[128] It cannot be questioned that there is a probability of some ultimate loss on the "Baa" and "Ba" bonds which have a market value of $281,255,000 less than the admitted asset value.[129] This amount is, of course, offset by the appreciation in the better quality bonds, so that the entire portfolio on December 31, 1938, had a market value of slightly over $200,000,000 in excess of the admitted asset or balance-sheet value.[130] To balance the losses in the "Baa" and "Ba" bonds against the gains made in bonds of better quality, however, is a questionable practice, since the companies generally expect to hold bonds to maturity, and so the market gains will never be realized; in the case of the inferior bonds the incidence of any loss must fall on the companies holding them.

There is no uniform rule of valuation of the bond portfolio, and as a result there is a wide variation between the practices of different

[123] Pt. 10A, R. 139.
[124] Pt. 10A, R. 138.
[125] Moody's Bond Record, Key to Moody's ratings.
[126] Pt. 10A, R. 138.
[127] Pt. 10A, R. 157.
[128] Pt. 10A, R. 156, 157.
[129] Pt. 10A, R. 157.
[130] Id.

companies in the group of the principal 26. These variations occur principally in the "Ba" bonds. The valuation situation becomes particularly confused when it is recognized that there are substantial differences among the companies in accounting for the same securities which fall in this borderline group. In some instances, companies have written such bonds down to market. In other instances, companies accounting for the same bonds may carry them at their amortized value. For example, Baltimore & Ohio Railroad, Southern Division First 5's of 1950 were carried by the Aetna, Travelers, and Prudential at 34 whereas the Metropolitan and New York Life carry them at 100¾ and 98⅝, respectively. In the case of Hudson & Manhattan, First Lien Mortgage Series, "A" 5's, 1957, the Prudential carries them at 45 and the Mutual Benefit at 45 while the Aetna and the Equitable of New York carry them at 97¾ and 98¾, respectively. In the case of the Florida East Coast Railroad 50-year first mortgage 4½'s of 1959, they were carried by the Prudential and Travelers at 62 whereas the Metropolitan, New York Life, and Mutual Life carry the bonds at 95⅝, 94⅝, and 98¾, respectively.[131]

Marketability and maturity are factors of secondary importance in the construction of the companies' bond portfolios.[132] Recently there has been a decided tendency on the part of the companies to seek issues of short maturity in the expectation that interest rates may rise and thus the money can be reinvested at a better rate of return. The inadequacy of the supply, however, has been such as to prevent the companies from confining their purchasing activities entirely to short term issues. Taking the portfolio as a whole, it appears that 13 percent of the bonds other than United States Governments mature prior to 1945; 12.97 percent mature between 1945 and 1949, and 73.85 percent mature subsequent to 1950. The average maturity of bonds in this group as of the end of 1938 was 20 years and 6 months. In the case of United States Governments 52 percent of the bonds held mature after 1950.[133]

From the point of view of marketability, the companies are faced with a condition which obviates the necessity of giving much heed to this factor. Their holdings are so large that in the event they desire to dispose of them, their efforts to sell in any large quantity would undoubtedly depress the market, particularly as their action would be followed by other institutional holders which also have an interest in that particular issue.[134] It follows that a high degree of marketability is impossible. In any event the continuous excess of income over disbursements operates to enable the companies to satisfy their obligations without liquidating their security holdings. The willingness of the companies to take issues purchased through private negotiations and not listed on any exchange or traded in the over-the-counter market demonstrates their feeling that marketability is a relatively insignificant factor.

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[131] Schedule D, 1938 convention form annual statements. Also see pt. 28, testimony of Ernest J. Howe, February 14, 1940.

[132] See testimony of John Stedman, vice president of Prudential, pt. 28, testimony of February 27, 1940

[133] Pt. 10A, R. 140, 141.

[134] Verbatim record of the Proceedings of the Temporary National Economic Committee, vol. 12, p. 129.

The companies have not been entirely successful in the management of their bond portfolios. During the 10-year period from 1929 to 1938 they have realized a total gain from sales or redemptions of bonds and stocks of $140,533,000. Only one company, the State Mutual, realized a loss from the sale of bonds and stocks during this period, and in fact the companies in the aggregate realized a gain during each of the 10 years except 1932, when losses were experienced by 11 companies and an aggregate loss for the entire group of $591,000 was registered.[135] These gains are, as stated, realized gains, but they cannot be considered without regard for adjustments in the asset value of bonds and stocks made during the same period. With the exception of only two companies, the Western & Southern and Union Central, all companies have adjusted the value of their bonds and stocks downward. In fact, an aggregate write-off of $624,153,000 has been taken.[136] This write-off, necessitated largely by bond defaults, will probably never be recaptured and must, at least until actual experience can be taken into account, be considered as an offset to the profits reported since it represents either a net decrease in book value of securities or changes in the difference between book and market values of nonamortizable securities. The net result, therefore, of these capital gains, losses, and adjustments as they relate to bonds and stocks is that there was a net loss for the 26 companies in question over this 10-year period of $483,620,000.[137]

D. GENERAL INVESTMENT CONSIDERATIONS

The aggregate size of the life-insurance companies is such that their investment activity vitally affects the credit and financial structure of the country. At the end of 1937 the holdings of the 26 principal companies accounted for 12.4 percent of the total long-term debt in the United States.[138] These companies held the following percentages of the different indicated classes of long-term debt:[139]

	Percent		*Percent*
Federal	11. 6	Public utility	18. 2
State and local	6. 7	Farm mortgage	10. 5
Railway	17. 4	Urban mortgage	13. 0
Industrial	11. 7		

The effect of the concentration of funds under life-insurance-company control may be seen by weighing the importance of the $26,189,870,000 of gross investments made by these 26 companies during the 10-year period.[140] Figures which are available from 1934 to 1938 indicate that in this time alone the companies purchased 32.8 percent of all new corporate bonds and notes issued. During 1937 and 1938 the percentage purchased approximated one-half of the total issued.

135 Pt. 10A, R. 87.
136 Pt. 10A, R. 88.
137 Pt. 10A, R. 87, 88.
138 Pt. 28, exhibit No. 2259.
139 Id.
140 Pt 10A, R. 94.

The total issues and the amount and percentage of the new issues purchased by the major life-insurance companies were as follows:[141]

	New corporate bonds and notes issued	New corporate bonds and notes purchased by 26 companies [1]	Percent
1934	$515,000,000	$122,000,000	23.7
1935	2,572,000,000	637,000,000	24.8
1936	4,254,000,000	1,043,000,000	24.5
1937	1,713,000,000	838,000,000	48.9
1938	2,187,000,000	1,043,000,000	47.7
Total	11,241,000,000	3,683,000,000	32.8

[1] Figures for the Pacific Mutual are not available for years prior to 1936. Therefore, data for the years 1934 and 1935 relate to the 25 largest companies.

Many of the new issues were not eligible investments for life-insurance companies, and in the light of that fact the significance of the percentage is even more apparent. It must also be recognized that during recent years cash and Government-bond holdings have increased enormously until combined they total $5,190,503,000.[142] In fact if the increase in the cash account of these 26 companies plus the increase of their holdings of United States Government bonds had been invested in corporate bonds and notes issued during this period the companies would have absorbed 68 percent of the new issues offered.[143]

The experience of the companies with industrial bonds is particularly revealing. During the 10-year period from 1929 to 1938 the principal companies increased their holding of industrial bonds by close to $1,000,000,000. In this same period the total amount of industrial bonds outstanding was steadily declining, with the result that the ownership of industrial bonds rose from 2.5 percent of the industrial debt in 1930 to 11.7 percent by the end of 1937. It is clear that the increased holdings of insurance companies represented to some extent an absorption of debt previously held by other lenders.[144]

The increasing importance of the insurance companies, with their ever increasing need for investments, is shown dramatically in the case of certain oil and rubber companies. The following schedule shows the percentage of the outstanding funded debt of 5 oil companies and 4 rubber companies held by the 26 life insurance companies in 1929 as compared with the amount so held in 1938. In 8 of the cases indicated the increase in the percentage of total funded debt held by the 26 companies was accomplished in spite of the fact that there was during the period also an increase in the amount of the companies' debt outstanding.[145]

[141] Pt. 10A. R. 125.

[142] Pt. 10A, R. 98.

[143] Pt. 28, testimony of Ernest J. Howe, February 12, 1940.

[144] Id. Our most prosperous corporations in our expanding industries do little or no bond financing. Beginning shortly after the Great War, the previous business policy of trading on their equity was abandoned by most of such corporations. See Mead and Grodinsky, The Ebb and Flow of Investment Values (1939) at p. 290 et seq.

[145] Pt. 28, testimony of Ernest J. Howe, February 12, 1940; exhibit No. 2260.

Name of company	Percentages of the total funded debts held by 26 life insurance companies	
	1929	1938
Oil companies:		
Gulf Oil Corporation (Pennsylvania)	10.8	100.0
Shell Union Oil Corporation (Delaware)	5.6	38.8
Socony Vacuum Oil Co., Inc. (New York)	8.3	66.6
Standard Oil Co. (New Jersey)	4.1	23.6
Texas Corporation (Delaware)	6.2	8.25
Rubber companies:		
Firestone Tire & Rubber Co. (Ohio)	0	25.8
Goodrich (B. F.) Co. (New York)	1.4	(1)
Goodyear Tire & Rubber Co. (Ohio)	1.7	80.2
United States Rubber Co. (New Jersey)	.8	100.0

1 Less than one-tenth of 1 percent.

Other features of economic significance in these ever-changing and constantly increasing investments must be emphasized. The funds which life insurance companies invest are investment capital. They represent savings, not short-term credits. As savings funds they are available for long periods of time and are adaptable for use in the construction and development of business enterprises. It is the character of these funds which gives the life insurance companies their particular influence in the financial and business community. The constant readiness and ability of the companies to invest serves further to enhance their unique position. In this regard no concern or individual can, for example, equal the position of the Metropolitan whose officers, backed by approximately $5,000,000,000 of assets, invest over $2,000,000 each business day.[146] Then, too, it must be recognized that the bulk of the life insurance funds are handled by a group of eastern companies located in or neighboring on New York City. These eastern companies draw in funds from throughout the Nation and return them to distant cities and counties. Through their hands passes much of the country's wealth. The power to invest the tremendous sums involved under circumstances which permit the companies to exert the rights of creditors in exercising a continued control over their investments brings to them influence and prestige far beyond the borders of their immediate communities. Indeed their decisions made in handling free cash balances, in foreclosing or scaling down farm and urban mortgages, in selecting the types and sizes of bonds or properties for investment, in fixing the areas within which they shall operate and the entire procedure followed in the acquisition and disposal of securities are matters of such great moment that they often influence the actions of the whole business community in these matters.

From 1929 to 1938 the total assets of principal savings institutions, including life insurance companies and fraternal associations, time deposits of commercial banks, assets of mutual savings banks, building and loan associations, Government pension funds and trust funds, total savings deposits and baby bonds increased $11,044,000,000.

146 Pt. 10, A, R. 94.

Of this increase 94.7 percent is accounted for by the increase in the assets of life insurance companies and life insurance fraternal associations. While this increase occurred, assets of building and loan associations have declined and the rate of increase of assets of savings banks has slowed down. Savings deposits in commercial banks are still less than before the depression.[147]

As these facts indicate life insurance companies are becoming the principal savings institutions of the country. It must be recognized that their assets represent to a large extent the accumulation of savings. Under the operations of the level premium plan, reserves for life policies are principally accumulated savings established by the policyholders for the purpose of preventing their premium from rising as they grow older. Endowment and other plans of insurance are actually savings plans combined with insurance, and a large part of the reserves set up for these policies are in the nature of a savings deposit. Thus life reserves clearly involve the savings element. Other assets of the life companies are even more in the nature of savings. Annuity reserves and liabilities for supplementary contracts not involving life contingencies as well as the increase in the amount of dividends left with the companies and the amount of premiums and rents paid in advance are all indicative of the extent to which the savings element is essential in insurance company operations. In fact if the growth of the life insurance companies is examined in this regard it will be seen that these aspects of the business are primarily accountable for the great increase in size which has taken place since 1929. The following table indicates the tremendous increase over this 10-year period in the four specified categories of savings: [148]

	1929	1938	Percent increase
Annuity reserves	$400,641,000	$2,665,052,000	565
Supplementary contracts	241,115,000	1,182,416,000	390
Dividends left with the companies	196,775,000	372,533,000	89
Premiums and rents in advance	45,378,000	130,150,000	187
Total	883,909,000	4,350,151,000	....

Many of the operations of an insurance company parallel those of a savings bank or trust company. Like banks, life insurance companies accept and invest the savings of people in every walk of life. They also lend sums of money to their policyholders for which they charge a rate of interest. Not only do people pay money to life insurance companies in the form of premiums but they actually deposit money with such companies through the payment of premiums in advance or by leaving dividends to accumulate with their companies without making arrangements for them to be credited against their policy. As in the case of banks these funds are subject to return on demand or within a short time thereafter. The annuity contracts which the companies offer, as well as settlement options and other special contracts for the disposal of funds after death, place the

[147] Pt. 28, testimony of Ernest J. Howe, February 12, 1940; pt. 4, R. 1186–1188, exhibit No. 221.
[148] Pt. 10A, R. 99.

insurance companies even more definitely in the banking field and because of their predominant investment aspects suggest strong similarities between insurance companies and trust companies or investment trusts.[149]

In this connection it should be noted that a substantial portion of the funds held as policy reserves are subject to immediate withdrawal on demand of the policyholder. Some indication of the importance of this banking feature may be gained from the fact that 78.55 percent of the total policy reserves of 20 principal companies was subject to withdrawal in cash.[150]

Policyholders may withdraw cash by two principal methods. They may either surrender their policies and take the cash surrender value or they may borrow on their policies and thus draw down some of their reserve while still keeping the policy in force. The banking features of the life insurance business are clearly demonstrated by the cash turn-over through the making of these policy loans and their repayment.

Policy loans are in reality advances against policy claims. The policy usually provides that a policyholder has a right to call for a policy loan at any time and he may repay the loan in part or in whole at any time. The company, however, cannot call for repayment prior to the termination of the policy, no matter what its needs may be. The policy loan is, of course, completely riskless in that it is never made for a greater amount than can be satisfied, with interest, from the proceeds of the policy at its termination, whether by surrender or maturity.[151]

At the close of 1938, the 26 principal companies had policy loans and premium notes outstanding in the amount of $2,822,410,000, an amount equal to 11.62 percent of the total admitted assets of these companies. In one company the policy loans accounted for as much as 17.25 percent of the total assets while in the case of 8 companies such loans accounted for over 15 percent. During the height of the depression, when need of policyholders for cash was greatest and when banks were experiencing heavy withdrawals, policy loans reached their peak. In 1933, these loans amounted to $3,117,465,000 and accounted for over 20 percent of the admitted assets of as many as 15 of the 25 principal companies. In the case of the Union Central they reached the high point of 26.23 percent of admitted assets.[152]

These loans are of extraordinary importance to the life insurance companies because of the large amount of income received from them. Most policy loans at the present time are made at an interest rate of 5 percent although until recently a rate of 6 percent was usual. During the 10-year period from 1929 to 1938, interest income received from policy loans by the 26 principal companies has aggregated $1,503,048,000. Not only has this sum equaled over 1½ billion dollars in the 10-year period but it has uniformly accounted for a substantial proportion of the total income of the company. Such loans amounted to only 11.62 percent of admitted assets of these principal companies, but the interest received therefrom accounted for 18.66 percent of the aggregate investment income. In the case of six companies interest

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[149] See testimony of Mr. Thomas A. Buckner, pt. 4, R. 1420–1421.

[150] Pt. 10A, R. 275. The total sum subject to withdrawal in these companies amounts to $7,996,065,000. Id.

[151] Pt. 28, testimony of Thomas A. Buckner, February 12, 1940, and testimony of Ernest J. Howe, February 14, 1940.

[152] Pt. 10A, R. [illegible], 102, 108.

from policy loans was in excess of 25 percent of the total investment income during the year 1938.[153]

Another banking activity of the life insurance business, and one that has not been as profitable to the companies as policy loans, is the handling of the proceeds of life insurance policies left with the companies to be disbursed to beneficiaries over long periods of time. Under the stress of economic depression the insuring public has become aware of the liberality of the guaranteed interest rates and of other provisions of the settlement options contained in life insurance policies, and the options are exercised with greater frequency than formerly. An intercompany committee appointed to revise the practice on optional settlements reported: [154]

> Owing to general investment conditions and the difficulty in investing funds elsewhere, optional settlements have greatly increased. Funds currently left with the companies under these settlements vary from about 30 to 50 percent of the sum of all current death claims and matured endowments. The "consideration for supplementary contracts" received during 1936 varied from 22 to 39 percent of the entire increase in ledger assets during the year.

The present value of supplementary contracts not involving life contingencies reflects this growing tendency to exercise the optional modes of settlement under which policy proceeds are left with the companies. As of December 31 of each year, the liabilities of the 26 companies [155] on these contracts was as follows: [156]

1929	$241, 115, 000	1934	$658, 521, 000
1930	287, 883, 000	1935	789, 831, 000
1931	366, 319, 000	1936	939, 962, 000
1932	458, 367, 000	1937	1, 065, 616, 000
1933	543, 394, 000	1938	1, 182, 416, 000

The banking aspects of the life insurance business emphasize the importance of interest earnings to the companies. All life insurance contracts as well as annuities and agreements affecting the disposition of funds after death guarantee the policyholder a specified rate of interest on money deposited with the company, whether deposited as reserve or in trust. The rate guaranteed ranges on outstanding policies from 2½ to 4 percent, depending upon the nature of the particular contract and its date of issue. The amount of interest guaranteed under policies currently being issued is 3 or 3½ percent for life contracts and 2½ or 3 percent for annuity contracts and supplementary contracts not involving life contingencies.[157]

With the fall of interest rates which has taken place in recent years, the life insurance companies have been brought face to face with a serious investment and operating problem—the problem of earning enough interest to meet policy guarantees. The acuteness of this problem is apparent from the fact that on the average the 26 companies have 31.19 percent of their ledger assets, or a total of $7,378,224,000,

[153] Pt. 10A, R. 9, 102, 108, 109; pt. 28, exhibit No. 2267. Policy loans are made from reserves and the companies are obligated to net a sufficient amount on their policy loans to meet interest assumptions. The interest rate charged is in excess of that required for this purpose.

[154] Pt. 10, exhibit No. 785.

[155] Data for Pacific Mutual included only since 1936. Data for 1929 to 1935, inclusive, for 25 companies only.

[156] Pt. 10A, R. 99.

[157] Convention Form Annual Statements, Statement of Liabilities.

earning less than the rate of interest necessary to maintain reserves, that is, to meet interest guarantees.[158] The assets in this category are cash, Government bonds, delinquent farm and city mortgages and some defaulted bonds. The following schedule shows the percentage of interest required and the percentage of assets earning less than the required rate for each of the 26 companies: [159]

	Interest necessary to maintain reserves in percent of ledger assets	Percent of ledger assets earning less than interest required		Interest necessary to maintain reserves in percent of ledger assets	Percent of ledger assets earning less than interest required
Metropolitan	3.22	31.94	Union Central	3.37	27.75
Prudential	3.18	31.45	Provident Mutual	3.28	32.07
New York Life	2.81	32.60	Connecticut Mutual	3.08	17.71
Equitable of New York	3.03	27.01	Connecticut General	3.27	30.74
Mutual of New York	2.92	35.54	Phoenix Mutual	3.26	36.06
Northwestern	2.85	20.32	Bankers Life	3.34	29.79
Travelers	3.49	55.36	National Life	2.99	23.32
John Hancock	3.09	26.34	Pacific Mutual	3.47	26.40
Penn Mutual	2.98	32.56	State Mutual	2.89	27.59
Mutual Benefit	2.90	29.07	Equitable Iowa	3.26	27.00
Massachusetts Mutual	3.13	22.41	Western & Southern	2.90	46.22
Aetna	3.34	41.66	Lincoln National	3.06	21.42
New England Mutual	2.96	30.75	Guardian Life	2.96	33.84

The extensive refunding of corporate debt during the past 6 years has taken away from the insurance companies the high interest bearing bonds which they held before 1933. During the period from 1932 to 1938 a total of $4,942,587,000 of bonds owned by the 26 companies has been redeemed by their issuers, usually to be replaced by lower interest bonds.[160] $2,206,068,000 of the bonds redeemed were United States Government bonds, which have been refunded at very low rates.[161] During this same period the 26 companies have purchased $4,469,531,000 [162] of new bonds, the bulk of which have reflected the current low rates of interest and are for long terms.

In addition to a reduction in the interest rate of bonds resulting from refundings and new offers at low money rates, there has been a substantial reduction in the interest which may be obtained on farm and urban mortgages. In the case of farm mortgages, for example, 5.3 percent was the lowest rate at which mortgage money was to be had in 1917 and the average rate at that time was 6.1 percent. By 1939 the rate was as low as 4.5 percent and averaged 5 percent for the entire country.[163] In 1932 the range of average rates

[158] Pt. 28, testimony of Ernest J. Howe, February 14, 1940; exhibit No. 2266. Gains from mortality and loading are in most cases sufficiently large to give the companies a substantial fund to draw on should their reserves fail to earn the amount of interest required to meet policy guarantees.

[159] Pt. 28, exhibit No. 2266. Includes mortgages delinquent as to interest 1 year or more. In some instances some interest was received on such delinquent mortgages and occasionally the mortgage though delinquent may have paid an amount of interest sufficient to meet the company's reserve requirements.

[160] Pt. 10A, R. 135, 137.

[161] Pt. 10A, R. 135.

[162] Excluding purchases in the open market. Pt. 10A, R. 126, 127, 129.

[163] Pt. 28, testimony of Norman J. Wall, February 15, 1940; exhibit No. 2272.

in new farm mortgages made by the 26 companies was from 5.28 to 6.27 percent. By 1938 this range was from 4.08 to 5.44 percent,[164] with most of the companies paying the commission to loan correspondents as well. Experience on urban mortgages was similar. In 1932 the range on new urban mortgages was from 5.30 to 6.34 percent. In 1938 it had decreased to from 3.96 to 5.25 percent.[165]

The effect of these trends is that, while these companies have had a large increase in assets during the last few years since 1931, they have experienced a decline in the margin of investment income in excess of that required to meet their guarantees on policy contracts. In 1931 this excess of interest earned over that guaranteed was $256,740,000. This declined to a low point of $86,418,000 in 1935 and in 1938 stood at $93,024,000.[166] During the period from 1929 to 1938 the assets increased 51.2 percent while the net income on investments increased only 10.6 percent.[167] Describing the growing difficulty in still another way, net income on investments in 1929 expressed in percentage o. ledger assets ranged from 5.83 percent in the case of the Guardian Life to 4.78 percent in the case of the Mutual of New York. By 1938 interest rates being earned were generally low, ranging from 3.90 percent in the case of the Pacific Mutual to 3.30 percent in the case of the Mutual Life.[168] In recent years there have actually been two companies which have failed to make interest sufficient to meet the amount required to maintain reserves. This occurred in the case of the Travelers during 1936 and the Lincoln National in the period 1935–37, inclusive.[169] That the margin of investment income in excess of that required to maintain policy reserves is diminishing may be demonstrated by the fact that in 1929 the companies had on an average a 56.91 percent margin of interest while by 1938 it had fallen until the margin on the average was but 13.65 percent.[170] This margin was considerably higher for some companies but seriously close in the case of several.[171]

The narrow margin existing in the case of some companies as a result of 1938 operations is indicated in the following table:[172]

	Percent		*Percent*
Travelers	3. 30	Phoenix Mutual	4. 09
Union Central	1. 05	Lincoln National	1. 68
Connecticut General	4. 43		

In considering the question of interest it must be recognized that life insurance contracts are long-term contracts. When a life insurance company guarantees a rate of interest it is making a guarantee which it may have to satisfy for a period of 50 or more years. The tremendous development of supplementary contracts brings this situation into bold relief. As was indicated in the discussion of intercompany agreements designed to bring about uniform settlement option provisions [173] the companies, as a result of a desire for some temporary

[164] Pt. 10A, R. 163.
[165] Pt. 10A, R. 197.
[166] Pt. 10A, R. 83.
[167] Pt. 10A, R. 5, 80.
[168] Pt. 10A, R. 81.
[169] Pt. 10A, R. 83.
[170] Pt. 10A, R. 84.
[171] Id.
[172] Id.
[173] Supra, p. 158.

sales advantage, have permitted the naming of many contingent payees or secondary beneficiaries and have in effect undertaken as part of the settlement option agreements to guarantee monthly incomes at fixed rates of interest to "unborn generations." Many of the settlement option contracts contain guaranteed rates of interest in excess of those which the companies are currently able to earn and are therefore certain to involve the companies in a loss. One type of settlement option is particularly important in this connection. This is the so-called deposit option which binds the company to pay fixed rates of interest over periods running up to 30 years by providing that the beneficiary has the right to withdraw his balance at any time. The beneficiary under such a deposit option may leave his funds with the insurance company when rates of interest are low or withdraw them if outside investments of comparable security can be made at higher rates. Should interest rates rise to any appreciable extent it is not unlikely that the companies will be faced with large withdrawals at precisely the time that their high-grade low-interest bonds are selling at a discount.[174]

From the discussion of company investment operations in particular types of assets it has been demonstrated that this guaranteed interest factor places the companies on the horns of a serious dilemma. A company must under all circumstances put its money to work. It must also invest at a rate of interest which will enable it to meet its contract guarantees. With the tremendous increase in assets which has taken place even during the last 10 years the problem of putting funds to work at a satisfactory interest rate has become more acute. Anxious to maintain their investments in high-grade bonds, they have not been able to find outlets for their funds at a rate of interest which is satisfactory to them in the light of their policy contract commitments. Vast sums of money have been sterilized and withdrawn from our capital markets, or routed into channels of investment already suffering from a surfeit of excess credit

In the light of the foregoing it seemed appropriate to ask, What have been the broad considerations influencing life insurance company investment practices.[175] In general the State laws regulating insurance investments have followed a broad pattern of permitting investments in bonds and mortgages and forbidding investments in stocks. There is no evidence that the insurance companies have attempted to vary the pattern. As Mr. Thomas A. Buckner, chairman of the board of the New York Life, stated—

> Common stocks haven't much appeal to me.[176]

[174] Pt. 28, testimony of Ernest J. Howe, March 1, 1940.

[175] Pt. 9, R. 3799. In discussing legal restrictions on investments or trust funds, which restrictions are closely akin to those governing life insurance investments, Mr. William R. White, superintendent of banks of the State of New York, pointed out that these restrictions were originally set up when conditions were greatly different from what they are today. He said (pt. 9, R. 3800): "In weighing the advisability of granting broader discretion to trustees to select investments, we should also take into account the fact that the bulk of trust investments of the trust business today is done by corporate fiduciaries which are able to retain the services of experts to pass upon their investments, whereas the legal list was originally set up at a time when trustees were usually individual laymen and needed more guidance, probably, than they do today; and it was also important to bear in mind that at the time these standards were set up the issuance and sale of securities was not regulated in the manner that it is today."

[176] Pt. 28, testimony of Mr. Thomas A. Buckner, February 12, 1940.

A study of the investment statutes of 11 States,[177] including the principal States in which the 26 companies under review are operating, governing the investments of most of the legal reserve life insurance companies, reveals the range of investments permissible in the investment of insurance funds. Some of the States are more liberal than others, but in general the legal restrictions are somewhat similar. Generally speaking, Government obligations of the United States and its various political subdivisions are eligible for investment and loan purposes, as are the obligations of the Dominion of Canada and its Provinces. Many of the States permit investment in obligations of political subdivisions in Canada, while a few authorize direct investment in Canadian industrials.

Loans on mortgages secured by real estate in the United States are generally permitted while some States permit loans on mortgages secured by real estate in Canada.

Mortgage loans in all cases examined are restricted to first liens and may be made up to various percentages of the appraised value of the real estate at the date the loan is made. This percentage is 66⅔ percent in all of the 11 States examined except Massachusetts and Iowa, which permit 60 percent, and Wisconsin, which permits loans only to the extent of 50 percent. In New Jersey, while the general provision is 66⅔ percent, under certain circumstances mortgages up to 75 percent of the appraisal value may be made. All States permit policy loans. In every instance, investment in real estate is definitely restricted to the business needs of the company although real property acquired as the result of foreclosure or in satisfaction of debts previously contracted may be held for a limited period.

Corporate obligations of some companies are legal investments in all States under a wide range of restrictions, limitations, and earnings requirements. Two of the States reviewed, Wisconsin and Iowa, prohibit the acquisition of corporate shares of any description, while two, New York and Ohio, specifically prohibit investment in common stocks. The other seven States permit investments in common stocks under various limitations. The State of Connecticut, for example, prohibits the holdings of any mining stocks as well as the common stocks of manufacturing companies other than those engaged in the manufacture and distribution of gas and electricity. The State of Massachusetts restricts the holding of shares of other insurance companies and stocks subject to assessment, and the State of Illinois forbids the purchase of the common shares of any banking, real estate, insurance, or holding companies.

These statutes and the weight of custom have resulted in confining life insurance company investments to investments in debt. In spite of the fact that the companies are required to invest an increasing amount each year and must seek outlets for their funds when the supply of industrial bonds is gradually constricting, they have not purchased nor indeed have they desired to purchase any substantial

[177] The summary given is taken from Verbatim Record of the Proceedings of the Temporary National Economic Committee, vol. 11, pp. 577, 578. States covered in this review were New York, Connecticut, Massachusetts, New Jersey, Pennsylvnaia, Ohio, Illinois, Iowa, California, Michigan, and Wisconsin.

amounts of common stock.[178] This remains true although the companies are having difficulty in investing their funds and although the common stocks of our better established industrial companies would give certain definite investment advantages, permitting a wider diversification and lifting the depressing effects upon interest rates resulting from an insufficient supply of bonds. Yields on common stocks of established industries tend in the long run to approximate the yields of bonds of the same or similar industries and it cannot be questioned that common stocks have a steadiness of return and a safety admittedly as great as has been experienced by the companies on many of their investments.

The consideration of common stocks as possible investment outlets does not result from any feeling that such investments will bring greater liquidity or give greater opportunities for capital gains, since these are not questions of primary importance in the handling of insurance-company portfolios. Rather, it results from the fundamental question, namely whether or not the present investment practices of the insurance companies are not sterilizing the capital markets and are not certain to bring about an eventual deterioration of the very securities upon which the companies have relied in the past. There is also merit in the proposition that if American enterprises were less burdened with corporate debt they would be more flexible and in a better position to adjust their operations in changing economic and business circumstances.[179]

[178] Subject to a variety of restrictions the life insurance companies are permitted to invest in preferred stocks. This type of investment, however, has certain distinct disadvantages recognized by students of corporate finance. Frequently the preferred stock is not protected against the corporation incurring, after its issuance, an immense amount of debt which ranks ahead of the preferred stocks. Because of inadequate protective provisions, preferred stockholders are also subject to coercion by common shareholders as a result of which they may in certain circumstances be forced to yield their rights to unpaid and accumulative dividends. Furthermore, State laws are frequently inadequate in protecting the rights of preferred shareholders. See pt. VII of the Commission's Report on the Study and Investigation of the Work, Activities, Personnel, and Functions of Protective and Reorganization Committees, sec. III; Security Analysis, Graham and Dodd (1934), and dissenting opinion, The North American Co. et al. (4 S. E. C. 434, at p. 462).

[179] The average insurance official appears to be primarily interested in finding an investment which will pay a steady return and which will require his company to have slight, if any, participation in the affairs of the underlying properties. Insurance officials do not wish their companies to take an active part in the management of corporations whose securities are held in their portfolios. It is true that they have been forced on occasion to foreclose mortgages and operate the underlying properties or to enter into reorganization proceedings for the purpose of salvaging whatever may be left of an investment "gone sour," but until actual default has occurred their relation to management has been entirely negative. As owners of the debt they have not had legal authority to interject themselves into management affairs albeit they may have sensed that certain activities of the management were going forward which were adverse to the best interest of their policyholders. (It is true that if the management appears to be undesirable the insurance company can attempt to sell its bonds; but that it is usually reluctant to do partly because there is a limited supply of bonds available and companies are having difficulty in keeping their portfolios full and partly because in most cases the companies own such quantities of bonds that any attempt to sell would depress the market and be taken as a sign by persons in the financial community that there was something wrong with the underlying security.) When default occurs then the life insurance companies' huge creditor position leads to their taking an interest in management; but even then they act reluctantly as in the case of railroad reorganizations. (See investigation of railroads, holding companies, and affiliated companies pursuant to S. Res. 71, 76th Cong., 1st sess., S. Rept. No. 25, pt. 2, at p. 81.) The company attitude was well expressed by Mr. John W. Stedman, Prudential vice president, who stated: "We are inclined to shy away from responsibilities of becoming collective partners in enterprise." (Pt. 28, testimony of John W. Stedman, February 27, 1940.) Aside from default the interest in management on the part of life insurance companies is necessarily limited for the most part to the time when it buys its bonds. For once a bond investment is made, the insurance company has no legal right to question management until default occurs.

It would appear that the traditional practice of confining invest ments solely to bonds and mortgages should be reexamined in the light of the different conditions which prevail today. The companies are faced with a situation where not enough of the investments of the required type are available and the interest on many of those which are available is too low to meet the companies' interest guaranties; while on the other hand the great capital reservoirs of the insurance companies are closed to a substantial portion of the business world.

The narrowing of the field for new investment and the difficulties companies are experiencing in placing their funds were fully discussed by company representatives. It was acknowledged that the 551 percent increase in cash and the 1,395 percent increase in U. S. Government bond holdings was to a considerable extent a measure of the companies' inability to invest. Mr. John W. Stedman, vice president in charge of investments for the Prudential, testified:[180]

Mr. Gesell. How much does the company invest in a year in bonds, Mr. Stedman, in round figures? About how much do you get out a year?

Mr. Stedman. I can give you the exact figure if I can find it. The gross investment, of course, is large.

Mr. Gesell. I was merely looking for the new-money figure.

Mr. Henderson. I would like to know the gross.

Mr. Stedman. About $180,000,000 for 1939.

Mr. Gesell. The gross?

Mr. Stedman. That is the net.

Mr. Gesell. What is the gross figure?

Mr. Stedman. The gross figure is $354,000,000.

Mr. Henderson. About two to one.

Mr. Gesell. Is the company able to invest all the money which it wants to invest in bonds?

Mr. Stedman. No.

* * * * * * *

Mr. Gesell. * * * How much of that cash account, first of all, would you say represents money which under favorable conditions you would like to have invested?

Mr. Stedman. Well, from the $95,000,000 under normal conditions I should suppose could be subtracted $50,000,000.

Mr. Gesell. So let's say $40,000,000 in the cash account which under normal conditions, favorable conditions, you would want to have out. In the Government account of $802,000,000 of United States Governments, how much of that under normal conditions would you like to have out in bonds other than Governments or in mortgage loans?"

* * * * * * *

Mr. Gesell. * * * Would you say there are probably $500,000,000 Governments that should be elsewhere—taking rough figures?

Mr. Stedman. Instead of having the Government portfolio amount to approximately 23 percent of our total admitted assets, it would be preferable to have it not exceed 10 percent.

Mr. Gesell. So that there would be probably about $400,000,000 in Governments?

Mr. Stedman. Yes.

Mr. Gesell. Which you would like to put elsewhere?

[180] Verbatim Record of the Proceedings of the Temporary National Economic Committee, vol. 12, pp. 122, 123. See also p. 129.

Mr. STEDMAN. Yes; it is more than that today.

Mr. GESELL. More than that today. At least we have about half a billion dollars, do we not, in cash and in Governments, which under normal conditions conditions you would want to have elsewhere?

Mr. STEDMAN. Yes.

The financial vice president of the Mutual Life testified to the same effect, stating that his company had an excess of about $30,000,000 in cash and $102,000,000 in short-term Government securities which it would prefer to have invested in bonds or mortgages.[181] The acting manager of the Mutual's real estate department stated that the company would be glad to place thirty or forty millions of dollars in city mortgage loans if such loans meeting the requirements of the company could be found.[182] The representative of the Metropolitan testified that the United States Government bond account of his company which stood at 17.57 percent of total admitted assets should under favorable circumstances be reduced to 10 percent, thus releasing approximately $300,000,000 for investment in other channels.[183]

As has been indicated, life insurance has been the outstanding and most dynamic savings institution and this development has brought the companies such a tremendous proportion of the country's savings that the continued direction of these funds into channels where no assistance can be given to the small businessman or new enterprise is certain to result in cutting out from under the economic structure the business foundation upon which the prime trustee securities rest. This situation deserves closer analysis. An examination of the testimony of some of the company representatives appearing before the committee is in order. Mr. Thomas A. Buckner, chairman of the board of the New York Life, testified that his company usually desired to make an investment in excess of $100,000; that if some small businessman came to the company and wanted to borrow $25,000 the company would consider the transaction speculative and not worthwhile. The New York Life apparently is not interested in supplying purely venture capital. The company requires ample security, a background of experience, a going concern in business for a reasonable length of time, and a wise management engaged in the manufacture of a product that is going to be permanent.[184] The investment vice president of the Prudential testified that his company had been able to make only two loans to small businessmen despite an effort to find outlets for investment in this direction which would meet the company's requirements for safety and security.[185] The testimony of representatives of the Metropolitan and Mutual Life was to the same effect.[186]

An indication of the exact standards which are applied by life insurance companies in the purchase of bonds may be found in an analysis of the procedure followed by the Prudential in investing in public-utilities securities. The company employs investment analysts, engineers and other trained technicians, and makes a thorough examination of the properties of the companies whose securities are

[181] Pt. 28, testimony of Dwight S. Beebe, February 27, 1940.
[182] Pt. 28, Testimony of John D. McLaughlin, February 19, 1940.
[183] Pt. 28, testimony of F. W. Ecker, February 27, 1940.
[184] Pt. 28, testimony of Thomas A. Buckner, February 12, 1940.
[185] Pt. 28, testimony of John W. Stedman, February 27, 1940.
[186] Dwight S. Beebe and F. W. Ecker, February 27, 1940.

up for consideration. Debentures of holding companies are purchased occasionally but the company will not purchase either preferred stock of holding companies or common stock. It prefers to confine its purchases to the bonds of the underlying operating properties. A public-utility engineer on its staff inspects and roughly appraises the property and reports on the efficiency of the management, its growth and the industrial diversity of the territory served, the character and size of the load particularly in relation to its generating capacity, the percentage of the company's power which is purchased, the manner in which it and its affiliated holding companies handle matters of management and public relations, management contracts, dividend policies, upstream loans and the likelihood of public competition. If the engineer's report is favorable, it is coupled with a study of the company's balance sheet and income accounts for a 10-year period and the Prudential's analysts scrutinize the company's depreciation and dividend procedure. If this study shows that the rate returned on a fair value is returned after adequate depreciation and maintenance and is derived from rates charged consumers which are about the average or lower than the average from similar companies in similar localities and that the balance available for interest has averaged over the 10-year period an amount equal to at least 10 percent of the mortgage debt then the company will purchase, provided, in addition, that the covenants in the indenture are in good order, an adequate cushion of preferred and common equity is present and the company is satisfied with other general considerations of this character.[187] In the case of an industrial investment the company's industrial engineer inspects the plant and properties and talks with the management in order to size up the principal executive officers and their understudies and to acquire information concerning the efficiency of the organization, the nature of its business, its competition, sources of raw material, the location of plants with regard to labor, access to raw material, etc. A 10-year certified audit of a public accountant is invariably required.[188] In this connection, Mr. Stedman testified:[189]

Mr. GESELL. That, if I may pause on it, is a very interesting point. You want a 10-year certified balance sheet of an industrial, or perhaps longer, in order to get a test of the company's experience through a business cycle or over a representative number of years. That would seem to me to bar from the reservoir of capital which you have, many, many business ventures, especially new business ventures, would it not?

Mr. STEDMAN. New business ventures; yes.

The VICE CHAIRMAN. Right on that point, will you develop whether or not an indisposition to purchase the securities of a new business venture is controlling?

Mr. STEDMAN. It would not be, in our judgment, suitable for the funds of life insurance; in other words, it is not a trustees' investment.

The VICE CHAIRMAN. Would no other consideration balance against the absence of a 10-year record?

Mr. STEDMAN. I think when we look back over the past 10 years I have to say no.

The VICE CHAIRMAN. I think that is one of the most interesting facts that has been brought out in this whole hearing.

187 Pt. 28, testimony of John W. Stedman, February 27, 1940.

188 Id.

189 Id.

Mr. GESELL. Perhaps I can develop it a little bit further, Judge. Let me ask you this: We hear a great deal these days about loans to small businessmen. Have you tried to make loans to small businessmen?

Mr. STEDMAN. Yes; we have.

Mr. GESELL. Can you tell us what you have done in that regard and what success you have had?

Mr. STEDMAN. I spoke of our having stationed in Chicago nearly a year and a half ago a man whose function it was to find, if possible, small industrial loans. We didn't want to go much below one hundred thousand, possibly fifty, and considered small industrial loans to be limited by the figure of a million dollars. Our hope was that we might make the loan as a mortgage loan, secured by a first mortgage, and write the necessary covenants on the paper. The expense of a small issue providing for a corporate trustee could not be borne. It would not be economical. The rate would be too high for the borrower. In a word we have had practically no success.

Mr. GESELL. How many such loans have you made, sir?

Mr. STEDMAN. We have made exactly two.

Thus the companies in clinging to the traditional channels of investment which they feel are the only channels suitable for life insurance funds are not in a position to loan money to new enterprises or to put their money into equity securities. Yet it must be observed that bonds or other types of debt investment are not entirely riskless. In the event of a bond default, for example, the security is rarely taken in by foreclosure and sold in full satisfaction of the obligation. Rather, through reorganization, new bonds of less security will be substituted for the old and the investor (especially one who holds large quantities of each issue as do the insurance companies) must stand his ground and trust the situation will improve. All too frequently in such circumstances the security, so-called, is gradually dwindled away through repeated reorganization.[190]

Indeed it would appear that the companies' efforts to make riskless investments are the very things which are making their investments more risky. This seeming paradox will stand some examination. The constant demand for bonds as opposed to common stocks has also resulted in the companies purchasing bonds which are definitely inferior to those they consider ideally suited to their needs. Thus the representatives of the Prudential and the Mutual stated that the ideal capitalization ratios for utilities were 45 percent bonds and 55 percent common or, if there is preferred outstanding, 45 percent bonds, 25 percent preferred, and 30 percent common.[191] The records of this Commission indicate many cases of insurance companies buying utility bonds where the ratios are far more topheavy than those indicated above. Indeed it is the very pressure for bonds as opposed to stock, that is helping to bring about excessive bond ratios in utilities.[192]

The supply of bonds is so small in terms of the demand, or the insurance companies' appetite as it is called, that the very process

[190] It is of course equally true that the property securing a bond issue is often permitted to diminish in value prior to reorganization because the management, in a desire to avoid default, will skimp maintenance so that in effect the debtor continues to make payments of "interest" which are really payment to the bondholder of part of the capital or corpus of the company, thus leaving a reduced capital when default occurs.

[191] Pt. 28, testimony of Mr. John W. Stedman and Mr. Dwight S. Beebe, February 27, 1940.

[192] See statement of Mr. Samuel Ferguson, president, Hartford Electric Light Co., Round Table Discussions of Public Utility Outlook, printed in Savings Bank Journal, vol. XXI, No. 111, at p. 37 (May 1940). This article considers in detail many points covered in this subsection.

of bidding between companies unquestionably contributes to a lowering of the interest rate. It is partly for this reason that, as has been indicated, insurance-company returns on their investments have been going lower, and have actually fallen below the return required to meet contractual commitments.[193]

In brief the situation may be summarized in these terms. An ever-increasing amount of the country's savings are flowing to life insurance companies, which are in effect sterilizing the savings funds received and preventing them from flowing into new enterprises or undertakings where the element of venture or risk is present. Thus the small businessman or average industrialist is denied access to this more important capital reservoir. The life insurance companies, on the other hand, are finding themselves unable to put their funds to work and yet are clinging to the notion that investment in bonds is the only road to safety.

This emphasis upon bond investment is certain to bring difficulties. With the investment problems created by the present rapid rate of accumulation of assets the companies cannot anticipate that they will be able to achieve complete security or even to get their money out by confining their investments to gilt-edge bonds and mortgages. As the companies continue to grow this situation will become more and more acute. Unless the life insurance companies can find methods by which the funds flowing under their control will become available as equity for the stimulation of new enterprises and accessible to the small- and medium-size businessmen and by which investments in common stocks will become more prevalent in order that industrial enterprise may not become overburdened with debt, consideration will have to be given to the extent to which the insurance companies may longer monopolize and dictate the direction of the flow of the savings of the people.

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[193] An officer of the Prudential indicated the average rate of return on that company's securities was in the neighborhood of 3.29 percent but the average rate on recent investments, i. e., those made during the last year, was only 2.70 percent. Pt. 28, testimony of Mr. John W. Stedman, February 27, 1940.

APPENDIX A

75 Largest Legal Reserve Life Insurance Companies

[All companies with assets in excess of $20,000,000 (Dec. 31, 1938)]

Name of company	Location of company home office	Rank by amount of assets	Total admitted assets	Total amount of insurance in force	Plan of company operation	Number of States in which company is licensed [1]
Acacia Mutual Life Insurance Co	Washington, D. C	35	$79, 688, 000	$401, 349, 000	Mutual	34
Aetna Life Insurance Co	Hartford, Conn	12	621, 319, 000	3, 984, 353, 000	Stock	48
American Farmers Mutual Life Insurance Co	Des Moines, Iowa	61	28, 478, 000	90, 726, 000	Mutual	16
American National Insurance Co	Galveston, Tex	36	74, 672, 000	704, 194, 000	Stock	32
American United Life Insurance Co	Indianapolis, Ind	45	49, 226, 000	278, 597, 000	Mutual	21
Atlantic Life Insurance Co	Richmond, Va	58	29, 837, 000	134, 455, 000	Stock	11
Bankers Life Co	Des Moines, Iowa	20	228, 391, 000	752, 120, 000	Mutual	35
Bankers Life Insurance Co	Lincoln, Nebr	52	40, 784, 000	121, 516, 000	Stock	13
Berkshire Life Insurance Co	Pittsfield, Mass	40	61, 552, 000	209, 911, 000	Mutual	21
California-Western States Life Insurance Co	Sacramento, Calif	43	51, 490, 000	242, 661, 000	Stock	[2] 10
Central Life Assurance Society	Des Moines, Iowa	46	46, 469, 000	162, 291, 000	Mutual	21
Central States Life Insurance Co	St. Louis, Mo	73	20, 547, 000	70, 608, 000	Stock	10
Colonial Life Insurance Co. of America	Jersey City, N. J	75	20, 427, 000	114, 886, 000	do	4
Columbian National Life Insurance Co	Boston, Mass	47	46, 217, 000	175, 854, 000	do	27
Columbus Mutual Life Insurance Co	Columbus, Ohio	55	31, 899, 000	133, 764, 000	do	15
Connecticut General Life Insurance Co	Hartford, Conn	17	246, 599, 000	1, 147, 143, 000	do	33
Connecticut Mutual Life Insurance Co	do	16	336, 216, 000	1, 013, 090, 000	Mutual	36
Continental American Life Insurance Co	Wilmington, Del	67	23, 096, 000	132, 240, 000	Stock	11
Continental Assurance Co	Chicago, Ill	57	30, 438, 000	231, 972, 000	do	28
Equitable Life Assurance Society of the United States.	New York, N. Y	4	2, 260, 913, 000	6, 749, 178, 000	Mutual	[2] 49
Equitable Life Insurance Co. of Iowa	Des Moines, Iowa	23	182, 252, 000	577, 404, 000	Stock	28
Fidelity Mutual Life Insurance Co	Philadelphia, Pa	28	123, 172, 000	363, 441, 000	Mutual	37

[1] Includes District of Columbia.

[2] Does business in United States Territories or foreign countries.

75 Largest Legal Reserve Life Insurance Companies—Continued

[All companies with assets in excess of $20,000,000 (Dec. 31, 1938)]

Name of company	Location of company home office	Rank by amount of assets	Total admitted assets	Total amount of insurance in force	Plan of company operation	Number of States in which company is licensed
Franklin Life Insurance Co.	Springfield, Ill.	53	$37,503,000	$175,108,000	Stock	17
General American Life Insurance Co.	St. Louis, Mo.	27	126,069,000	712,976,000	do	[2] 24
Great Southern Life Insurance Co.	Houston, Tex.	44	49,895,000	250,386,000	do	6
Guarantee Mutual Life Insurance Co.	Omaha, Nebr.	70	21,857,000	135,724,000	Mutual	22
Guardian Life Insurance Co. of America	New York, N. Y.	26	132,964,000	489,481,000	do	[2] 34
Home Life Insurance Co.	do	31	101,203,000	390,103,000	do	30
Illinois Bankers Life Assurance Co.	Monmouth, Ill.	63	27,567,000	110,956,000	Stock	16
Indianapolis Life Insurance Co.	Indianapolis, Ind.	69	22,095,000	108,106,000	Mutual	8
Jefferson Standard Life Insurance Co.	Greensboro, N. C.	34	80,009,000	385,059,000	Stock	[2] 25
John Hancock Mutual Life Insurance Co.	Boston, Mass.	8	920,508,000	4,175,557,000	Mutual	[2] 39
Kansas City Life Insurance Co.	Kansas City, Mo.	30	108,467,000	443,056,000	Stock	40
Life & Casualty Insurance Co.	Nashville, Tenn.	71	21,809,000	229,802,000	do	13
Life Insurance Co. of Virginia	Richmond, Va.	32	100,671,000	500,441,000	do	16
Lincoln National Life Insurance Co.	Fort Wayne, Ind.	25	147,947,000	995,423,000	do	[2] 40
Manhattan Life Insurance Co.	New York, N. Y.	74	20,470,000	71,887,000	Mixed	8
Massachusetts Mutual Life Insurance Co.	Springfield, Mass.	11	647,747,000	1,931,760,000	Mutual	[2] 38
Metropolitan Life Insurance Co.	New York, N. Y.	1	4,942,900,000	22,612,404,000	do	49
Midland Mutual Life Insurance Co.	Columbus, Ohio	59	29,477,000	114,068,000	Stock	13
Minnesota Mutual Life Insurance Co.	St. Paul, Minn.	49	44,473,000	225,535,000	Mutual	27
Monumental Life Insurance Co.	Baltimore, Md.	56	31,013,000	272,314,000	Stock	14
Mutual Benefit Life Insurance Co.	Newark, N. J.	10	677,549,000	2,044,470,000	Mutual	44
Mutual Life Insurance Co. of New York	New York, N. Y.	5	1,399,427,000	3,787,705,000	do	[2] 48
Mutual Trust Life Insurance Co.	Chicago, Ill.	50	43,588,000	171,479,000	do	18
National Life & Accident Insurance Co.	Nashville, Tenn.	39	63,075,000	645,638,000	Stock	21
National Life Insurance Co.	Montpelier, Vt.	21	205,110,000	548,966,000	Mutual	37
New England Mutual Life Insurance Co.	Boston, Mass.	13	435,724,000	1,539,232,000	do	[2] 39
New York Life Insurance Co.	New York, N. Y.	3	2,647,455,000	6,793,826,000	do	[2] 48
Northwestern Mutual Life Insurance Co.	Milwaukee, Wis.	6	1,233,102,000	3,893,592,000	do	43
Northwestern National Life Insurance Co.	Minneapolis, Minn.	37	70,142,000	427,028,000	Mixed	29

Occidental Life Insurance Co. of California	Los Angeles, Calif	41	59,541,000	452,818,000	Stock	[2] 27
Ohio National Life Insurance Co	Cincinnati, Ohio	48	46,033,000	186,262,000	do	31
Old Line Life Insurance Co. of America	Milwaukee, Wis	72	21,718,000	78,502,000	do	7
Pacific Mutual Life Insurance Co	Los Angeles, Calif	19	232,782,000	592,316,000	do	40
Pan-American Life Insurance Co	New Orleans, La	54	36,560,000	164,108,000	do	[2] 24
Penn Mutual Life Insurance Co	Philadelphia, Pa	9	702,630,000	1,951,750,000	Mutual	48
Phoenix Mutual Life Insurance Co	Hartford, Conn	18	237,487,000	658,569,000	do	37
Presbyterian Ministers' Fund	Philadelphia, Pa	62	28,109,000	60,884,000	do	[3] 49
Provident Mutual Life Insurance Co	do	15	346,419,000	970,901,000	do	34
Prudential Insurance Co. of America	Newark, N. J	2	3,800,787,000	17,788,034,000	do	49
Reliance Life Insurance Co	Pittsburgh, Pa	29	116,130,000	468,974,000	Stock	26
Security Mutual Life Insurance Co	Binghamton, N. Y	66	23,330,000	91,400,000	Mutual	18
Southland Life Insurance Co	Dallas, Tex	60	29,431,000	184,338,000	Stock	6
Southwestern Life Insurance Co	do	38	63,490,000	342,617,000	do	
State Life Insurance Co	Indianapolis, Ind	42	52,888,000	191,432,000	Mutual	[2] 23
State Mutual Life Assurance Co	Worcester, Mass	22	182,384,000	595,433,000	do	29
Teachers Insurance & Annuity Association of America.	New York, N. Y	33	94,170,000	59,427,000	Mixed	[2] 49
Travelers Insurance Co	Hartford, Conn	7	975,527,000	4,644,923,000	Stock	49
Union Central Life Insurance Co	Cincinnati, Ohio	14	374,398,000	1,131,340,000	do	[2] 47
Union Mutual Life Insurance Co	Portland, Maine	68	22,295,000	75,643,000	Mutual	[2] 16
Volunteer State Life Insurance Co	Chattanooga, Tenn	65	24,309,000	100,179,000	Stock	11
Washington National Insurance Co	Evanston, Ill	51	43,114,000	211,420,000	do	47
West Coast Life Insurance Co	San Francisco, Calif	64	24,899,000	119,274,000	do	[2] 14
Western & Southern Life Insurance Co	Cincinnati, Ohio	24	171,599,000	881,996,000	do	8
Total			26,733,528,000	103,976,345,000		[4] 27

[2] Does business in United States Territories or foreign countries.

[3] Licensed in 1 State only, writes in all other States by correspondence.

[4] Average.

Source: Best's Life Reports, 1939.

APPENDIX B

Accounting Practices of Life Insurance Companies

For an adequate understanding of the problems involved in interpreting the convention form annual statement which life insurance companies are required to file yearly in each State in which they do business, a more detailed consideration of the statement is necessary. For convenience of reference a copy of the convention form as used in 1939 is here reproduced in full. The form as reproduced contains both the old and the new gain and loss exhibit. This exhibit was revised in 1939 but the new form is not as yet in general use. The pages and lines of the form as here reproduced are numbered as in the original, and references in the discussion which follows are to these pages and lines. Copies of the supporting schedules are also included, although they are not considered in the discussion which follows. These schedules are valuable for their detail, but it will be noted that no reconciliation of them with the operating statements is provided. No attempt has been made in the discussion to consider the various modifications of the convention form which are required by some States.[1]

[1] These modifications contribute to the general confusion of the companies' annual statements. For example, in 1936 one company was required to prepare four different sets of statements to meet the requirements of four different States. Each statement reached a different result. Thus the gain from interest, for example, shown in the gain and loss exhibit prepared for New York was stated at $1,251,000. In the statement prepared for Massachusetts it was stated at $2,470,000 (pt. 28, testimony of Ernest J. Howe, February 13, 1940).

LIFE COMPANIES—ASSOCIATION (CONVENTION) EDITION, 1939

ANNUAL STATEMENT

For the Year Ended December 31, 1939

OF THE CONDITION AND AFFAIRS OF THE

________________________ Life Insurance Company

Organized under the Laws of the State of ________________________, made to the

DEPARTMENT OF BANKING AND INSURANCE OF THE STATE OF NEW JERSEY

PURSUANT TO THE LAWS THEREOF

Incorporated ____________________ Commenced Business ____________________

Home Office ____________________ (Street and Number), ____________________ (City or Town and State)

Mail Address ____________________ (Street and Number), ____________________ (City or Town and State)

OFFICERS

President ____________________

Secretary ____________________ Vice-Presidents ____________________

Treasurer ____________________

Actuary ____________________

DIRECTORS OR TRUSTEES

(To be reported by New Jersey Companies only.)

Principal Office in New Jersey (City or Town, Street and No.) .... *N. J.;*

Name of agent therein and in charge thereof, upon whom process may be served ....

ANNUAL STATEMENT FOR THE YEAR 1939 OF THE ______________________ (Write or stamp name of Company) Form 2

DOLLARS | CENTS

I.—CAPITAL STOCK

1. Amount of capital paid up December 31 of current year . . . . $________
2. Amount of ledger assets (as per balance) December 31 of previous year . . . . $________
3. ____crease of paid up capital during the year . . . . ________

Extended at

II.—INCOME

	(1)	(2)	(3)	(4)	(5)	(6)
	Total Gross Premiums		Deduct Reinsurance		Gross Premiums less Reinsurance	
	First Year	Renewal	First Year	Renewal	First Year	Renewal
4. Life						
5. Disability benefits . .						
6. Additional accidental death benefits . .						
7. Annuities . . .						
7A. ‡Dividends applied, per items 9 (a), (b) and (c) page 3 .						
8. *Totals . . .						

DOLLARS | CENTS

9. **Consideration for supplementary contracts involving life contingencies . . . .
10. **Consideration for supplementary contracts not involving life contingencies including $________ disability . . . .
11. Dividends left with the company to accumulate at interest . . . .
12. Ledger assets, other than premiums, received from other companies for assuming their risks. . . . .
13. Gross interest on mortgage loans, less $________accrued interest on mortgages acquired during the year
14. Gross interest on collateral loans, per Schedule C . . . .
15. Gross interest on bonds $________, and dividends on stocks $________, less $________accrued interest on bonds acquired during the year, per Schedule D. .
16. Gross interest on premium notes, policy loans and liens . . . .
17. Gross interest on deposits in trust companies and banks, per Schedule E . . . .
18. Gross interest on other debts due the company (give items and amounts):
    (a) ________
    (b) ________
19. Gross discount on claims paid in advance . . . .
20. Gross income from company's property, including $________for company's occupancy of its own buildings, less $________interest on incumbrances, per Schedule A . . . .
21. Total interest, dividends and real estate income . . . .
22. From other sources (give items and amounts):
    (a) ________
    (b) ________
    (c) ________
23. †Borrowed money, gross $________, less amount repaid $________ . . . .
24. From agents' balances previously charged off . . . .
25. ________
26. ________
27. Gross profit on sale or maturity of ledger assets, viz.:
    (a) Real estate, per Schedule A . . . .
    (b) Bonds, per Schedule D . . . .
    (c) Stocks, per Schedule D . . . .
    (d) ________
28. Gross increase, by adjustment, in book value of ledger assets, viz.:
    (a) Real estate, per Schedule A . . . .
    (b) Bonds, per Schedule D (including $________for accrual of discount). . . .
    (c) Stocks, per Schedule D . . . .
    (d) ________
29. Total Income . . . .
30. Amount carried forward

*To be supported by distribution of premiums by States as per Schedule T.
**Commuted value of instalments or benefits adjusted but not due. See Nos. 1-6 of Disbursements.
†Company is at liberty to state transaction briefly so that explanation can be carried as footnote in department report.

‡Indicate distribution of item 7A, columns (5) and (6)

No. of Line	Column (5)	Column (6)
4	$	$
5		
6		
7		
Total		

Form 1 ANNUAL STATEMENT FOR THE YEAR 1939 OF THE ______________ (Write or stamp name of Company)

Amount brought forward | DOLLARS | CENTS

III.—DISBURSEMENTS

	(1) Gross Amount*	(2) Deduct Reinsurance*	Dollars	Cents
1. Death claims				
2. Matured endowments				
3. Permanent and total disability: (a) Payments made				
(b) Premiums waived				
4. Additional accidental death benefits				
5. Totals				

6. For annuities involving life contingencies, excluding payments on supplementary contracts (including cash refund payments)
7. Premium notes and liens voided by lapse, less $______ restorations
8. Surrender values
9. Dividends to policyholders
   - (a) Applied to pay renewal premiums $______
   - (b) Applied to shorten the endowment or premium paying period ______
   - (c) Applied to purchase paid up additions and annuities ______ $______
   - (d) Paid in cash or applied in liquidation of loans or notes ______
   - (e) Left with the company to accumulate at interest ______
10. Total paid policyholders
11. Paid for claims on supplementary contracts:
    - (a) Involving life contingencies
    - (b) Not involving life contingencies
12. Dividends held on deposit disbursed.
    - (a) Dividends $______ and interest thereon $______ held on deposit surrendered during the year
    - (b) Dividends $______ and interest thereon $______ held on deposit applied during the year to shorten the endowment or premium paying period
13. Expense of investigation and settlement of policy claims, including $______ for legal expenses
14. Commissions to agents (less commissions on reinsurance):
    First year's premiums $______; renewal premiums $______
    Annuities (original) $______; annuities (renewal) $______
15. Commuted renewal commissions
16. Compensation of managers and agents not paid by commission for services in obtaining new insurance
17. Agency supervision and traveling expenses of supervisors (except compensation for home office supervision)
18. Branch office expenses, including salaries of managers and clerks not included in Item 16
19. Medical examiners' fees $______, Inspection of risks $______
20. Salaries and all other compensation of officers, directors, trustees and home office employees
21. Payments to inactive employees, exclusive of $______ reported in Item 6
22. Home office travel
23. Rent, including $______ for company's occupancy of its own buildings, less $______ received under sublease
24. Miscellaneous expenses:
    - (a) Bureau and association dues and assessments
    - (b) Legal expenses not included in Item 13
    - (c) Furniture and fixtures
    - (d) Printing and stationery
    - (e) Books, newspapers and periodicals
    - (f) Postage, express, telegraph, telephone and exchange
    - (g) Advertising
    - (h) Insurance except on real estate
    - (i) General office maintenance and expense
    - (j) ______
    - (k) ______
    - (l) ______
    - (m) ______
    - (n) ______
25. Taxes, licenses and fees:
    - (a) State taxes on premiums
    - (b) Insurance department
    - (c) Other state taxes, including $______ social security
    - (d) Federal, including $______ social security
    - (e) All other (except on real estate)
26. Real estate:
    - (a) Repairs and expenses
    - (b) Taxes
27. Paid stockholders for dividends (cash $______, stock $______)
28. Borrowed money repaid, gross $______, less amount borrowed $______
29. Interest on borrowed money
30. Agents' balances charged off
31. ______
32. ______
33. Gross loss on sale or maturity of ledger assets, viz.:
    - (a) Real estate, per Schedule A
    - (b) Bonds, per Schedule D
    - (c) Stocks, per Schedule D
    - (d) ______
34. Gross decrease, by adjustment, in book value of ledger assets, viz.:
    - (a) Real estate, per Schedule A
    - (b) Bonds, per Schedule D (including $______ for amortization of premiums)
    - (c) Stocks, per Schedule D
    - (d) ______
35. Total Disbursements
36. Balance

*Including commuted values of supplementary contracts.

ANNUAL STATEMENT FOR THE YEAR 1939 OF THE ________________ Form 1
(Write or stamp name of Company)

IV.—LEDGER ASSETS

		Dollars	Cents	Dollars	Cents
1.	Book value of real estate (less $____ incumbrances), per Schedule A				
2.	Mortgage loans on real estate, per Schedule B, first liens (including $____ foreclosed liens subject to redemption) . . . . $____ other than first liens				
3.	Loans secured by pledge of bonds, stocks or other collateral, per Schedule C				
4.	Loans made to policyholders on this company's policies assigned as collateral				
5.	Premium notes on policies in force, of which $____ is for first year's premiums				
6.	Book value of bonds, $____; and stocks, $____; per Schedule D				
7.	Cash in company's office . . . $____				
8.	Deposits in trust companies and banks not on interest, per Schedule E . . ____				
9.	Deposits in trust companies and banks on interest, per Schedule E . . . ____				
10.	Bills receivable, $____; agents' balances (debit, $____, credit, $____), net, $____				
11.	____				
12.	Total Ledger Assets, as per balance on page 3,				
	Non-Ledger Assets				
13.	Interest due, $____ and accrued, $____ on mortgages				
14.	Interest due, $____ and accrued, $____ on collateral loans, per Schedule C, Part 1				
15.	Interest due, $____ and accrued, $____ on premium notes, policy loans or liens				
16.	Interest due, $____ and accrued, $____ on bonds not in default, per Schedule D, Part 1				
17.	Interest due, $____ and accrued, $____ on deposits in trust companies and banks				
18.	Interest due, $____ and accrued, $____ on other assets (give items and amounts):				
19.	____				
20.	Rents and interest due, $____ and accrued, $____ on company's property or lease				
21.	Total interest and rents due and accrued				
22.	Market value of real estate over book value, per Schedule A				
23.	*Market / Amortized or investment value (not including interest in item 16) of bonds over book value, per Schedule D				
23A.	Market value of stocks over book value, per Schedule D				
24.	Due from other companies for paid losses or claims on policies of this company reinsured, per Schedule S				

		(1) New Business (Paid-for Basis)	(2) Renewals	Dollars	Cents
25.	Gross premiums due and unreported on policies in force December 31 of current year (less reinsurance premiums)	$	$		
26.	Gross deferred premiums on policies in force December 31 of current year (less reinsurance premiums)				
27.	Totals	$	$		
28.	Deduct loading				
29.	Net amount of uncollected and deferred premiums	$	$		

		Dollars	Cents	Dollars	Cents
30.	All other assets (give items and amounts): ____				
31.	____				
32.	____				
33.	____				
34.	____				
35.	Gross Assets				
	Deduct Assets Not Admitted				
36.	Company's stock owned, $____; loans on $____	$			
37.	Supplies, stationery, printed matter, $____; furniture and fixtures $____				
38.	Commuted commissions, $____; agents' debit balances, gross $____				
39.	Cash advanced to or in the hands of officers or agents				
40.	Loans on personal security, endorsed or not, $____; bills receivable $____				
41.	Premium notes, policy loans and other policy assets in excess of net value and of other policy liabilities on individual policies				
42.	Deposits in suspended banks, less $____ estimated amount recoverable				
43.	Book value of real estate over market value, per Schedule A				
44.	Book value of bonds over *market / amortized or investment value, per Schedule D				
44A.	Book value of stocks over market value, per Schedule D				
44B.	Interest due and accrued on mortgage loans (state basis)				
44C.	____				
45.	Other assets not admitted, viz				
46.	Total Admitted Assets				

*Strike out "Market" or "Amortized or investment."

Form 1 ANNUAL STATEMENT FOR THE YEAR 1939 OF THE ____________________ (Write or stamp name of Company)

V.—LIABILITIES, SURPLUS AND OTHER FUNDS

	DOLLARS	CENTS	DOLLARS	CENTS	DOLLARS	CENTS
Net present value of all the outstanding policies in force on December 31 of current year, as computed on the following tables of mortality and rates of interest, viz:						
1. American Experience table at ____ per cent. on* ____						
American Experience table at ____ per cent. on* ____						
3. American Men table at ____ per cent. on* ____						
4. Other tables and rates, viz:*						
5. Net present value of annuities (including those in reduction of premiums). Give tables and rates of interest, viz:						
Total						
6. Deduct net value of risks of this company reinsured in other solvent companies						
7. Net Reserve (paid-for basis), excluding disability						
8. Reserve for additional accidental death benefits included in life policies, less $____ reinsurance						
9. Reserve for total and permanent disability benefits included in life and annuity contracts:						
(a) Active lives, less $____ reinsurance						
(b) Disabled lives, less $____ reinsurance						
10. Present value of amounts not yet due on supplementary contracts not involving life contingencies, excluding disability claims included in Item 9						
11. Liability on policies cancelled and not included in "net reserve" upon which a surrender value may be demanded						
12. Policy claims and losses outstanding:						

	(1) Due but Unpaid	(2) Incomplete Proofs Under Adjustment, or Adjusted but not Due	(3) Resisted per Schedule F	(4) Deduct Reinsurance	(5) Net Reported Outstanding Policy Claims and Losses	(6) Estimated Net Losses Incurred but not yet Reported	(7) Total Liability for Outstanding Policy Claims and Losses
13. Death							
14. Additional Accidental Death Benefits							
15. Disability Benefits							
16. Matured Endowments							
17. Annuities Involving Life Contingencies							
18. Totals							

	DOLLARS	CENTS
19. Due and unpaid on supplementary contracts not involving life contingencies		
20. Dividends left with the company to accumulate at interest, and accrued interest thereon		
21. Gross premiums paid in advance, including surrender values so applied, less discount, if any		
22. Unearned interest and rent paid in advance		
23. Commissions to agents, due or accrued, including commissions due on premium notes when paid		
24. "Cost of collection" on uncollected and deferred premiums, in excess of the total loading thereon		
25. Salaries, rents, office expenses, bills and accounts due or accrued		
26. Medical examiners' fees $____, inspection of risks $____ and legal fees $____ due or accrued.		
27. Estimated amount due or accrued for taxes		
28. Borrowed money, $____ and interest thereon, $____.		
29. Unpaid dividends to stockholders		
30. Dividends or other profits due policyholders, including those contingent on payment of outstanding and deferred premiums.		
31. Dividends declared on or apportioned to annual dividend policies payable to policyholders to and including (month) ____ (day) ____, of following year, whether contingent upon the payment of renewal premiums or otherwise		
32. Dividends declared on or apportioned to deferred dividend policies payable to policyholders to and including (month) ____ (day) ____, of following year		
33. Amounts set apart, apportioned, provisionally ascertained, calculated, declared or held awaiting apportionment upon deferred dividend policies, not included in Item 32		
34. (a) Reserve to cover the non-deduction of deferred fractional premiums at the death of the insured (if not included in items 1–8 above)		
35. All other liabilities (give items and amounts):		
36. ____		
37. ____		
38. ____		
39. ____		
40. Reserve, special or surplus funds not included above (give items and amounts separately, and state for what purpose each of said funds is held):		
41. ____		
42. ____		
43. Capital paid up		
44. Unassigned funds (surplus)		
45. Total		

*State definitely the dates of issue and class of policies covered by each basis of valuation.
(a) Do not calculate the extra reserve on the basis of yearly renewable term premiums.

Form 1

ANNUAL STATEMENT FOR THE YEAR 1939 OF THE ______________________
(Write or stamp name of Company)

EXHIBITS OF INSURANCE POLICIES—PAID-FOR BUSINESS ONLY

ORDINARY BUSINESS

The following is a correct statement of the ORDINARY business of the year on policy account as it stood at close of business December 31. Additional accidental Death Benefits provided in life policies must NOT be included in this exhibit.

CLASSIFICATION	1. Whole Life Policies (Excluding Group)		2. Endowment Policies (Excluding Group)		3. Term and Other Policies (Excluding Group), including Return Premium Additions		4. Group Policies		5. Additions to Policies by Dividends	6. Total Numbers and Amounts	
	No.	Amount	No.	Amount	No.	Amount	No.	Amount	Amount	No.	Amount
1. At end of previous year											
2. *Issued during year											
2A. †Reinsurance											
3.* Revived during year											
4. Increased during year											
4A. Totals, lines 2 to 4, inclusive											
5. Totals before transfers											
Transfers:											
6. Deductions											
7. Additions											
8. Balance of transfers											
9. Totals after transfers											
Deduct ceased by:											
10. Death											
11. Maturity											
12. Disability											
13. Expiry											
14. Surrender											
15. Lapse											
16. Decrease											
17. Withdrawal											
17A. †Reinsurance											
18. Total terminated											
19. (a) Outstanding end of year											
20. Policies reinsured											

INDUSTRIAL BUSINESS

The following is a correct statement of the INDUSTRIAL business of the year on policy account as it stood at close of business December 31.

CLASSIFICATION	1. Whole Life Policies		2. Endowment Policies		3. Term and Other Policies, including Return Premium Additions		4. Additions to Policies by Dividends	5. Total Numbers and Amounts	
	No.	Amount	No.	Amount	No.	Amount	Amount	No.	Amount
21. At end of previous year									
22. *Issued during year									
22A †Reinsurance									
23. Revived during year									
24. Increased during year									
24A. Totals, lines 22 to 24, inclusive									
25. Totals before transfers									
26. Transfers, deductions									
27. Transfers, additions									
28. Balance of Transfers									
29. Totals after transfers									
Deduct ceased by:									
30. Death									
31. Majurity									
32. Disability									
33. Expiry									
34. Surrender									
35. Lapse									
36. Decrease									
36A. †Reinsurance									
37. Total terminated									
38. (a) Outstanding end of year									
39. Policies reinsured									

Note.—Instalment policies and other, involving supplementary contracts should be entered and deducted in above Exhibit of Policies for the commuted value of instalments only.
*In this line should be included bona fide new business only. In case of Group Policies, the initial coverage should be entered in this line. Paid-up and extended term insurance issued in lieu of other insurance should be treated as a policy change. Has this been done? Answer: ______
(a) Paid-up insurance included in the final totals of items 19 and 38 (including additions to policies), No. of ORDINARY policies ______, amount, $______; No. of INDUSTRIAL policies ______, amount, $______
Additional accidental Death Benefits included in life policies were in amount, $______
† This is to include reinsurance of the entire business of a company or of its business in a state or section of the country, but is not to include reinsurance of individual risks. In the case of a company which has accepted such reinsurance, include the business assumed in 2A or 22A, and in the case of a company which has ceded its business, include the business so ceded in 17A or 36A.

ANNUAL STATEMENT FOR THE YEAR 1939 OF THE ____________________
(Write or stamp name of Company)

EXHIBITS OF ANNUITIES (PAID-FOR BASIS) AND SUPPLEMENTARY CONTRACTS INVOLVING LIFE CONTINGENCIES

CLASSIFICATION	1. Individual Annuities*		2. Group Annuities			3. Supplementary Contracts**		
	No.	Annual Income	Contracts	Certificates	Annual Income	No.	Annual Income	
1. Outstanding at end of previous year								
2. Issued during year						• •	• • •	
3. Transferred from Insurance account during year	• •	• • •	• •	• •	• • •			
4. Total								
5. Other net changes during year								
6. Outstanding at end of current year								

CLASSIFICATION OF ANNUITIES AND SUPPLEMENTARY CONTRACTS INVOLVING LIFE CONTINGENCIES OUTSTANDING AT THE END OF THE YEAR

CLASSIFICATION	1. Individual Annuities*		2. Group Annuities			3. Supplementary Contracts**		Total	
	No.	Annual Income	Contracts	Certificates	Annual Income	No.	Annual Income	No.	Annual Income
7. Income now payable			• •						
8. Deferred; fully paid			• •						
9. Deferred; not fully paid			• •						
10. Total			• •						

*Individual Annuities. Include here all survivorship annuities and deferred annuities, including contracts providing for deferred annuities purchased by accumulations during deferred period and which provide for a death benefit during the period of deferment substantially equal to the value of the non-forfeiture benefit available on lapse.

**Supplementary Contracts. Include only that portion of each supplementary contract which is dependent on the continued survivorship of an individual life or lives and for which the reserve is included in Item 5, Page 5

Form 1

ANNUAL STATEMENT FOR THE YEAR 1939 OF THE ____________ (Write or stamp name of Company)

GAIN AND LOSS EXHIBIT†

Showing the Sources of the Increases and Decreases in Surplus During the Year

INSURANCE EXHIBIT	(1) TOTAL	ALLOCATION BY LINE OF BUSINESS: (2) INDUSTRIAL (Including Total and Permanent Disability and Accidental Death Benefits)	ORDINARY: (3) Life Insurance	ORDINARY: (4) Total and Permanent Disability	ORDINARY: (5) Accidental Death Benefits	ORDINARY: (6) Annuities (Excluding Disability Annuities)	GROUP: (7) Insurance	GROUP: (8) Annuities
1 Premiums and other considerations								
2 Dividend accumulations and supplementary contracts without life contingencies								
3 Investment income (less $ ____ investment expenses including taxes)								
4 *								
5 Total Income								
6 Deaths								
7. Maturities, disabilities, annuities								
8 Surrenders								
9. Dividend accumulations and supplementary contracts without life contingencies								
10 Allocable insurance expenses and taxes								
11 Unallocable insurance expenses and taxes								
12. *								
13 Total Disbursements								
14 Increase in reserves on contracts involving life contingencies								
15. Increase in reserves for dividend accumulations and supplementary contracts without life contingencies								
16 Increase in other reserves and assets not admitted								
17. Total Increase in Reserves								
18. NET GAIN FROM INSURANCE (Item 5 less sum of Items 13 and 17)								

INVESTMENT PROFIT AND LOSS EXHIBIT	TOTAL	INDUSTRIAL	ORDINARY AND GROUP
19 Gross profit on sale or maturity			
20 Increase by adjustment in book value			
21 Gain from change in difference between book and admitted values			
22. *			
23. Totals			
24 Gross loss on sale or maturity			
25. Decrease by adjustment in book value			
26. Loss from change in difference between book and admitted values			
27. *			
28 Totals			
29 NET PROFIT FROM INVESTMENTS (Item 23 less Item 28)			

MISCELLANEOUS AND SURPLUS EXHIBIT	TOTAL
30. Surplus Dec. 31 of previous year	
31. Net gain from insurance (Item 18)	
32 Net profit from investments (Item 29)	
33 Surplus paid in or transferred from capital	
34 *	
35 Totals (Items 30 to 34)	
36 Dividends to policyholders	
37 Dividends to stockholders	
38 Increase in general contingency reserves	
39 *	
40. Surplus Dec. 31 of current year	
41. Totals (Items 36 to 40)	

†See "Instructions" attached
*Other items (Describe fully)

Allocation of Dividends to Policyholders by Line of Business

Industrial Insurance	$ ____
Ordinary Insurance	____
Ordinary Annuities	____
Group Insurance	____
Group Annuities	____
Total	$ ____

General Interrogatories

42. State below the amounts of insurance outstanding and reserves thereon according to the valuation methods indicated:

	Amount	Reserve
Net level premium	$ ____	$ ____
Illinois Standard	____	____
N. J. Standard	____	____
Ohio Standard	____	____
Full prelim. term	____	____
Select and Ult	____	____
Other	____	____
Totals	$ ____	$ ____

43. State below the valuation methods in current use and classes of insurance to which they are applied ____

44. Has the company ever issued both participating and non-participating policies? Answer ____

45 Does the company at present issue both participating and non-participating policies? Answer: ____ If not, state which kind is issued. Answer ____

46 State the amount of insurance, if any, on which the gross premiums are less than the net premiums according to the standard of valuation required by the State. Answer: $ ____

Also state the approximate amount of additional reserve to cover deficiencies in gross premiums (such additional reserve being included in Items 1 to 7 inclusive on page 5).

Answer: $ ____

47. State the amounts of insurance in force under each of the following plans

	Non-Participating	Participating Annual Div.	Participating Def. Div.
Industrial	____	____	____
Ordinary	____	____	____
Group	____	____	____
Totals	____	____	____

48. Is any surrender value promised in excess of the reserve as legally computed? If so, what amount therefor has been included in liabilities, and where?

Answer: ____

49. Has the company any assessment or stipulated premium policies in force?

Answer: ____ If so, state:

Amount of insurance $ ____

Amount of reserve $ ____

Basis of reserve: ____

Basis of regular assessments: ____

Basis of special assessments: ____

Assessments collected during year $ ____

INSTRUCTIONS

(Companies are required to follow these instructions in preparing the Gain and Loss Exhibit on pages 8 and 9, but are not required to fill in the figures in the poster. All references except as otherwise indicated are to items and columns on pages 8 and 9.)

1. All items are to be entered on the incurred or revenue basis.
2. **Premiums and other considerations** (1). Items 8 and 9, page 2, adjusted for item 27, page 4, and item 21, page 5.
3. **Dividend accumulations and supplementary contracts without life contingencies** (2 and 52). Items 10 and 11, page 2.
4. **Investment income** (3). Item 21, page 2, less item 29, page 3, adjusted for items 31 and 44B, page 4, item 22, page 5, interest in item 28, page 3, and amortization in items 28(b), page 2, and 34(b), page 3.
5. **Investment expenses including taxes** (3). Include any part of items 24 to 26, 31 and 32, page 3, applying exclusively to investment expenses. Adjust for investment expenses unpaid December 31st of current and previous years. Add for investment overhead an amount not to exceed ⅛ of 1 per cent. of mean ledger assets. Deduct any income items which may properly be considered as an offset to investment expenses. ATTACH EXHIBIT.
6. **Deaths; maturities; disabilities; annuities** (6 and 7). Items 5, 6, and 11a, page 3, adjusted for item 24, page 4, and item 18, page 5.
7. **Surrenders** (8). Item 8, page 3, adjusted for item 11, page 5.
8. **Dividend accumulations and supplementary contracts without life contingencies** (9 and 62). Items 11(b) and 12, page 3, adjusted for item 19, page 5.
9. **Insurance expenses and taxes** (10 and 11). Sum of items 13-26 and 30-32, page 3, adjusted for items 26, 37, and 38, page 4, and items 23-27, page 5, less any income items which may properly be considered as an offset to expenses. Report in item 10 all insurance expenses and taxes which are directly allocable by line of business without recourse to cost accounting or other approximate methods. Report balance in item 11 after deducting investment expenses per item 5 above. ATTACH EXHIBIT.
10. **Increase in reserves on contracts involving life contingencies** (14). Increase in items 7, 8, 9, and 34, page 5, and in item 41, page 4.
11. **Increase in reserves for dividend accumulations and supplementary contracts without life contingencies** (15). Increase in items 10 and 20, page 5.
12. **Increase in other reserves and assets not admitted** (16). Increase in any other reserves pertaining exclusively to insurance operations, and in any non-admitted asset items not considered elsewhere.
13. **Investment profit and loss exhibit** (19, 20, 24, 25). Items 27 and 28, page 2, and items 33 and 34, page 3, adjusted for amortization. (21 and 26) Report net (in item 21 if a decrease or item 26 if an increase) the change between years in algebraic sum of items 22, 23, 23A, 36, 39-40, 42-44A, page 4. (22 and 27) Include in item 22 or 27 the decrease or increase in special investment reserves, page 5.
14. **Dividends to policyholders** (36). Item 9, page 3, adjusted for items 30-33, page 5.
15. **Dividends to stockholders** (37). Item 27, page 3, adjusted for item 29, page 5.
16. **Increase in general contingency reserves** (38). Enter net increase in any special or contingency reserves not specifically applicable to insurance or investments.
17. **Reserves Dec. 31 of previous and current years** (50 and 64). Enter tabular reserves as per items 7-10, 20 and 34, page 5, plus item 41, page 4 of previous and current years' statements, respectively. Include in Col. (4) both active and disabled life reserves.
18. **Tabular premiums or considerations** (51). Enter tabular net premiums or considerations as determined by valuation bases employed. Tabular premiums on industrial business Col. (3) should be increased by one-half year's interest thereon.
19. **Tabular interest** (54). Employ valuation interest rate in calculation of this item. Use methods of calculation indicated below.
20. **Tabular less actual reserve released** (55 Cols. (4), (6), (8)). Use method of calculation indicated below.
21. **Other increases (net)** (57). Entries in this item should be confined to adjustments or unusual items not definitely provided for elsewhere. ATTACH EXHIBIT.
22. **Tabular cost** (59). Enter tabular cost of insurance Cols. (2), (3), (7); cost of disability Col. (4); cost of accidental death Col. (5). Use methods of calculation indicated below.
23. **Reserves released by death** (60). Enter terminal reserves released by death Cols. (2), (3).
24. **Reserves released by other termination (net)** (61). This item should include reserves released by all other causes (including matured endowments), less reserves on paid-up, extended term and restored policies or contracts.

Tabular Cost Minus Tabular Interest (C—I) on Life Insurance (Cols. 2, 3, 7) and Accidental Death Benefits (Col. 5)

	Col. (2)	Col. (3)	Col. (6)	Col. (7)
25. Mean reserve Dec. 31 of previous year (50)				
26. Tabular premiums (51)				
27. Other increases (56 and 57)				
28. Total				
Deduct:				
29. Mean reserve Dec. 31 of current year (64)				
30. Terminal reserves released by death (60)			XXX	XXX
31. Net reserves released by other termination (61)				XXX
32. Total deductions				
33. Balance (C—I)				
Tabular Interest:				
34. *One-half year's interest on mean reserve Dec. 31 of previous year				
35. *One-half year's interest on mean reserve Dec. 31 of current year				
36. One half year's interest on (C—I)				XXX
37. One-half year's interest on terminal reserves released by death			XXX	XXX
38. Total equals tabular interest (54)				
Tabular Cost:				
39. C—I				
40. Add I				
41. Total equals tabular cost (59)				

*Use full year's interest-group one year term (Col. 7)

Tabular Less Actual Reserve Released Plus Tabular Interest (T—A+I) on Annuities (Cols. 6, 8)

	Col. (6)	Col. (8)
42. Mean reserve Dec. 31 of current year (64)		
43. Annuity payments incurred during year (62)		
44. Total		
Deduct:		
45. Mean reserve Dec. 31 of previous year (50)		
46. Tabular considerations for annuities (51)		
47. Other increases net (56, 57 and 61)		
48. Total deductions		
49. Balance (T—A+I)		
Tabular Interest on Annuities:		
50. One-half year's interest on mean reserve Dec. 31 of previous year		
51. One-half year's interest on mean reserve Dec. 31 of current year		
52. Total		
53. Deduct one-half year's interest on (T—A+I)		
54. Balance equals tabular interest (54)		
Tabular Less Actual Reserve Released on Annuities:		
55. T—A+I		
56. Deduct I		
57. Balance equals tabular less actual reserve released (55)		

Tabular Interest on Dividend Accumulations and Supplementary Contracts without Life Contingencies:

58. Mean Reserve Dec. 31 of current year (64)	
59. Payments incurred during year (62)	
60. Total	
Deduct:	
61. Mean reserve Dec. 31 of previous year (50)	
62. Income during year (52)	
63. Other increases (56 and 57)	
64. Total deductions	
65. Balance equals tabular interest (54)	

Tabular Cost Minus Tabular Interest (C—I₁) on Disability, Active Lives (Part of Col. 4):

	Col. (4)
66. Mean active life reserve Dec. 31 of previous year (50)	
67. Tabular premiums (51)	
68. Other increases, applicable to active lives (56 and 57)	
69. Total	
Deduct:	
70. Mean active life reserve Dec. 31 of current year (64)	
71. Net reserves released by other termination (61)	
72. Total deductions	
73. Balance (C—I₁)	
Tabular Interest on Disability (Active Lives):	
74. One-half year's interest on mean reserve Dec. 31 of previous year	
75. One-half year's interest on mean reserve Dec. 31 of current year	
76. One half year's interest on (C—I₁)	
77. Total equals tabular interest (part of 54)	
Tabular Cost on Disability (Active Lives):	
78. C—I₁	
79. Add I₁	
80. Total equals tabular cost (59)	

Tabular Less Actual Reserve Released Plus Tabular Interest (T—A+I₂) on Disability Annuities (Part of Col. 4):

	Col. (4)
81. Mean disabled life reserve Dec. 31 of current year (64)	
82. Disability annuity payments during year (62)	
83. Total	
Deduct:	
84. Mean disabled life reserve, Dec. 31 of previous year (50)	
85. Present value of disability claims incurred during year (53)	
86. Other increases, (net) applicable to disabled lives (56, 57 and 61)	
87. Total deductions	
88. Balance (T—A+I₂)	
Tabular Interest on Disability Annuities:	
89. One-half year's interest on mean reserve Dec. 31 of previous year	
90. One-half year's interest on mean reserve Dec. 31 of current year	
91. Total	
92. Deduct one-half year's interest on (T—A+I₂)	
93. Balance equals tabular interest (part of 54)	
Tabular Less Actual Reserve Released on Disability Annuities:	
94. T—A+I₂	
95. Deduct I₂	
96. Balance equals tabular less actual reserve released (55)	
Tabular Interest on Disability (Col. 4):	
97. I₁	
98. I₂	
99. Total equals tabular interest (54)	

Form 1

ANNUAL STATEMENT FOR THE YEAR 1939 OF THE ______________
(Write or stamp name of Company)

GAIN AND LOSS EXHIBIT—Continued

Analysis of Increase in Reserve During the Year

	(1) TOTAL	(2) INDUSTRIAL (Including Total and Permanent Disability and Accidental Death Benefits)	ORDINARY				GROUP	
			(3) Life Insurance	(4) Total and Permanent Disability	(5) Accidental Death Benefits	(6) Annuities (Excluding Disability Annuities)	(7) Insurance	(8) Annuities
50. Reserve Dec. 31 of previous year								
51. Tabular net premiums or considerations								
52. Dividends left to accumulate and considerations for supplementary contracts without life contingencies								
53. Present value of disability claims incurred			x x x		x x x	x x x	x x x	x x x
54. Tabular interest								
55. Tabular less actual reserve released		x x x	x x x		x x x		x x x	
56. Increase in reserve on account of change in valuation basis								
57. Other increases (net)								
58. Totals (Items 50 to 57)								
59. Tabular cost						x x x		x x x
60. Reserves released by death				x x x	x x x	x x x	x x x	x x x
61. Reserves released by other terminations (net)							x x x	
62. Annuity, supplementary contract, disability and accumulated dividend payments								
63. Total Deductions (Items 59 to 62)								
64. Reserve Dec. 31 of current year								

NOTE—A company issuing both participating and non-participating policies shall make a separate statement as above with reference to each of said kinds of business, and also show the manner in which any general outlays of the company have been apportioned to each. (Subdivision 11, Section 70, New Jersey Insurance Law.)

16 ANNUAL STATEMENT FOR THE YEAR 1939 OF THE ______________________________ Form 1
(Write or stamp name of Company)

GENERAL INTERROGATORIES

1. Have all the transactions of the company of which notice was received at the home office on or before the close of business December 31, been truthfully and accurately entered on its books? Answer:
2. Except as shown in the next succeeding question, does this statement show the condition of the company as shown by the books, records, and data at the home office at the close of business December 31? Answer:
3. Have there been included in this statement proper reserves to cover liabilities which may have been actually incurred on or before December 31, but of which no notice was received at the home office until subsequently? Answer:
4. Is the business of the company conducted upon the mutual, mixed or strictly proprietary plan? Answer:
5. What dividends and what proportion of the profits of the company may be paid to the stockholders? Answer:
6. State total amount of advances to surplus not repaid (Mutual Companies only) $
7. Is the surplus or unassigned funds, per item 44, page 3 of this statement, the property of the stockholders or of the policyholders? Answer:
8. If any part of such surplus or unassigned funds may be claimed by or paid to the stockholders, what was the amount thereof on Dec. 31 of current year? Answer:
9. Total dividends paid stockholders since organization of the company, cash, $; stock, $
10. What interest, direct or indirect, has this company in the capital stock of any other insurance company? Answer:
11. Is the company directly or indirectly owned or controlled by any other company or corporation and/or group of companies? Answer: If so, give full particulars.

12. CAPITAL STOCK OF THIS COMPANY

Class	No. Shares Outstanding	Par Value Per Share	Is Stock Callable?	Is Dividend Rate Limited?	Are Dividends Cumulative?
Preferred		$			
Common		$	• • • • •	• • • • •	• • • • •

13. Does the company own real estate in the name of a holding company? Answer: No. of Parcels ; Total Book Value $
14. Did any person while an officer, director or trustee of the company receive directly or indirectly, during the period covered by this statement, any commission on the business transactions of the company? Answer:
15. Amount of compensation, if any, received during the year by any representative, officer, trustee or director of the company for services rendered as a member of any bondholders' or stockholders' reorganization or protective committee with which the company has deposited any securities. Answer: $
16. Amount of such compensation retained by the representative. Answer: $
17. Total amount loaned during the year to directors or other officers $, to stockholders not officers $. Total amount of loans outstanding at end of year to directors or other officers $, to stockholders not officers $ (exclusive of policy loans).
18. Have the future loadings on the premiums, or any part thereof, been assigned or hypothecated in any way? If so, give full information. Answer:
19. What proportion of premiums on policies issued by the company may be taken in notes, or other form of lien, on the policies? Answer:
20. Were all the stocks, bonds and other securities owned December 31 of current year, in the actual possession of the company on said date, except as shown by the Schedules of Special and Other Deposits? Answer:
If not, give full and complete information relating thereto
21. Were any of the stocks, bonds or other assets of the company loaned during the year covered by this statement? Answer:
If so, give full and complete information relating thereto
22. State when last examination of this company's affairs was conducted by any insurance department, and by what department or departments. Answer:
23. Has any change been made during the year of this statement in the charter, articles of incorporation, or deed of settlement of the company? Answer:
If not previously filed, furnish herewith a certified copy of the instrument as amended.

(Only United States Branches of foreign companies need answer interrogatories 24.)

24. What changes have been made during the year in the United States Manager or the United States Trustees of the company? Answer:

Does this statement contain all business transacted for the company through its United States Branch on risks wherever located? Answer:

25. What officials and heads of departments of the company supervised the making of this report? Answer:
26. In what states, territories, or foreign countries is the company authorized to transact business? Answer:
27. Is the purchase or sale of all investments of the company passed upon either by the Board of Directors or a subordinate committee thereof? Answer:
28. Does the company keep a complete permanent record of the proceedings of its Board of Directors and all subordinate committees thereof? Answer:
29. Have the instructions printed on the inside front cover of this blank been followed in every detail? Answer:

BUSINESS IN THE STATE OF NEW JERSEY DURING THE YEAR

(Prepare this Exhibit on the same basis as is required in the Exhibit of Policies on page 9 of statement blank)

	Ordinary (Excluding Group)		Group		Industrial	
	No.	Amount	No.	Amount	No.	Amount
30. Policies on the lives of citizens of said State in force December 31 of previous year		$		$		$
31. Policies on the lives of citizens of said State issued during the year						
32. Total		$		$		$
33. Deduct ceased to be in force during the year						
34. Policies in force December 31 of current year		$		$		$

	No.	Amount	No.	Amount	No.	Amount
35. Losses and claims unpaid December 31 of previous year		$		$		$
36. Losses and claims incurred during current year						
37. Total		$		$		$
38. Losses and claims settled during current year, in full $______; by compromise, $______ (amount actually paid, $______ —do not include in extension); by rejection, $______						
39. Losses and claims unpaid December 31 of current year		$		$		$

40. Premiums collected or secured in cash and notes or credits without any deduction for losses, dividends, commissions or other expenses: Ordinary $______ Group $______; Industrial $______; Total $______
41. Consideration for annuities, $______

State of ______ } ss:
County of ______

______ President ______ Secretary

of the ______, being duly sworn, each for himself deposes and says that they are the above-described officers of said company, and that on the thirty-first day of December last all the above-described assets were the absolute property of the said company, free and clear from any liens or claims thereon except as above stated; and that the foregoing statements, with the schedules and explanations therein contained, annexed or referred to, are a full and correct exhibit of all the assets, liabilities, income and disbursements and of the condition and affairs of the said company on the said thirty-first day of December last, and for the year ended on that date, according to the best of their information, knowledge and belief, respectively.

Subscribed and sworn to before me this ______ day of ______, 1940.

______ President.

______ Secretary.

THE GAIN AND LOSS EXHIBIT OF THE ANNUAL STATEMENT WAS MODIFIED IN 1939. SINCE MOST GAIN AND LOSS FIGURES CONTAINED IN THE BODY OF THE REPORT ARE BASED UPON FIGURES COMPILED ON THE BASIS OF THE EARLIER FORM, NAMELY, THE 1938 GAIN AND LOSS EXHIBIT, IT IS SET FORTH BELOW.

Form 1 ANNUAL STATEMENT FOR THE YEAR 1938 OF THE ____________________ (Write or stamp name of Company)

PARTICIPATING—GAIN AND LOSS EXHIBIT

	Gain in Surplus	Loss in Surplus

INSURANCES

RUNNING EXPENSES

1. Total gross premiums received during the year, $________ per item 8, page 2 of current year's statement, plus such gross premiums paid in advance December 31 of previous year, $________ per item 21, page 5 of that year's statement, less such gross premiums paid in advance December 31 of current year $________, per item 21, page 5 of current year's statement, giving total gross premiums of the year . . . . .
2. Deduct net premiums on same. . . . .
3. Loading on gross premiums of the year (averaging ________ per cent. of the gross premiums). . . . .
4. †Insurance expenses paid during the year, $________, plus $________ unpaid December 31 of current year, less $________ unpaid December 31 of previous year, giving insurance expenses of the year (averaging ________ per cent. of the gross premiums). . . . .
5. *________ from loading . . . . .

INTEREST

6. Interest, dividends and rents received during the year, per item 21, page 2 (less item 29, page 3, and less $________ amortization and plus $________ accrual). . . . .
7. Add the excess of interest and rents due and accrued over interest and rents paid in advance December 31 of current year, determined as follows: item 21, page 4, less the sum of item 44B, page 4, item 22, page 5, and the interest in item 28, page 5 . . . . .
8. Total. . . . .
9. Deduct the excess of interest and rents due and accrued over interest and rents paid in advance December 31 of previous year, determined as follows: item 21, page 4, less the sum of item 44B, page 4, item 22, page 5, and the interest in item 28, page 5 of previous year's statement . . . . .
10. Interest earned during the year (________ per cent. of mean ledger assets less one-half of interest earned) .
11. †Investment expenses paid during the year, $________, plus $________ unpaid December 31 of current year, less $________ unpaid December 31 of previous year, giving incurred investment expenses (averaging ________ per cent. of mean ledger assets) . . . . .
12. Net interest (including rents) on investments (averaging ________ per cent. of mean ledger assets, less one-half of net interest on investments). . . . .
13. Deduct net interest, $________, on disability and $________ on accidental death benefits. . . . .
14. Balance. . . . .
15. †Interest required to maintain reserve. . . . .
16. *________ from interest . . . . .

MORTALITY (INSURANCES)

17. †Expected mortality on net amount at risk. . . . .
18. Total death losses incurred during the year, determined as follows: item 1, column 3, page 3, plus item 13, column 7, page 5, less death claims included in item 24, page 4, December 31 of current year's statement, less item 13, column 7, page 5, plus death claims included in item 24, page 4 of previous year's statement, less $________ terminal reserves released by death; giving actual mortality on net amount at risk (equaling ________ per cent. of expected mortality on net amount at risk) . . . . .
19. *________ from mortality under insurance policies. . . . .

MORTALITY (ANNUITIES, EXCLUDING DISABILITY ANNUITIES)

20. †*________ from mortality under annuities (excluding disability annuities). . . . .

SURRENDERS, LAPSES AND CHANGES

21. Reserves on policies surrendered during the year for cash values or on account of which extended or paid-up insurance was granted (incurred basis) . . . . .
22. Deduct amount paid in cash or applied on indebtedness, initial reserves on extended insurance, and initial reserves on paid-up insurance under said policies (incurred basis) . . . . .
23. *________ from policies surrendered for cash or on account of which extended or paid-up insurance was granted during the year. . . . .
24. *________ from changes and restorations made during the year . . . . .
25. Gain during the year from reserves released on lapsed policies on which no cash or other value, paid-up or extended insurance was allowed . . . . .
26. Total gain during the year from surrendered, lapsed and changed policies. . . . .

DIVIDENDS

27. Dividends declared to stockholders. . . . .
28. Decrease in surplus on dividend account, determined as follows: the sum of items 9 (a) to (e) inclusive of page 3 $________; plus $________ increase (or less $________ decrease) in unpaid, deferred, apportioned and provisionally ascertained dividends per items 30, 31, 32 and 33 of page 5.

SPECIAL FUNDS

29. ________crease in special funds and special reserves during the year, being the difference between such funds and reserves on December 31 of previous year (per items ________, page ________), and on December 31 of current year (per items ________, page ________) . . . . .

PROFIT AND LOSS (EXCLUDING INVESTMENTS)

30. †Carried to profit account (per items ________, page ________) . . . . .
31. †Carried to loss account (per items ________, page ________) . . . . .
32. Net to ________ account. . . . .

INVESTMENTS

REAL ESTATE

33. Total gain from real estate, being the sum of $________ profit on sales, per item 27(a) page 2; $________ increase in book value, per item 28(a), page 2; and $________ from change in difference between book and market values during the year . . . . .
34. Total loss from real estate, being the sum of $________ loss on sales, per item 33(a), page 3; $________ decrease in book value, per item 34(a), page 3; and $________ from change in difference between book and market values during the year . . . . .

STOCKS AND BONDS

35. Total gain from stocks and bonds, being the sum of $________ profit on sales or maturity, per items 27(b) and (c), page 2; $________ increase in book value, other than for accruals, per items 28(b) and (c), page 2, and $________ from change in difference between book and market values, during the year . . . . .
36. Total loss from stocks and bonds, being the sum of $________ loss on sales or maturity, per items 33(b) and (c), page 3; $________ decrease in book value, other than for amortization, per items 34(b) and (c), page 3; and $________ from change in difference between book and market values during the year . . . . .
37. *________ on other investments, viz:
38. ________ — ________
39. ________
40. *________ from assets not admitted . . . . .

MISCELLANEOUS

41. †Net*________ on account of total and permanent disability benefits included in life policies excluding loading: *________, $________ active lives and *________ $________ disabled lives. . . . .
42. †Net*________ on account of accidental death benefits included in life policies excluding loading . .
43. *________ from all other sources (give items and amounts):
44. *________ from assets not admitted excepting that reported under item 40, page 9. . . . .
45. ________
46. †Balance unaccounted for . . . . .
47. Total gains and losses in surplus during the year. . . . .

SURPLUS

48. Surplus December 31 of previous year, per item 44, page 5 of previous year's statement . . . . .
49. Surplus December 31 of current year, per item 44, page 5 of current year's statement . . . . .
50. ________crease in surplus (enter in column to balance) . . . . .
51. Totals . . . . .

*In the "Running Expenses" section "Disability and Accidental Death" benefits are included with the classes of insurance in connection with which such benefits were written.

*Write "Gain" or "Loss." †See "Instructions" attached.

Form 1

ANNUAL STATEMENT FOR THE YEAR 1938 OF THE ____________ (Write or stamp name of Company)

PARTICIPATING—GAIN AND LOSS EXHIBIT—(Continued)

General Interrogatories Regarding Gain and Loss Exhibit

52. Does the company value on the full level premium reserve system, the preliminary term, the modified preliminary term or the select and ultimate basis? Answer:

53. If the company uses more than one of the above methods, give the amounts of insurance and reserve under each method

54. Has the company ever issued both non-participating and participating policies? Answer:

55. Does the company at present issue both non-participating and participating policies? (If the company does not at present issue both, state which kind is issued.) Answer:

56. Give the amounts of insurance in force under each of these plans, stating separately amounts of annual dividend business and deferred dividend business respectively

57. Has the company any assessment or stipulated premium insurance in force? Answer:
If so, give the amount thereof........ $

Exhibit of the Changes in Surplus for the Year, According to Classes or Lines of Business

INCOME	Industrial	Ordinary	Total and Permanent Disability Included in Ordinary Policies	Accidental Death Benefits Included in Ordinary Policies	Annuities (Excluding Disability Annuities)	GROUP: Group Annuities	GROUP: Group Life	Total
58. Premiums								
59. Investment (less $, investment expenses, including taxes)								
60. Other income								
61. Total Income								
DISBURSEMENTS								
62. Death claims								
63. Disability claims								
64. Maturities								
65. Surrender values								
66. Dividends—policyholders								
67. Other payments to policyholders								
68. Dividends—stockholders								
69. Expense (excluding investment expense and taxes)								
70. Taxes (excluding taxes included in investment expenses)								
71. Other disbursements								
72. Total Disbursements								
73. INCOME OVER DISBURSEMENTS								
74. INCREASE IN NON-LEDGER ASSETS								
75. TOTAL								
76. INCREASE IN NON-ADMITTED ASSETS								
77. DIFFERENCE								
78. INCREASE IN LIABILITY								
79. INCREASE IN †SURPLUS								

† Include unassigned funds and all special or contingency reserves which are in the nature of surplus. Such funds and reserves should be excluded from the amount of liabilities reported in Item 73.

Form 1 ANNUAL STATEMENT FOR THE YEAR 1939 OF THE.. 11
(Write or stamp name of Company)

Note.—In case the following schedules do not afford sufficient space, companies may furnish them on separate forms, provided the same are upon paper of same size and arrangement, contain the information asked for herein, and have the name of the company printed or stamped at the top thereof.

SPECIAL DEPOSIT SCHEDULE

Showing all deposits or investments NOT *held for the protection of* ALL *the pol holders of the company*

(1) State or Country	(2) Description of Deposit (Indicating [illegible] form of registration of securities)	(3) Par Value	(4) *........ Value
		$	$
	Totals . . .	$	$

SCHEDULE OF ALL OTHER DEPOSITS

Showing all deposits made with any government, province, state, district, county, municipality, corporation, firm or individual, except the regular deposits in banks and trust companies subject to check, and those shown in "Special Deposit Schedule" above

(1) State or Country	(2) Description of Deposits (Indicating [illegible] form of registration of securities)	(3) Par Value	(4) *........ Value
		$	$
	Tot . .	$	$

*[illegible]

Form 1 — ANNUAL STATEMENT FOR THE YEAR 1939 OF THE ______ (Write or stamp name of Company) — 12

SCHEDULE A—Part 1

Showing all Real Estate OWNED *December 31 of Current Year, the Cost, Book and Market Value thereof, the Nature and Amount of all Liens and Incumbrances thereon, Including Interest Due and Accrued, etc*

Report individually each property owned, except as indicated below in subsections (a) and (c)

(a) Acquired prior to current year and owned at end of current year (but not then under contract of sale)

No.	(1) Size and Location of Lands; Size and Description of Buildings; or Nature of Additions and Improvements (Nature of Incumbrances, if any, including interest due and accrued)	(2) *Date Acquired	(3) Year of Last Appraisal	(4) Name of Vendor	(5) Amount of Incumbrances	(6) **Cost to Company	(7) Book Value Less Incumbrances	(8) Market Value Less Incumbrances	(9) Increase, by Adjustment, in Book Value during Year	(10) Decrease, by Adjustment, in Book Value during Year	(11) †Expended for Additions and Permanent Improvements during Year	(12) ‡Amounts Received during Year, for Sales of Rights or Privileges	Gross and Net Income, Taxes, Repairs and Expenses for Last Three Years — 1939 — (13) Gross Income, Less Interest on Incumbrances	1939 — (14) Expended for Taxes, Repairs and Expenses	1939 — (15) Net Income	1938 — (16) Gross Income, Less Interest on Incumbrances	1938 — (17) Net Income	1937 — (18) Gross Income, Less Interest on Incumbrances	1937 — (19) Net Income
					$	$	$	$	$	$	$	$	$	$	$	$	$	$	$
• •	Summary—Items of less than $10,000.	• •	•	• • •															
• •	Summary—Items of $10,000 and less than $25,000.	• •	•	• • •															
				Totals, Part 1 (a)	$	$	$	$	$	$	$	$	$	$	$	$	$	$	$

(b) Acquired during current year and owned at end of current year (but not then under contract of sale)

No.	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)
					$	$	$	$	$	$	$	$	$	$	$	$	$	$	
				Totals, Part 1 (b)	$	$	$	$	$	$	$	$	$	$	$	$	$	$	
				Totals, Part 1 (a) and (b)	$	$	$	$	$	$	$	$	$	$	$	• • • • • •	• • • • • •	• • • • • •	

(c) Acquired prior to current year and owned under contract of sale at end of current year

No.	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	Contract Sale Price — Total	Contract Sale Price — Due to Date under Contract	Contract Sale Price — Actually Paid to Date	Due Current Year and Unpaid
					$	$	$	$	$	$	$	$	$	$	$	$	$	$	$
• •	Summary—Items of less than $10,000.	• •	•	• • •															
• •	Summary—Items of $10,000 and less than $25,000.	• •	•	• • •															
				Totals, Part 1 (c)	$	$	$	$	$	$	$	$	$	$	$	$	$	$	$

(d) Acquired during current year and owned under contract of sale at end of current year

No.	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	Total	Due to Date under Contract	Actually Paid to Date	Due Current Year and Unpaid
					$	$	$	$	$	$	$	$	$	$	$	$	$	$	
				Totals, Part 1 (d)	$	$	$	$	$	$	$	$	$	$	$	$	$	$	
				Totals, Part 1 (c) and (d)	$	$	$	$	$	$	$	$	$	$	$	• • • • • •	• • • • • •	• • • • • •	
				Grand Totals, Part 1	$	$	$	$	$	$	$	$	$	$	$	• • • • • •	• • • • • •	• • • • • •	

*Under parts (b) and (d) indicate how acquired, by: f. foreclosure; p. purchase; t. trade.

**Include cost of acquiring title and all amounts expended for additions and permanent improvements to end of current year, less all amounts received for sales on to end of current year. If acquired by foreclosure, include all amounts expended for taxes, repairs and improvements prior to the date of acquiring title.

†Report only those amounts expended after acquiring title, including reductions in incumbrances.

‡Include any interest in incumbrances. Rental value of space occupied by company (Give items and amounts) ______

CLASSIFICATION

Showing the total amount of Real Estate owned in each State and Foreign Country

State	Market Value — Farm Properties	Market Value — Other than Farm Properties	State	Market Value — Farm Properties	Market Value — Other than Farm Properties	State	Market Value — Farm Properties	Market Value — Other than Farm Properties	Foreign Country	Market Value — Farm Properties	Market Value — Other than Farm Properties
	$	$		$	$		$	$		$	$
Totals	$	$		$	$		$	$		$	$

Form 1

ANNUAL STATEMENT FOR THE YEAR 1939 OF THE........................ (Write or stamp name of Company)

SCHEDULE A—Part 2

Showing all Real Estate SOLD *during the Year, including Payments during the Year on "Sales under Contract"*

Report individually each property sold except as indicated below.

No.	(1) Site and Location of Lands, Size and Description of Buildings or Nature of Additions and Improvements (Nature of incumbrances, if any, including interest due and accrued)	(2) *Date Purchased	(3) Name of Vendor	(4) Date Sold	(5) Name of Purchaser	(6) **Cost to Company	(7) Increase by Adjustment in Book Value during Year	(8) Decrease by Adjustment in Book Value during Year	(9) †Expended for Additions and Permanent Improvements during Year	(10) Book Value at Date of Sale, less Incumbrances	(11) ‡Amounts Received during Year for Sales of Rights or Privileges	(12) §All Other Amounts Received Including Payments on Sales under Contract	(13) Profit on Sale	(14) Loss on Sale	(15) Gross Income during Year less Interest on Incumbrances	(16) Expended for Taxes, Repairs and Expenses during Year
	(a) Sold during current year but acquired prior to current year															
						$	$	$	$	$	$	$	$	$	$	$
	Summary—Payments during the year under sales under contract															
					Totals, Part 2 (a)	$	$	$	$	$	$	$	$	$	$	$
	(b) Sold during current year, acquired during current year															
						$	$	$	$	$	$	$	$	$	$	$
	Summary—Payments during the year under sales under contract															
					Totals, Part 2 (b)	$	$	$	$	$	$	$	$	$	$	$
					Grand Totals, Part 2	$	$	$	$	$	$	$	$	$	$	$

*Under part (b) indicate how acquired, by: f, foreclosure; p, purchase; t, trade.

**Include cost of acquiring title and all amounts expended for additions and permanent improvements to end of current year, less all amounts received for sales up to end of current year. If acquired by foreclosure, include all amounts expended for taxes, repairs and improvements prior to the date of acquiring title.

†Report only those amounts expended after acquiring title, including reductions in incumbrances.

‡Include any increases in incumbrances.

§Indicate payments on "Sales under Contracts" by inserting the letter "P" after the number of the parcel.

SCHEDULE A—Verification Between Years

Book Value, December 31, Previous Year (Item 1, Page 4, Annual Statement) . . . . ________

Current Year:—

Increase, by Adjustment; Grand Total, Part 1, Col. (9) . . . . ________
Grand Total, Part 2, Col. (7) . . . . ________
Total Increase (Item 28 (a), Page 2) . . . . ________

Cost of Acquired; Part 1 (b), Col. (6) . . . . ________
Part 1 (d), Col. (6) . . . . ________
Part 2 (b), Col. (6) . . . . ________
Total Acquired . . . . ________

Cost of Permanent Improvements; Part 1 (a), Col. (11) . . . . . . ________
Part 1 (c), Col. (11) . . . . . . ________
Part 2 (a), Col. (9) . . . . . . ________
Total Improvements . . . . ________

Profit on Sales, Grand Total, Part 2, Col. (13) (Item 27 (a), Page 2) . . . . ________ ________

Less:—

Decrease, by Adjustment; Grand Total, Part 1, Col. (10). . . . . . . ________
Grand Total, Part 2, Col. (8) . . . . ________
Total Decrease (Item 34 (a), Page 3). . . . . ________

Received on sales; Part 1 (a), Col. (12) . . . . ________
Part 1 (c), Col. (12) . . . . ________
Part 2 (a), Col. (11) . . . . ________
Grand Total, Part 2, Col. (12) . . . . ________
Total Received . . . . ________

Loss on Sales, Grand Total, Part 2, Col. (14) (Item 33 (a), Page 3) . . . . ________ ________

Book Value, December 31, Current Year (Item 1, Page 4) . . . . ________

Form 1 ANNUAL STATEMENT FOR THE YEAR 1939 OF THE ________________ 14
(Write or stamp name of Company)

SCHEDULE B—Part 1

Summary of MORTGAGES OWNED December 31 of Current Year in each State or Foreign Country, and all Mortgage Loans Made, Increased, Discharged, Reduced or Disposed of during the year. Show Individually all Loans Exceeding 2% of Total Admitted Assets; Summarise, in Manner Indicated, all other Mortgages.

(1)	FARM PROPERTIES									OTHER PROPERTIES									(10) TOTAL UNPAID DECEMBER 31 OF CURRENT YEAR		
STATE OR FOREIGN COUNTRY	(2) Amount Unpaid Dec. 31 of Previous Year		(3) Amount Loaned During Year (A)		(4) Amount Paid on Account or in Full During Year (B)		(5) Unpaid Dec. 31 of Current Year			(6) Amount Unpaid Dec. 31 of Previous Year		(7) Amount Loaned During the Year (A)		(8) Amount Paid on Account or in Full During Year (B)		(9) Unpaid Dec. 31 of Current Year					
							No.	Amount								No.	Amount		No.	Amount	
	Dollars	Cts.	Dollars	Cts.	Dollars	Cts.		Dollars	Cts.	Dollars	Cts.	Dollars	Cts.	Dollars	Cts.		Dollars	Cts.		Dollars	Cts.
TOTALS							....									....			....		

(A) Including all mortgages "purchased" or otherwise acquired during the year and all increases during the year on loans outstanding December 31 of previous year.
(B) Including mortgages under which company has secured title and possession by foreclosure.

SCHEDULE B—Part 2

Showing all MORTGAGE LOANS MADE OR INCREASED during the year: (A) on farm properties actually in use for farming purposes; (1) where the loan exceeds 60% of the value of the land, (2) where more than 25% of the land is unfit for farming purposes (swamp, timber, desert, etc.), except where the loan does not exceed 60% of the value of the arable land; (B) on other properties; (1) where the loan is $25,000 or over, (2) where the loan exceeds 60% of the combined value of the land and buildings, except where the loan is amortized over a period of twenty years, or less, and the buildings are covered by fire insurance.

NUMBER	(1) DATE		(2) RECORD OF MORTGAGE		(3)	(4)	PRINCIPAL		(7)	(8)	(9)	(10)
	Year Given	Year Due	State	County	Acreage of Farm Property or Location of Other Property	Nature of Use or Occupancy	(5) Amount Unpaid Dec. 31 of Previous Year	(6) Amount Loaned During Year	Additional Loan for Payment of Taxes, Assessments, Etc.	Rate of Interest	Value of Land Mortgaged	Value of Buildings
							$	$	$		$	$

(1) Including mortgages under which company has secured title and possession by foreclosure.

Form 1

ANNUAL STATEMENT FOR THE YEAR 1939 OF THE ______________________________
(Write or stamp name of Company)

SCHEDULE B—Part 3

Showing information concerning all MORTGAGE LOANS (a) IN PROCESS OF FORECLOSURE, PROPERTIES SOLD, transfer of legal title awaiting expiration of redemption or moratorium period; (aa) ALL OTHER MORTGAGE LOANS IN PROCESS OF FORECLOSURE; (b) UPON WHICH INTEREST IS OVERDUE (or the time for payment of interest has been extended) more than three months, and (c) UPON WHICH TAXES, ASSESSMENTS OR OTHER LIENS ARE DELINQUENT more than two years

NOTES: (i) Each section is to be sub-divided into "Farm Properties" and "Other than Farm Properties" and each such sub-division according to States. In each State sub-group, Mortgage Loans for $25,000 or more (exclusive of interest) are to be listed first; following these, the remainder may be summarized and presented in aggregate. (ii) Interest under sections (a), (aa) and (b) is to be reported only on loans on which interest is overdue more than three months, in such cases all overdue interest is to be reported. Taxes under section (a), (aa), (b) and (c) need not be reported unless delinquent more than two years; in such cases all delinquent taxes, whether advanced by the Company or not, are to be reported.

(1) STATE	(2) Number of Loans	(3) Loan Number	(4) DATE		(5) AMOUNT OF LOAN		(6) INTEREST			(7) DELINQUENT TAXES ETC.		(8) VALUE OF LANDS AND BUILDINGS
			Year Given	Year Due			Rate	Amount Past Due Dec. 31 Current Yr.				
					Dollars	Cts.		Dollars	Cts.	Dollars	Cts.	Dollars
SECTION (a) MORTGAGE LOANS IN PROCESS OF FORECLOSURE—Properties sold, transfer of legal title awaiting expiration of redemption or moratorium period												
			Total Part 3 (a)									
SECTION (aa) ALL OTHER MORTGAGE LOANS IN PROCESS OF FORECLOSURE												
			Total Part 3 (aa)									

(1) STATE	(2) Number of Loans	(3) Loan Number	(4) DATE		(5) AMOUNT OF LOAN		(6) INTEREST			(7) DELINQUENT TAXES ETC.		(8) VALUE OF LANDS AND BUILDINGS
			Year Given	Year Due			Rate	Amount Past Due Dec. 31 Current Yr.				
					Dollars	Cts.		Dollars	Cts.	Dollars	Cts.	Dollars
SECTION (b) MORTGAGE LOANS, not included in Section (a) or (aa), on which interest is overdue (or the time for payment of interest has been extended) more than three months.												
			Total Part 3 (b)									
SECTION (c) MORTGAGE LOANS, not included in Sections (a), (aa) or (b), upon which taxes, assessments or other liens are delinquent more than two years.												
								X	X			
			Total Part 3 (c)									
			Grand Totals Part 3									

GENERAL INTERROGATORIES

1. Are there any prior liens on mortgaged properties other than those shown in Part 3? Answer: .... If so, give particulars ....
2. Rates of interest on loans made during year of statement? Farm properties: maximum ...., minimum .... Other properties: maximum ...., minimum ....
3. Maximum percentage of any one loan to the value of security at time loan is made, exclusive of purchase money mortgages taken in connection with sales of real estate? ....
4. Are any investments included in Schedule B, such as land contracts or ground rents, which are not really mortgage loans? Answer: ....
5. Where a loan is secured by both land and buildings, is fire insurance carried in every case at least equal to the excess of the loan over the maximum loan which would be permitted by law on the land without the buildings? Answer: ....
6. Show following information on mortgage loans with interest more than one year overdue: Number .... Amount loaned $ .... Total of overdue interest $ ....
7. Show data on mortgage loans where interest rate has been reduced as follows: Reduction 3%, Number .... Amount $ ....; Reduction 2%, Number .... Amount $ ....; Reduction 1%, Number .... Amount $ ....
8. Amount of taxes and expenses $........ and past due and accrued interest $........ capitalized in current year by the company on account of mortgage loans and included in item 2, page 4.

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Form 1 ANNUAL STATEMENT FOR THE YEAR 1939 OF THE ____________________ 16

(Write or stamp name of Company)

SCHEDULE C—Part 1

Showing all Collateral Loans IN FORCE *December 31 of Current Year, and all Substitutions of Collateral Thereon During Said Year*

No.	(1) Description of Securities Held as Collateral December 31 of Current Year (Give in this column the number of shares of each block of stock and rate of interest and year of maturity of each bond held as collateral)	(2) Par Value	(3) Rate Used to Obtain Market Value	(4) Market Value Dec. 31 of Current Year	(5) Amount Loaned Thereon	(6) Date of Loan	(7) Maturity of Loan	(8) Interest				(9) Substitutions of Collateral, viz:								(10) Name of Actual Borrower
								Rate of Loan	Amount Past Due Dec. 31 of Current Year	Amount Accrued Dec. 31 of Current Year	Amount Received During Year	Collateral Substituted				Collateral Released				
												Description	Date	Par Value	Market Value	Description	Date	Par Value	Market Value	
		$		$	$				$	$	$			$	$			$	$	
	Totals	$	....	$	$	....	....	....	$	$	$	....	....	$	$	....	....	$	$	

SCHEDULE C—Part 2

Showing all Collateral Loans MADE *During the year and all Substitutions of Collateral Thereon During Said Year*

No.	(1) Description of Security Accepted as Collateral When Loan was Made	(2) Par Value	(3) Rate Used to Obtain Market Value	(4) Market Value at Date of Loan	(5) Amount Loaned Thereon	(6) Date of Loan	(7) Maturity of Loan	(8) Rate of Interest on Loan	(9) Substitutions of Collateral, viz:								(10) Name of Actual Borrower
									Collateral Substituted				Collateral Released				
									Description	Date	Par Value	Market Value	Description	Date	Par Value	Market Value	
		$		$	$						$	$			$	$	
	Totals	$	....	$	$	....	....	....	....	....	$	$	....	....	$	$	

SCHEDULE C—Part 3

Showing all Collateral Loans DISCHARGED *in Whole or in Part During the year and all Substitutions of Collateral Thereon During Said Year*

No.	(1) Description of Collateral Released When Loan Was Discharged (in case of partial payments enter collateral released only)	(2) Par Value	(3) Rate Used to Obtain Market Value	(4) Market Value at Date of Discharge	(5) Amount of Loan Repaid	(6) Date of Loan	(7) Date of Repayment	(8) Interest		(9) Substitutions of Collateral, viz:								(10) Name of Actual Borrower
								Rate of Loan	Amount Received During Year	Collateral Substituted				Collateral Released				
										Description	Date	Par Value	Market Value	Description	Date	Par Value	Market Value	
		$		$	$				$			$	$			$	$	
	Totals	$	....	$	$	....	....	....	$	....	....	$	$	....	....	$	$	

NOTE—Indicate partial payments in Part 3 by the letter "P" in number column.

NOTE—Substitutions of collateral need be shown in detail in only one exhibit. Refer in each of the other exhibits to the number of the loan in the exhibit in which the substitution is shown and show the substitution in Part 1 when possible.

Form 1

Bonds to be grouped in following manner and each group arranged alphabetically:
Government
States, Territories and Possessions
Political Subdivisions of States, Territories and Possessions
Railroad
Public Utilities
Industrial and Miscellaneous Show sub-totals for each group.

ANNUAL STATEMENT FOR THE YEAR 1939 OF THE ....
(Write or stamp name of Company)

SCHEDULE D—Part 1

Showing all BONDS *Owned December 31 of Current Year*

Supplemental columns for data concerning Amortization. *See Note*

(1) DESCRIPTION Give complete and accurate description of all bonds owned, including the location of all street railway and miscellaneous companies. If bonds are serial issues give amount maturing each year	(2) INTEREST		(3) DATE OF			(4) Book Value	(5) Par Value	(6) Rate Used to Obtain Market Value	(7) Market Value (excluding accrued interest)	(8) Actual Cost (excluding accrued interest)	(9) INTEREST		(10) Increase, by Adjustment, in Book Value During Year	(11) Decrease, by Adjustment, in Book Value During Year	(12) †Amount of Interest due and accrued Dec. 31, current year, on bonds in default as to principal or interest	(13) Are These Bonds Amply Secured?	(14) Year Acquired	(15) Effective Rate of Interest at Which Purchase Was Made	(16) ‡Amortized or Investment Value Dec. 31 of Current Year	(17) Increase in Amortized Value During Year	(18) Decrease in Amortized Value During Year
	Rate of	*How Paid	Maturity Year	Maturity Month	Option						Amount Due and Accrued Dec. 31 of Current Year on bonds not in default	Gross Am't Received During Year									
						$	$		$	$	$	$	$	$	$				$	$	$
Totals	....	....	....	....	....	$	$	....	$	$	$	$	$	$	$	....	....	....	$	$	$

*Insert Initial Letters of months in which interest is payable.

†Perpetual bonds, bonds in default as to principal or interest, and bonds not amply secured, are to be entered in this column at market value. All companies must report amortized values, whether or not this basis of valuation is used on page 4.

‡Companies which use "Amortized Values" as "Book Values" may omit entering figures in these columns, and provide the following footnote: "The increases and decreases in amortized values are the same as those shown in the columns for 'Increase and Decrease by Adjustment in Book Value,' excepting as otherwise indicated."

NOTE—This supplemental information, required of all Companies which amortize their bonds, is not to be used as a substitute for the information required in the preceding columns but in addition thereto.

Stocks to be grouped in following manner and each group arranged alphabetically:
Railroad
Public Utilities
Banks, Trust and Insurance Companies
Industrial and Miscellaneous Show sub-totals for each group

SCHEDULE D—Part 2

Showing all STOCKS *Owned December 31 of Current Year*

(1) DESCRIPTION Give complete and accurate description of all stocks owned, including redeemable options, if any, and location of all street railway, bank, trust and miscellaneous companies.	(2) No. of Shares	(3) Par Value Per Share	(4) Book Value	(5) Rate Per Share Used to Obtain Market Value	(6) Market Value	(7) Actual Cost	(8) DIVIDENDS				(9) Increase, by Adjustment, in Book Value During Year	(10) Decrease, by Adjustment, in Book Value During Year	(11) Year Acquired
							Rate % on Each on Last Three Years: 1937	1938	1939	Amount Received During Year			
		$	$		$	$				$	$	$	
Totals.	....	....	$	....	$	$	....	....	....	$	$	$	....

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Form 1

ANNUAL STATEMENT FOR THE YEAR 1939 OF THE ________________ (Write or stamp name of Company)

SCHEDULE D—SUMMARY

Bonds and Stocks OWNED *December 31 of Current Year*

Description	Book Value		Par Value of Bonds		Market Value (Excluding accrued interest)		Actual Cost (Excluding accrued interest)		*Amortized or Investment Value		This column to be left blank
	Dollars	Cts.	Dollars	Cts.	Dollars	Cts.	Dollars	Cts.	Dollars	Cts.	
1. **BONDS**											
2. Government:											
3. United States											
4. Canada											
5. Other Countries											
6. Total (Items 3-5)											
7. States, Territories and Possessions:											
8. United States											
9. Canada											
10. Other Countries											
11. Total (Items 8-10)											
12. Political Subdivisions of States, Territories and Possessions.											
13. United States											
14. Canada											
15. Other Countries											
16. Total (Items 13-15)											
17. Railroad:											
18. United States											
19. Canada											
20. Other Countries											
21. Total (Items 18-20)											
22. Public Utilities:											
23. United States											
24. Canada											
25. Other Countries											
26. Total (Items 23-25)											
27. Industrial and Miscellaneous:											
28. United States											
29. Canada											
30. Other Countries											
31. Total (Items 28-30)											
32. Total Bonds (Items 6, 11, 16, 21, 26 and 31)											
33. **STOCKS**											
34. Railroad:											
35. United States			X X X	X					X X X	X	
36. Canada			X X X	X					X X X	X	
37. Other Countries			X X X	X					X X X	X	
38. Total (Items 35-37)			X X X	X					X X X	X	
39. Public Utilities:											
40. United States			X X X	X					X X X	X	
41. Canada			X X X	X					X X X	X	
42. Other Countries			X X X	X					X X X	X	
43. Total (Items 40-42)			X X X	X					X X X	X	
44. Banks, Trust and Insurance Companies:											
45. United States			X X X	X					X X X	X	
46. Canada			X X X	X					X X X	X	
47. Other Countries			X X X	X					X X X	X	
48. Total (Items 45-47)			X X X	X					X X X	X	
49. Industrial and Miscellaneous:											
50. United States			X X X	X					X X X	X	
51. Canada			X X X	X					X X X	X	
52. Other Countries			X X X	X					X X X	X	
53. Total (Items 50-52)			X X X	X					X X X	X	
54. Total Stocks (Items 38, 43, 48 and 53)			X X X	X					X X X	X	
55. Total Bonds and Stocks (Items 32 and 54)			X X X	X					X X X	X	

*Companies, societies, and associations which do not amortize their bonds should leave this column blank.

Form 3

ANNUAL STATEMENT FOR THE YEAR 1939 OF THE ____________________
(Write or stamp name of Company)

Stocks and bonds to be grouped separately showing sub-totals for each group.

SCHEDULE D—Part 3

Showing all Bonds and Stocks ACQUIRED *During the Current Year*

(1) Description Give complete and accurate description of each bond and stock, including location of all street railway, bank, trust and miscellaneous companies. If bonds are serial issues give amounts maturing each year. Give full information as to redeemable options, if any, for each bond and stock.	(2) Date Acquired	(3) Name of Vendor	(4) No. of Shares of Stock	(5) Cost to Company (Excluding Accrued Interest on Bonds)	(6) Par Value of Bonds	(7) Paid For Accrued Interest on Bonds Acquired During Year
				$	$	$
		Totals		$	$	$

Stocks and bonds to be grouped separately showing sub-totals for each group.

SCHEDULE D—Part 4

Showing all Bonds and Stocks SOLD, REDEEMED *or otherwise* DISPOSED OF *During the Current Year*

(1) Description Give complete and accurate description of each bond and stock, including location of all street railway, bank, trust and miscellaneous companies. If bonds are serial issues give amounts maturing each year. Give full information as to redeemable options, if any, for each bond and stock.	(2) Date Sold	(3) Name of Purchaser	(4) No. of Shares of Stock	(5) Consideration (Excluding Accrued Interest on Bonds)	(6) Par Value of Bonds	(7) Cost to Company (Excluding Accrued Interest on Bonds)	(8) Book Value at Date of Sale	(9) Increase, by Adjustment, in Book Value During Year	(10) Decrease, by Adjustment, in Book Value During Year	(11) Profit on Sale	(12) Loss on Sale	(13) Interest on Bonds Received During Year (Including Accrued Interest on Bonds Sold)	(14) Dividends on Stocks Received During Year
				$	$	$	$	$	$	$	$	$	$
		Totals	......	$	$	$	$	$	$	$	$	$	$

Form 1

ANNUAL STATEMENT FOR THE YEAR 1939 OF THE .... (Write or stamp name of Company) 20

SCHEDULE E

Showing all Balances (according to Company's records) December 31, and largest Balance Carried in Each Bank or Trust Company During Each Month of the Current Year

BANK OR TRUST COMPANY* (Give Full Name and Location)	JANUARY		FEBRUARY		MARCH		APRIL		MAY		JUNE		JULY		AUGUST		SEPTEMBER		OCTOBER		NOVEMBER		DECEMBER		BALANCE December 31 of Current Year		Rate of Interest	Amount of Interest Received During Year	
	Dollars	Cts.	Dollars	Cts.	Dollars	Cts.	Dollars	Cts.	Dollars	Cts.	Dollars	Cts.	Dollars	Cts.	Dollars	Cts.	Dollars	Cts.	Dollars	Cts.	Dollars	Cts.	Dollars	Cts.	Dollars	Cts.		Dollars	Cts.
Totals																													

*[illegible] the word "PRIVATE" in capitals and in parentheses, thus—(PRIVATE), should be inserted to the left of the name of the depository. [illegible]

Form 1 ANNUAL STATEMENT FOR THE YEAR 1939 OF THE ______________________ 21

(Write or stamp name of Company)

SCHEDULE F

**Showing all claims for death losses and all other policy claims resisted or compromised during the year, and all claims for death losses and all other policy claims resisted December 31 of current year*

(1) Policy Numbers	(2) State of Residence of Claimant	(3) Amount Claimed	(4) Amount Paid During the Year	(5) Amount Resisted Dec. 31 of Current Year	(6) Why Compromised or Resisted
		$	$		
Totals,			$	$	

*Claims should be classified and reported in the following sub-divisions:
(a) Claims disposed of during current year (b) Claims resisted. In each of the above sections, Death claims, Additional Accidental Death Benefit claims, Disability Benefit claims, Matured Endowment claims and Annuities involving Life Contingencies claims, should be listed separately with sub-totals for each group.

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SCHEDULE G

Showing all salaries, compensation and emoluments, excepting bona fide commissions paid to or retained by agents, of whatever amount received in the current year by officers and directors and, where the same amounted to more than $5,000, by any person, firm or corporation except for amounts included in Schedules I, J and K

(1) TITLE	(2) NAME OF PAYEE	(3) LOCATION OF PAYEE	(4) AMOUNT PAID		(5) DATE	(6) BY WHOM AUTHORIZED
			Dollars	Cents		

SCHEDULE I

Showing all commissions and collection fees paid in connection with loans or properties during the year where the same amounted to more than $5,000 to any person, firm or corporation

(1) DATE	(2) PAYEE		(3) WHAT ACQUIRED OR DISPOSED OF		(4) AMOUNT OF COMMISSION PAID
	NAME	ADDRESS	DESCRIPTION	AMOUNT INVOLVED	
				$	$

ANNUAL STATEMENT FOR THE YEAR 1939 OF THE ________________________ Form 1
(Write or stamp name of Company)

SCHEDULE J

Showing in detail all legal expenses paid during the year (List individually items of $100 or more)

Payee		(3) Amount Paid	(4) Occasion of Expense
(1) Name	(2) Address		
		$	
	Total of all Other Items	$	
	Grand Total		

Form 1 ANNUAL STATEMENT FOR THE YEAR 1939 OF THE ______________ 25

(Write or stamp name of Company)

SCHEDULE K

Showing all expenditures in connection with matters before legislative bodies, officers or departments of government during the Year

(1) DATE	PAYEE		(4) AMOUNT PAID	(5) MEASURE OR PROCEEDING	(6) INTEREST OF THE CORPORATION THEREIN
	(2) NAME	(3) ADDRESS			
			$		
		Total	$		

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(Write or stamp name of Company)

SCHEDULE L

Proceedings at last annual election held on ______________________

NAMES OF CANDIDATES FOR DIRECTOR OR TRUSTEE	NUMBER OF VOTES CAST FOR EACH CANDIDATE			TOTAL VOTES
	IN PERSON	BY PROXY	BY MAIL	
Totals				

NOTE.—Attach to this schedule a copy of the official minutes of annual meeting.

Form 1

ANNUAL STATEMENT FOR THE YEAR 1939 OF THE ______________________
(Write or stamp name of Company)

SCHEDULE M

Age 25

Showing rates of annual dividends declared (paid) in current Year and annual premiums per $1,000 of insurance at age 25, at date of issue

YEARS IN WHICH THE POLICIES WERE ISSUED

KIND OF POLICY	1938		1937		1936		1935		1934		1929		1924		1919		1914		1909		1904		1899		1894		1889		1884		1879		1874		1869		1864	
	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd
Ordinary Life,																																						
5-Payment Life,																																						
10 " "																																						
15 " "																																						
20 " "																																						
All other, viz:																																						
5-Year Endowment Assurance,																																						
10 " " "																																						
15 " " "																																						
20 " " "																																						
25 " "																																						
" "																																						
35 " " "																																						
40 " " "																																						
45 " " "																																						
50 " " "																																						
All other, viz:																																						
All other plans of Insurance, viz:																																						

NOTE:—Attach to this schedule explanation showing precise methods by which dividends were calculated.

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Form 1

ANNUAL STATEMENT FOR THE YEAR 1939 OF THE ____________________
(Write or stamp name of Company)

SCHEDULE M—(Continued)

Age 35

Showing rates of annual dividends declared (paid) in current Year and annual premiums per $1,000 of insurance at age 35, at date of issue

YEARS IN WHICH THE POLICIES WERE ISSUED

KIND OF POLICY	1938		1937		1936		1935		1934		1929		1924		1919		1914		1909		1904		1899		1894		1889		1884		1879		1874		1869		1864	
	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd
Ordinary Life,																																						
5-Payment Life,																																						
10 " "																																						
15 " "																																						
20 " "																																						
All other, viz:																																						
5-Year Endowment Assurance,																																						
10 " " "																																						
15 " " "																																						
20 " " "																																						
25 " " "																																						
30 " " "																																						
35 " " "																																						
40 " " "																																						
45 " " "																																						
50 " " "																																						
All other, viz:																																						
All other plans of Insurance, viz:																																						

NOTE.—Attach to this schedule explanation showing precise methods by which dividends were calculated.

ANNUAL STATEMENT FOR THE YEAR 1939 OF THE .... (Write or stamp name of Company)

SCHEDULE M—(Continued)

Age 45

Showing rates of annual dividends declared (paid) in current Year and annual premiums per $1,000 of insurance at age 45, at date of issue

YEARS IN WHICH THE POLICIES WERE ISSUED

KIND OF POLICY	1938		1937		1936		1935		1934		1929		1924		1919		1914		1909		1904		1899		1894		1889		1884		1879		1874		1869		1864	
	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd
Ordinary Life,																																						
[illegible]-Payment Life,																																						
10 " "																																						
15 " "																																						
[illegible] " "																																						
All other, viz:																																						
[illegible]-Year Endowment Assurance,																																						
10 " " "																																						
15 " " "																																						
[illegible] " " "																																						
[illegible] " " "																																						
[illegible] " "																																						
[illegible] " " "																																						
[illegible] " " "																																						
" " "																																						
[illegible] " " "																																						
other, viz:																																						
All other plans of insurance, viz:																																						

NOTE—[illegible]

Form 1 | ANNUAL STATEMENT FOR THE YEAR 1939 OF THE .... (Write or stamp name of Company) | 38

SCHEDULE M—(Continued)

Age 55

Showing rates of annual dividends declared (paid) in current Year and annual premiums per $1,000 of insurance at age 55, at date of issue

	YEARS IN WHICH THE POLICIES WERE ISSUED																																					
	1938		1937		1936		1935		1934		1929		1924		1919		1914		1909		1904		1899		1894		1889		1884		1879		1874		1869		1864	
KIND OF POLICY	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd	Prem.	Div'd
Ordinary Life,																																						
5-Payment Life,																																						
10 " "																																						
15 " "																																						
20 " "																																						
All other, viz:																																						
5-Year Endowment Assurance,																																						
10 " " "																																						
15 " " "																																						
20 " " "																																						
25 " " "																																						
30 " " "																																						
35 " " "																																						
40 " " "																																						
45 " " "																																						
50 " " "																																						
All other, viz:																																						
All other plans of Insurance, viz:																																						

NOTE:—Attach to this schedule explanation showing precise methods by which dividends were calculated.

Form 1 ANNUAL STATEMENT FOR THE YEAR 1939 OF THE ______________ 31
(Write or stamp name of Company)

SCHEDULE S

Showing Names and Locations of Companies and Amounts Recoverable for all Reinsurance on Paid and Unpaid Losses and Claims

NAME OF COMPANY	LOCATION	(1) PAID LOSSES		(2) UNPAID LOSSES	
		Dollars	Cts.	Dollars	Cts.
	Totals				

Form 1

ANNUAL STATEMENT FOR THE YEAR 1939 OF THE ....
(Write or stamp name of Company)

SCHEDULE X—UNLISTED ASSETS

**Showing all property owned by or in which the Company had any interest, on December 31 of current year, which is not entered on any other schedule and which is not included in the financial statement for the current year*

Description	From Whom Acquired	Date When Acquired	Date When Charged off From Statement	Par Value	Actual Cost	Book Value When Charged off	Market Value December 31 of Current Year	Gross Income Therefrom During Year	Outlays Made During Year	Reasons for Not Carrying Property on Books
				$	$	$	$	$	$	
		Totals	....	$	$	$	$	$	$	

*Companies should limit entries in this schedule to items transferred from asset accounts.

Form 1

ANNUAL STATEMENT FOR THE YEAR 1939 OF THE ______________________
(Write or stamp name of Company)

SCHEDULE Y—Part 1

Showing all property purchased during the year except that shown in Schedules A, B, C and D and except furniture, fixtures and supplies

DESCRIPTION	Date of Purchase	From whom purchased	Par Value	Actual Cost	Market Value December 31 of Current Year	Gross Income Therefrom During Year	Outlay Thereon During Year Other Than Cost
			$	$	$	$	$
		Totals	$	$	$	$	$

SCHEDULE Y—Part 2

Showing all property sold during the year except that shown in Schedules A, B, C and D

DESCRIPTION	Date of Acquisition	From Whom Acquired	Par Value	Actual Cost	Date of Sale	To Whom Sold	Consideration	Gross Income Therefrom During Year	Outlay Thereon During Year Other Than Cost
			$	$			$	$	$
		Totals	$	$			$	$	$ 22

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(Write or stamp name of Company)

SCHEDULE T—EXHIBIT OF PREMIUMS COLLECTED
Allocated by States and Territories

States, etc.	Direct Business	Reinsurance Assumed From: Unauthorized Companies (2)	Reinsurance Assumed From: Authorized Companies (3)	Reinsurance Ceded To: Unauthorized Companies (4)	Reinsurance Ceded To: Authorized Companies (5)	Premiums Less Reinsurance Ceded (6)	Consideration For Annuities (7)
Alabama							
Alaska							
Arizona							
Arkansas							
California							
Colorado							
Connecticut							
Delaware							
Dist. Columbia							
Florida							
Georgia							
Hawaii							
Idaho							
Illinois							
Indiana							
Iowa							
Kansas							
Kentucky							
Louisiana							
Maine							
Maryland							
Massachusetts							
Michigan							
Minnesota							
Mississippi							
Missouri							
Montana							
Nebraska							
Nevada							
New Hampshire							
New Jersey							
New Mexico							
New York							
No. Carolina							
No. Dakota							
Ohio							
Oklahoma							
Oregon							
Pennsylvania							
Rhode Island							
So. Carolina							
So. Dakota							
Tennessee							
Texas							
Utah							
Vermont							
Virginia							
Washington							
West Virginia							
Wisconsin							
Wyoming							
Canada							
Cuba							
Porto Rico							
Philippine Is.							
Mexico							
Other foreign							
†Dividends applied to purchase paid-up additions		X X X X	X X X X	X X X X	X X X X		X X X X
†Dividends applied to shorten endt or premium-paying period		X X X X	X X X X	X X X X	X X X X		X X X X
Premiums waived under disability provisions							
Annuity considerations see line 7, page 2		X X X X	X X X X	X X X X	X X X X		
Part of line 7A, page 2 applicable to annuities		X X X X	X X X X	X X X X	X X X X		
Totals (per line 8, page 2)							

State in detail method of allocation by states, etc., of insurance premiums and annuity considerations

____

____

____

____

†Dividends applied to pay renewal premiums must be included in column (1) and distributed by states.
*Insert total of annuity considerations to agree with line 7, sum of columns (5) and (6), page 2.

402812

The Balance Sheet (Assets, Liabilities, Surplus and Other Funds)

It has been previously explained [2] that the asset side of the balance sheet is made up by listing ledger assets, adding nonledger assets, and deducting assets not admitted.

Ledger assets are principally investment accounts. They include book value of real estate, mortgage loans, policy loans, premium notes, book value of bonds and stocks, cash, bills receivable, agents balances (the gross amount of which is later deducted as a not admitted asset) and certain other miscellaneous receivables and debit and credit suspense items which have been recorded during the year in the suspense account.

Under the caption "nonledger assets" are grouped those assets belonging to a company which do not appear of record on the books of the company. They may be classified as follows:

Interest and rents due and accrued.

Uncollected and deferred net premiums.

Deferred charges.

Excess of market values of real estate and stocks over their book values.

Excess of amortized or investment, convention, or market values as the case may be of bonds over their book values.

Miscellaneous receivables.

Due and accrued receivables and deferred items usually constitute the major portion of the nonledger assets. As the books are not kept on an accrual basis, an annual inventory has to be taken of these unrecorded assets so that the balance sheet at the close of the year may properly portray the company's financial position, something which the books of account do not do.

As will be observed, "assets not admitted" are of three types: First, assets considered valueless, such as delinquent interest, deposits in suspended banks, premium notes, policy loans and other policy assets in excess of net value of other policy liabilities on individual policies; second, assets of value but excluded as assets by custom, law, or regulation such as furniture and fixtures, materials and supplies, balances due from agents, company's stock owned or loaned on, cash advanced to or in the hands of officers or agents and loans on personal security; third, deductions from the values at which certain assets are carried in ledger or nonledger assets. These latter deductions, which in the aggregate usually involve the most important amounts deducted as "assets not admitted" are the "book value of real estate over market values," "book value of bonds over market, or amortized or investment value" (as the case may be), and "book value of stocks over market value."

The unusual method of arriving at the value of assets in life insurance balance sheets has been mentioned, but further ramifications of this peculiar accounting should be examined. The methods used provide opportunity for much tinkering with values. Final balance-sheet values are unsupported in the accounts of the companies, except insofar as the "book" values are used for some assets in the balance sheet. Instead of carrying their assets in the books at cost, and providing separate reserve or valuation accounts to be used for additions or deductions, as the case may be, in determining balance-sheet values,

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[2] Reference is made to the summary discussion of life insurance company accounts, pp. 319 to 322, infra.

the companies prefer to carry them at "book" values, subject to arbitrary increases or decreases by adjustments. As the adjustments in "book" values do not necessarily bring the assets in question to the values to be stated in the balance sheet, further adjustments have to be made. These further adjustments appear in the statement, but not on the books, as follows:

If increases: By inclusion in nonledger assets.

If decreases: By inclusion in not-admitted assets, or by inclusion in the inventory of liabilities, as "contingency reserves" depreciation allowances, or reserves for fluctuation in values.

The effect of this is that by changing book values the cost or historical values in the balance sheet are destroyed and a gain or loss is shown in the income and disbursements statement and the gain and loss exhibit in amount equivalent to the adjustment. When an increase in asset value is accomplished by increase in nonledger assets, however, the balance-sheet value is increased, the book or ledger value remains the same, no gain results in the income and disbursements statement, but the full amount of the increase will appear as a gain in the gain and loss exhibit. When a decrease in asset value is accomplished through inclusion in assets not admitted, the balance-sheet value is decreased, the book or ledger value remains the same, no loss results in the income and disbursements statement, but the full amount of the decrease will appear as a loss in the gain and loss exhibit.

The final method of producing an effective but not easily apparent recognition of depreciation in asset values is by the inclusion in the inventory of liabilities a reserve to offset excess asset values on the asset side of the balance sheet. This method is replete with opportunities for legerdemain. In the first place, the total assets will appear at a higher figure in the balance sheet than proper valuation justifies. Otherwise, there is no necessity for the reserve. Second, no adjustment of the books is necessary and the amount of the deduction does not have to be shown and classified among the "not-admitted assets." Furthermore, as the convention blank provides no specific designations for such reserves the amount included among liabilities may be hidden in some general item such as "general voluntary reserve" or "contingency reserve" or any other similar designation which the company may elect. Under this arrangement no loss will appear in the income and disbursements statement and although surplus will be decreased in the gain and loss exhibit, it is usually shown as a decrease due to special reserves or miscellaneous, rather than due to investments. Furthermore, unless the item is clearly captioned in the balance sheet (which is rarely the case) the reader will be unable to determine whether the item is of a character which should be deducted from the assets (as it should if it is an asset-valuation account) or whether it is simply a portion of the company's surplus appearing under another name.

Another example of unorthodox balance-sheet presentation is revealed by the manner in which the companies show the total due to or due from their agents. The total amount due to agents is not shown as a liability but is combined with the total amount due from agents and the resulting debit or credit is reported under ledger assets in line 10 of page 4 of the convention blank. There is then deducted, as a not-admitted asset, the gross amount due from agents. In sub-

stance this means that the agents' debit balances are omitted from the balance sheet altogether, while the agents' credit balances are applied as a reduction of the ledger assets.

Even more flagrant disregard for proper methods of accounting is sometimes shown by life insurance companies. An illustration is given in the case of the Metropolitan Life Insurance Co., in its annual statement for the year 1938. Under the caption of "Nonledger Assets" there appear the following three items:

Checks for annuities and supplementary contracts involving life contingencies issued in advance	$576, 541. 43
Checks for supplementary contracts not involving life contingencies issued in advance	88, 890. 95
Checks for disability payments issued in advance	121, 009. 79
Total	786, 442. 17

Why these items are listed as assets is not clear. Apparently they represent checks drawn against the company's bank accounts in payment of contracts not due until after December 31, 1938. If the payments were not yet due, it seems absurd to issue the checks, reduce the bank balances shown as a part of the ledger assets, and then return the total of the outstanding checks to the balance sheet as a part of the nonledger assets with which they have no connection whatsoever. Under ordinary and elementary principles of double-entry bookkeeping this method of portrayal would not be possible, but apparently the company was forced to make the entries in order to balance the statement. Thus, when the company inventories its liabilities as of December 31, 1938, it found that the liabilities for which the checks had been issued were still liabilities as of December 31, 1938, and had to be included on the liability side of the balance sheet. It was necessary, therefore, as the bank accounts had already been reduced by the amounts of the checks issued in advance, to provide a balancing figure in the statement to offset the liability.

It should also be noted that two types of assets are included as such in the balance sheet, though they should be more properly treated as deductions from the liabilities. They are:

Policy loans (ledger asset, line 4 of p. 4).

Net amount of uncollected and deferred premiums (nonledger asset, line 29 of p. 4).

Strictly speaking, policy loans are not investments and cannot be realized on to meet general liabilities. They represent a reduction in policy reserves. However, due to the fact that these loans yield a relatively high rate of interest and contribute in a large measure to the interest earnings on the investments of a company, they have generally been shown on the asset side of the balance sheet. The more conservative method of stating them would be as a deduction from the reserves, to avoid an overstatement of assets.

An extreme illustration of the danger in carrying policy loans as an asset is evidenced by the annual statement of the Illinois Bankers Life Assurance Co., Monmouth, Ill., for the year 1931. The figures now quoted are taken from Best's Life Insurance Reports—1932. As of December 31, 1931, that company reported total admitted assets of $19,106,795 of which policy loans or liens amounted to $10,884,973, or 57 percent of the total. On the liability side of the statement the

policy reserves amounted to $11,679,027. A more misleading statement cannot be imagined. It is obvious what happens to the statement when the policy loans are applied to the reserves where they properly belong.

The nonledger asset for the net amount of uncollected and deferred premiums is also better stated as a deduction from the policy reserves because of the actuarial assumptions used in arriving at the liability for those reserves. Net uncollected premiums are those premiums due but not yet reported to the company's home office as paid. Net deferred premiums cover installment premiums for the current policy year, but which are not payable at the close of the calendar year. However, in determining the policy reserves it is assumed that all premiums are paid annually and that any premiums due on or before the last day of the calendar year have actually been paid. It would seem wiser accounting to adjust the policy reserve by offsetting this "asset" to equalize the assumptions used in determining policy reserves.

Liabilities

With the exception of policy reserves and policy claims which are segregated, liabilities, reserves, and surplus are set forth in such conglomerated fashion as to make comprehension difficult. Generally speaking, the liability side of the form, page 5, may be summarized as follows:

Lines 1 to 9: Policy, or statutory reserves.

Line 10: Present value of amounts not yet due on supplementary contracts not involving life contingencies.

Line 11: Liability on policies canceled.

Lines 12 to 18: Policy claims and losses outstanding.

Lines 19 to 39: Current and accrued liabilities, prepaid items of income, and liabilities for trust funds.

Lines 40 to 42: Contingency reserves (special funds).

Line 43: Capital stock outstanding.

Line 44: Surplus (unassigned funds).

The major portion of the liabilities consists of the policy reserves, sometimes called the statutory reserves. They constitute, as a rule, from 80 to 90 percent of the total.

The amount of reserve on a given policy is the accumulation of those parts of the net premiums paid which represent the excess over the amount required to meet current death or other contract claims. Stated in another way, it is the difference between the present value of the net premiums to be paid by the policyholder and the present value of the benefits to be paid by the company under the terms of the contract. Theoretically, the total reserves of a company are exactly enough to meet all claims on all outstanding policies when they shall become due. Lines 1 to 9, inclusive, of page 5 of the convention blank, give the detail of these reserves.

The responsibility for the adequacy of the reserves rests to an important degree with the actuaries of the companies. Laws of the various States prescribe minimum standards only, and these are not adequate in all cases.[3] As in the case of all other liabilities, the inventory method is applied to ascertain the amount of policy reserves

[3] See, e. g., report of the Committee to Study the Need for a New Mortality Table, p. 121

for inclusion in the balance sheet. Usually a company, toward the close of the year, prepares the necessary data from the cards on file in its office.

Another large item is the liability for the present value of amounts not yet due on supplementary contracts not involving life contingencies. The calculation of this liability involves an assumption as to interest rates, but not as to mortality, and it is, therefore, an accounting rather than an actuarial problem. It is not to be confused with the liability for supplementary contracts which involve life contingencies, and which are included as part of annuity reserves.

The undesirability of treating policy loans and the net amount of the uncollected and deferred premiums as assets has already been remarked herein. The allowance, therefore, should be made for their deduction from the liability for policy reserves.

Line 12 is captioned "Policy claims and losses outstanding." Although this account should represent only the direct liability for known policy claims and losses, it includes an actuarial estimate for claims and losses which may have been incurred but have not yet been reported. Presumably the liabilities on these claims has also been included in the calculation of policy reserves.

In lines 22 to 39, inclusive, are set forth the current and accrued liabilities usual to a large business, together with prepaid items of income and deferred liabilities, such as dividends left with the company to accumulate at interest. All of these liabilities are found by inventorying.[4]

Line 31 is entitled "Dividends declared or apportioned to annual dividend policies payable to policyholders to and including December 31, of the following year, whether contingent upon the payment of renewal premiums or otherwise, and $———— for dividends payable on coinsured policies." Under the insurance laws of the State of New York it is mandatory on the companies domiciled in that State to distribute surplus on a calendar year basis or within 4 months subsequent thereto. As a matter of fact, however, the distribution is actually made on a policy year basis, except for industrial business, and the dividends to be paid are usually determined before the close of the calendar year and the dividend year is then treated as the calendar year. Under this method a dividend liability is established for a 12-month period which causes an overstatement of the liability as much of the dividend, being on a policy year basis, is not a liability until the following year. Again, the dividend years of some companies are not made to coincide with the calendar years, but commence

[4] Line 28 is designated "Borrowed money and interest thereon." In at least 1 instance this line was not used to show a transaction which should have been so classified. The Lincoln National Life Insurance Co. in effect borrowed money which did not appear as a liability in its balance sheet. This was accomplished by assigning a proportion of its renewal premium income to Mr. Arthur M. Hall, then president, and now chairman of the board of the company, which Mr. Hall pledged to obtain bank loans made in his own name during the years 1930 and 1931 in the total amount of $682,000. The funds were used in consummating reinsurance contracts in Mr. Hall's name. These he assigned to the company without profit to himself. Final payment of the debt was made December 29, 1934. At no time during the existence of this liability did it appear on the company's books. The entire series of transactions appears to have been a subterfuge to avoid showing the liability on the company's statement although the reason assigned by Mr. Hall was that the company did not wish to decrease its surplus by the transactions. No trace of the borrowings appeared in the annual statement, except that the company in answering the general interrogatories of the convention form annual statement stated that the assignment existed, though no figures relating thereto were given (pt. 28, testimony of Mr. Arthur M. Hall, February 16, 1940).

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at a date subsequent to the close of the calendar year. In such cases the liability to be shown is only for dividends between the last day of the calendar year and the first day of the new dividend year.

Line 35 is captioned "All other liabilities," and lines 36 to 39, inclusive, provide blank spaces for these to be listed. Under this caption appear those liabilities for which provision has not been made elsewhere in the statement. It is a catch-all for many items. In its 1938 annual statement, for example, the Metropolitan included the following amounts in the "all other liabilities" category:

Amount set aside for adjustment during 1939 in the value of real estate	$10, 000, 000. 00
Fire insurance fund	2, 184, 367. 91
Due for taxes withheld at source	287, 264. 95
Withheld from employees for payments of insurance premiums	383. 90
Hegeman Memorial fund	295, 652. 32
Suspense, unadjusted items, etc	4, 050, 700. 29
Deposit accounts	119, 357. 96
Workmen's compensation fund, Ohio	169, 773. 22
Agents' cash deposits	3, 726, 381. 50
Accrued interest on deposits	54, 677. 95
Reserve for allowances to policyholders in consideration of direct payment of weekly premiums during current year at home office or district offices	4, 298, 395. 00
Accident and health division	11, 113, 554. 07
Total	36, 300, 609. 07

The above presentation gives an excellent illustration of the difficulties encountered in analyzing and interpreting the balance sheet of a company. Certainly the classification of a reduction of $10,000,000 in the value of an investment asset under the caption "all other liabilities" is indefensible. An item of $4,050,700.29 in a suspense account should not be tolerated. As to the lump sum of $11,113,554.01 reported as a total liability for the accident and health department, there is no reason why this amount cannot be divided up and classified with the policy reserve, claim, or other appropriate accounts.

Another example serves further to illustrate the varied and inconsistent ways in which companies report their liabilities. Under the same caption of "all other liabilities" in the statement of the Travelers Insurance Co. for 1938 appears this all-inclusive item:

Additional reserve for extra premiums, pro rata, paid-up insurance values, trust agreements, and conversions, etc	$4, 095, 855

The annual statement gives no clue as to the composition of this item. However, in the report of examination of the Travelers Insurance Co. made by the Connecticut Insurance Department for the year ended December 31, 1936, the examiner shows a make-up of an item similarly designated.[5] In 1936 this item amounted to $2,770,738 and was analyzed in the examination report as follows:

Unearned occupational extra premiums	$51, 588
Guaranteed paid-up values in excess of reserve	25, 000
Reserve for guaranties under trust agreements	1, 741, 573

[5] P. 36, Report of Examination of the Travelers Insurance Co., the Travelers Indemnity Co., the Travelers Fire Insurance Co., and the Chartered Oak Fire Insurance Co., as of December 31, 1936—Connecticut Insurance Department.

Reserve for group conversions	$290, 577
Reserve for group rate credits	592, 000
Extra reserve on group annuities	70, 000
Total	2, 770, 738

Most of these items should have been reported elsewhere. The "unearned occupational extra premium," the "extra reserves on group annuities," and the "reserve for group conversions" should be classified with policy reserves. "Guaranteed paid-up values not in excess of reserve" should be handled as a lump-sum addition to reserve.

Lines 40 to 42, inclusive, provide for so-called reserve, special or surplus funds not already appearing on the liability side of the balance sheet. The term "reserve, special or surplus funds" is capable of many interpretations and in the absence of further definition, many interpretations have been given to it by the companies. Therefore, there will always be confusion or lack of uniformity in the handling of these accounts until absolute distinction is made between them. A proper definition of these accounts places them in one or more of the following four categories:

True contingency reserves—the mere earmarking of surplus.
Reserves to supplement policy reserves.
Valuation accounts—allowances for reductions in values of assets.
Current or accrued liabilities.

True reserves, of course, appear on the liability side of the statement. The use of such terms as "reserve fund," "special fund," or "surplus fund" should be discouraged, as they imply asset rather than liability accounts. Literally speaking, in the insurance business, all reserves are funded reserves in the sense that the investment assets as a whole are behind them, although not specifically allocated to any particular reserve. True contingency reserves, or earmarked portions of surplus, are usually established as extra margins of safety to take care of probable future unaccrued liabilities or contemplated contingencies of sufficient importance to warrant consideration. Reserves to supplement policy reserves should be clearly designated with adequately descriptive titles and classified with policy reserves. Reserves for the purpose of valuation of assets should appear as deductions from the assets affected. So-called reserves for taxes, unpaid expenses, dividends payable, etc., are not reserves but direct liabilities of a current or accrued nature. They should, therefore, be so stated in the balance sheet.

Some idea of the widely different types of liabilities and reserves which are reported under the caption of "reserve, special, or surplus funds," by the companies named are:

Mutual Life Insurance Co. of New York:
- Fund for depreciation of securities and general contingencies.
- Reserve for unpaid expenses.
- Reserve for future expenses on paid-up annual dividend policies.
- Reserve for reinsurance deducted—companies not licensed in New York.

New York Life Insurance Co.:
- Special investment reserve.
- Reserve for future expenses on single premium policies and annuities.

The Travelers Insurance Co.:
- Special reserve.
- Reserve for capitalized interest and taxes under real estate mortgages.

The Equitable Life Assurance Society of the United States:
- Contingency reserve for group life insurance.

Metropolitan Life Insurance Co.:
- Reserve for dividends payable in following year.
- General voluntary reserve.
- Special group life reserve for epidemics.
- Reserve to cover all other possible items.

John Hancock Mutual Life Insurance Co.:
- Reserve for unrealized profits on sale of real estate.
- Contingency reserve for asset fluctuation.

Connecticut General Life Insurance Co.:
- Contingency fund.

Penn Mutual Life Insurance Co.:
- Reserve for mortality fluctuation.
- Reserve for asset fluctuation.

The Guardian Life Insurance Co. of America:
- Reserve for capital stock to be acquired under mutualization plan.
- Reserve for self-insurance against fire and other hazards.
- Reserve toward establishing a home office pension fund.

Policy reserves are very definite contractual liabilities, whether considered from the viewpoint of cash surrender values and death claims or of contracts payable at a future date. They must not, then, be confused with contra-accounts set up in reduction of asset values or with amounts appropriated from surplus to take care of contingencies. Some companies recognize this difference to a certain extent by calling a contingency reserve a "voluntary" reserve, to distinguish it from the policy or statutory reserves.

Line 43 of page 5 of the statement provides for the showing, in the case of stock companies, of the capital stock issued and outstanding.

Line 44, the last item on the liability side, states the surplus or "unassigned funds" of the company. The amount shown here represents the difference between the total assets and the total liabilities and reserves. In the case of a stock company, of course, the difference will also include the amount of capital outstanding as well as surplus.

The treatment of surplus by the companies differs greatly. An idea as to the extremes to which the companies go in the handling of this account is apparent in the annual statements of the Mutual Life. This company shows zero in its balance sheet for its surplus or unassigned funds and the reader is hard put to discover the excess of assets over liabilities. Investigation of the company's accounting methods discloses, however, that it has combined its divisible surplus with an account captioned "fund for depreciation of securities and general contingencies." The Penn Mutual is another company which does not show any surplus but carries it in two accounts, one as a reserve for mortality fluctuation, the other as a reserve for asset fluctuation. The Northwestern Mutual likewise shows no surplus, treating it as "contingency reserve."

Some companies label a portion of surplus in such indefinite terms as "special reserve," "general voluntary reserve," or "contingency fund." Besides being misleading this device enables the company to adjust the amount of its surplus almost at will.

It has been stated that the cash and investments of a company make up the principal part of its assets and that of the liabilities to be stated so called policy reserves constitute between 80 and 90 percent of the total. It is not to be inferred from these statements that the other assets and liabilities discussed are, therefore, comparatively unimportant. While they may appear small in comparison with their totals, they are large in relation to the annual increase or decrease in surplus and to surplus itself.

Statement of Income and Disbursements

The statement of income and disbursements is neither a cash statement nor a true income account although it has some of the attributes of each. It is neither on a cash basis nor on an accrual basis although in general it purports to be on a cash basis. The inclusion of "effective" cash transactions and certain ledger adjustments destroys its usefulness as a cash statement, and its failure to take account of changes in surplus makes it valueless as a true income account.

The following facts regarding the income and disbursement statement give some ideas of its limitations:

1. It is not a statement of operating income and disbursements for the year.

2. It is not a statement of all cash receipts and disbursements for the year.

3. It ignores all items of an accrued or deferred nature except in isolated cases, such as amortization of discounts or premiums on bonds.

4. It does not exclude items which properly belong to the business of other years such as past due interest and rents collected, and prepaid items of expense.

5. It shows profits or losses from sale or maturity of assets only to the extent that they are reflected among the "ledger assets" on the books. These "ledger asset" figures are often substantially different from those stated in the balance sheet. The result is that the profit or loss from sale or maturity of assets as shown in the statement of income and disbursements is frequently different to an important extent from that which would be shown in a true income statement.

6. It includes in part cash receipts and disbursements totally unrelated to income and expenses such as cash received from borrowed money, agents' deposits received, and miscellaneous cash receipts, and likewise records repayments of the liabilities created by such receipts.

7. It includes as cash transactions items effectively received and disbursed thereby causing an overstatement from an actual cash point of view. Surrender values paid include not only actual cash disbursements to retiring policyholders but also liquidation of policy loans previously disbursed, considerations for the purchase of nonforfeiture benefits such as extended term insurance or paid-up-insurance. Death claims include proceeds of death claims used to purchase annuities or left on deposit for subsequent distribution under supplementary contracts in spite of the fact that when actual cash is paid out pursuant to supplementary contracts this item also appears as a disbursement.

8. It includes adjustments to increase or decrease values of assets but only as they appear on the books and not necessarily as they appear in the balance sheet.

9. It includes many items of both receipts and disbursements which increase or decrease the ledger asset of cash at the same time creating or liquidating liabilities. As the only asset account affected is that of cash, and as the company's accounts consist only of ledger assets, the offsetting entries in such liability accounts are carried in a suspense account which is considered a part of the ledger assets regardless of whether it shows a debit or credit balance.

It may well be asked, then, what does this statement of income and disbursements signify? It signifies only the net increase or decrease in the total ledger assets as between the beginning and end of the year for which they are stated. That was the purpose for which the statement was originally intended. At the time the form was designed, business transactions were on a cash basis and the only assets affected were those coming into or going out of the business because of the cash transactions. Therefore, the only financial statement essential to the business was one showing:

1. Ledger assets at the beginning of the year.
2. Income during the year.
3. Total of 1 and 2.
4. Disbursements during the year.
5. Ledger assets at the end of the year (the difference between 3 and 4).

This is the statement today used by life-insurance companies, a statement wholly inadequate to meet the requirements of modern business or to give the true history of its operations, either on a cash basis or on an accrual basis.

In condensed form the present statement of income and disbursements may be summarized as follows:

INCOME

Lines 4 to 8: Premiums (exclusive of accident and health).

Line 9: Considerations, or premiums, for supplementary contracts involving life contingencies.

Lines 10 and 11: Trust funds held by the company for policyholders and beneficiaries. (Consideration for supplementary contracts not involving life contingencies, and dividends left with the company to accumulate at interest.)

Line 12: Ledger assets acquired from other companies because of reinsurance in bulk.

Lines 13 to 21: Interest, dividends, and rents (including discounts on claims paid in advance).

Line 22: Miscellaneous income and cash receipts.

Line 23: Proceeds from borrowed money.

Line 24: Bad debts recovered—agents.

Lines 25 and 26: Not classified.

Line 27: Gross profits on sales or maturities of ledger assets.

Line 28: Gross increases, by adjustments, in book values of ledger accounts.

DISBURSEMENTS

Lines 1 to 8: Payments of contractural liabilities.

Line 9: Dividends paid to policyholders.

Line 10: Total of lines 1 to 9.

Line 11a: Payments under supplementary contracts involving life contingencies.

Lines 11b and 12: Trust funds disbursed with interest. (Payments on supplementary contracts not involving life contingencies and dividends and interest thereon disbursed including dividends and interest held on deposit applied during the year to shorten the endowment or premium paying period.)

Lines 13 to 24: Selling and general expenses.

Line 25: Taxes, licenses, and fees.

Line 26: Real-estate expense.

Line 27: Dividends paid to stockholders.

Lines 28 and 29: Repayments of borrowed money and interest thereon.

Line 30: Bad debts written off—agents.
Lines 31 and 32: Unclassified.
Line 33: Gross losses on sales or maturities of ledger assets.
Line 34: Gross decreases, by adjustments in book values of ledger assets.

The lack of uniformity in the filling out of this statement by the various companies is not as noticeable as in the case of the balance sheet. This is because the form, although restricted in character, is more definite in its terminology.

INCOME

Premium receipts are, normally, the principal source of income to a life-insurance company. This item of income, exclusive of accident and health premiums and industrial premiums, is shown in block form on lines 4 to 8 of page 2 of the convention blank. It also includes premiums paid in advance. The block shows gross premiums received less amounts paid out for reinsurance, divided as between first year and renewal premiums and is stated according to lines of business as follows:

Line 4: Life.
Line 5: Disability benefits.
Line 6: Additional accidental death benefits.
Line 7: Annuities.

Line 7a, captioned "Dividends applied" is a weak feature in the block. This line reports the effective cash receipts by the applications of dividends due policyholders to pay renewal premiums, to shorten the endowment or premium paying period, and to purchase paid-up additions. Obviously, then, the amounts entered in lines 4 to 7 are not the totals they purport to be, as they do not include their proportionate share of the amounts reported in line 7a, although a footnote shows the distribution. There is no reason why a proper distribution could not be made. In fact, the whole block could be rearranged to include the industrial and accident and health premiums and the figures for each line of business reported. It is to be noted that no separate figures are given with respect to group insurance.

Considerations for supplementary contracts involving life contingencies are really the equivalent of premiums, although not so shown. They arise because a beneficiary has used the proceeds of a policy settlement to purchase at the net premium rate, in the form of a supplementary contract, what is in effect a life annuity. Actually they are an offset to the claims incurred shown as a part of the disbursements, which, from a strictly cash point of view, are overstated to that extent.

Trust funds held by a company for its beneficiaries and policyholders may generally be placed in two classes:

Considerations for supplementary contracts not involving life contingencies.
Dividends left with the company to accumulate at interest.

The first item represents the proceeds of policy settlements entrusted to the company by beneficiaries, to be repaid in certain and definite installments together with interest. It is not to be confused with the item for supplementary contracts which involve life contingencies.

The second item is self-explanatory. It illustrates, again, an "effective" item of cash received.

Line 12 of the statement provides for the showing of ledger assets acquired from other companies by reason of reinsurance in bulk. This happens when a company takes over the contractual liabilities of another company by reinsuring them itself. In this connection the reinsuring company acquires certain assets of the company going out of business.

In lines 13 to 21, inclusive, are reported receipts for interest, discounts on claims paid in advance, dividends on stocks, and rents. No separation is made for interest and rent paid in advance, or for items of income which are applicable to the operations of prior years. The items shown give no clue as to the amount of uncollected interest included in income which may result from the capitalization of delinquent interest on mortgages. Rents received include gross rent paid by the company for occupancy of its own property.

Line 22 is for reporting miscellaneous cash income or cash receipts under the caption of "From other sources." Typical items common to all companies are:

Miscellaneous deposits.
Tax refunds.
Income from unlisted assets.
Taxes withheld at the source.
Recoveries of doubtful receivables.
Policy fees.
Suspense items.

The caption, of course, provides for the stating of cash income or cash receipts not provided for elsewhere in the statement, although lines 25 and 26 appear to be for a similar purpose. Some of the items reported affect liability accounts which are carried, however, like suspense items, as a part of the ledger assets.

No further comments are necessary as to lines 23 and 24 of the statement which are receipts of borrowed money and agents' balances charged off.

In the block following line 27 are shown the various gross profits on the sales or maturities of the investment assets. The gross profits, however, are not necessarily actual profits, for they represent only the differences between the realized values and the "book" values of the assets involved, and the "book" value of an asset as will be shown in the next paragraph, is somewhat of an arbitrary figure.

Under the caption of "gross increase, by adjustment, in book value of ledger assets," line 28, appear "write-ups" of investment assets. They are in many instances arbitrary in nature, except for the accruing of bond discounts. This is one of the isolated instances in which income is reported on an accrual basis. The "book" values of the assets resulting from these adjustments, however, bear no true relation to market or sales values, or to the figures at which they are stated in the balance sheet.

Before proceeding with a discussion of the disbursement accounts, it will be seen that the income reported does not include such receipts as payments in cash on account of mortgage loan principal or repayments in cash of policy loans. As these receipts do not increase or decrease the total of the ledger assets, but only increase or decrease one asset as compared with another, they do not appear in the statement. Similarly, the purchases and sales or maturities of investment

assets are excluded from the statement, and only the "book" profits or losses appear therein.

In the case of policy loans which are liquidated with the proceeds of a policy settlement, or by the cash surrender value of the policy, there will again be an overstatement of the total cash payments to policyholders.

A very definite distinction has been made throughout these comments between payments actually made in cash to policyholders and payments "effectively" made to them. The distinction is worthy of note because the disbursements shown in the convention form are frequently summarized in the annual statement given to policyholders and such published figures, therefore, unless accompanied by an unusual amount of explanation are deceptive.

DISBURSEMENTS

Payments of contractual liabilities, lines 1 to 8, inclusive of page 3 of the statement, are by far the largest items of the disbursements. They represent claims incurred for:

Deaths.
Matured endowments.
Disability benefits.
Accidental death benefits.
Annuities.
Premium notes and liens voided by lapse.
Cash surrender values.

As previously stated, part of these amounts reported as being paid are subject to offset by the item of income reported as "considerations for supplementary contracts," since the disbursements show the claims in full, as incurred, or on an "effective" cash basis. For instance, the proceeds of a death claim now payable may be left with the company by a beneficiary, subject to the optional manner of payment in the terms of the policy, in which case the actual disbursement of cash will not occur until the first installment payment is made. Nevertheless, the statement shows "cash" disbursements and "cash" receipts for the full amount of the claim. Similarly, allowance must be made for that part of the cash surrender values which have been applied as reductions of policy loans.

Dividends paid to policyholders are also considered by the companies to be contract payments and as such appear in line 9 of page 3 of the statement. A dividend, as has been said, is in the nature of a refund to the policyholder of part of the gross premium paid by him. Stated in another way, a dividend represents an adjustment of the premium cost to the policyholder which is provided for out of surplus, and the policies of mutual companies generally carry a clause to that effect.[6]

Line 10, "Total paid policyholders," provides for the reporting of total contract payments to policyholders and beneficiaries, including dividends. Yet, immediately following, are lines 11 and 12 showing,

[6] There is another form of dividend or refund which is reported by the Metropolitan Life Insurance Co. Taking the annual statement of that company for the year 1938, there will be found this item reported in line 9A of p. 3 thereof: Amount returned to policyholders in consideration of direct payment of weekly premiums at home office or district offices, $7,406,754.69. Since the amount has been previously reported as income in line 8A of p. 2, "Total gross industrial premiums," it should be classified with and considered as offset against that amount.

respectively, payments under supplementary contracts, and payments to policyholders on account of "Dividends held on deposit disbursed." Therefore, line 10 appears to be a misnomer and is not really the "Total paid policyholders." For example, the amounts for "Paid for claims on supplementary contracts," lines 11a and 11b, have already been reported as "effective" cash disbursements in preceding lines as a part of the following:

Line 1: Death claims.

Line 2: Matured endowments.

Line 8: Surrender values (in some instances).

While the contract payments as a whole are offset, as already explained, by the income reported as "considerations for supplementary contracts," the installment payments, or actual cash disbursements, now have to be stated separately to avoid confusion.

Similar remarks apply to the amount for "Dividends held on deposit disbursed," as it includes payments under supplementary contracts not involving life contingencies as well as the return to policyholders of dividends left on deposit with the company to accumulate at interest.

Lines 13 to 24, inclusive, give the details of the principal expense accounts for the conduct of the business, consisting of selling expenses, such as commissions paid, agency supervision, medical and inspection fees, traveling, advertising, etc., and administrative and general expenses for salaries, office expenses, etc. Real-estate expense and taxes, shown separately in the statement, are discussed later herein. Purchases of office furniture, equipment, etc., are treated as miscellaneous expenses. This method of charging office furniture and fixtures, kitchen equipment, etc., to expense may cause a very uneven proration of these costs between years.

While the terminology of the accounts presented is definite, their classification and arrangement is wholly inadequate. The statement is nothing more than a narrative of various and sundry disbursements, without any segregation or summarization as to totals by class of expense or totals according to the natural divisions of the business. The statement lists relatively small miscellaneous expenses with meticulous care and provides blank lines for the companies to further elaborate on these accounts. On the other hand, it provides all inclusive terms for larger items, such as:

Line 17: Agency supervision and traveling expenses of supervisors.

Line 18: Branch office expenses, including salaries of managers, assistant managers, and clerks not included in line 16.

Line 20: Salaries and all other compensation of officers, directors, trustees, and home office employees (excluding salaries allocated to other disbursement accounts).

Under such conditions, an intelligent analysis of the expenses of the business is impossible. Important, also, is the form's failure to provide for the definition and separate classification of the large expense accounts incurred by some of the companies for health and welfare work, contributions to employees' retirement funds, free lunches for employees, free trips and conventions for employees, etc.

Under line 25 are grouped the taxes, licenses, and fees paid by the company, except real-estate taxes. As a classification in itself it is

incomplete, for it does not give the total taxes of all kinds paid, nor does it segregate income taxes paid. One instance was found where a company was reporting Federal taxes paid as a net amount after applying a refund of Federal income tax previously paid, though the annual statement does not reveal this. Reference here is made to the annual statement for the year 1937 of the Prudential. This company reported in line 25d of its statement, Federal taxes paid that year in the amount of $1,019,049.72. From information furnished in its reply to the questionnaire sent out by the Commission, it was ascertained that the actual taxes paid were $1,093,558.10, but an amount of $74,508.38 had been deducted as a credit for "Federal net income" taxes paid. Some companies report tax refunds as income "from other sources," in line 22 of page 2 of the statement.

Line 26 provides for the stating of the taxes, repairs, and expense incidental to the upkeep of the real estate owned by a company. The amounts are a part of investment expenses, other items for which are scattered elsewhere in the statement.

Lines 27, 28, 29, and 30, "paid stockholders for dividends," "borrowed money repaid," "interest on borrowed money," and "agents' balances charged off" explain themselves and require no comment.

The blank spaces provided in lines 31 and 32 appear to be for stating miscellaneous expenses and miscellaneous cash disbursements. To that extent they appear to conflict with the blank spaces for miscellaneous expense in line 24. Usually, the companies show miscellaneous losses and items of suspense in lines 31 and 32, rather than items of miscellaneous expense which appear under line 24.

The detailing, under lines 33 and 34, respectively, of the gross losses on sales or maturities of ledger assets and of the gross decreases, by adjustments, in "book" value of ledger assets is similar to the reverse of these items reported as income. These accounts, therefore, are subject to the comments made in preceding paragraphs, dealing with their counterparts.

One other peculiarity of the form for stating income and disbursements is that, while it is designed only to take care of the total increase in the ledger assets as between years, it must also provide for miscellaneous liability accounts occasioned by new money coming into the business which is not income or the result of the sale of an asset. A typical example is the increase in cash due to the receipt of proceeds of a loan, or an increase by receipts of deposits from agents. These transactions occasion the carrying of "suspense" accounts with the ledger assets.

The failure of the form to provide for segregation or summarization of the accounts by classes of expenses or by natural divisions of the business has already been discussed, but another of its notable weaknesses is that no distribution of income and expense is made by lines of business.

The statement provides no basis for an adequate segregation between first year and renewal expense. Lines 14 and 15 show the first year and renewal commissions. No effort is made to provide a further classification by means of which a segregation of these two types of expense may be made.

Gain and Loss Exhibit (1938)[7]

This statement is the result of the first official attempt in life insurance accounting to provide the equivalent of an ordinary profit and loss statement which would take into account not only the changes in the ledger assets, but also those in the nonledger assets, in the nonadmitted assets and in the liabilities and surplus. Similar forms are used for the ordinary and industrial departments but a different form is used for the accident and health department, as commented on later.

Much value of the statement is lost, because an actuarial analysis is superimposed upon an operating statement with unsatisfactory results.

While it purports to show the net increase or decrease in the surplus account for the year, it does not distinguish between items applicable to the current year's operations and those which are adjustments to the surplus account. As a matter of fact, some companies do not even show in this statement the increase or decrease in surplus, since they recognize no surplus account as such. Examples of this type of handling are found in the annual statements, previously discussed, of—

The Mutual Life Insurance Co. of New York.
Penn Mutual Life Insurance Co.
The Northwestern Mutual Life Insurance Co.

Because these companies treat surplus as a part of their contingency reserve accounts, any increase or decrease therein is automatically offset in the statement and the total "gains" and "losses" balance so that the figures show no increase or decrease in surplus during the year.

The figures in the gain-and-loss exhibit are shown on an accrued basis though the accounting methods used to determine the figures are crude in the extreme, and there is no tie-up with the statement of income and disbursements.

From an examination of the form it will be noted how various totals for cash, or effective cash, income and expense are first stated in the form of interlineation. To these totals are then applied the annual increases or decreases in the various asset and liability accounts not appearing of record on the books of the company. These are the

[7] In the 1939 convention form of annual statement, there appeared a new type of gain and loss exhibit, a copy of which is included in the form reproduced above (see p. 39). Although certain advantages are claimed for the new form it is understood that the supervisory officials of certain States (notably New York) have insisted that the companies continue to follow the gain and loss exhibit in the old form. The new exhibit is divided into two parts entitled: "(1) Gain and loss exhibit—showing the sources of the increases and decreases in surplus during the year," and "(2) gain and loss exhibit—analysis of increase in reserve during the year." The first section of the exhibit shows the year's operations from an accounting point of view, tracing operations from premium income down to gain from insurance and showing investment profits and losses and miscellaneous surplus adjustment. The second section is the actuarial analysis of the operations of the year. This latter, however, is so captioned as to be difficult or impossible for a layman to understand and requires considerable interpretation to derive the figures which were shown in the old form of gain and loss exhibit.

Both sections of the exhibit are prepared in columnar form showing the effect of operations of lines of business as classified in the exhibit of changes in surplus as it appeared in former years, which exhibit is abandoned in the new form. There is still no column provided for accident and health or casualty insurance.

In fact, the blank provides no method whatsoever for handling health and accident or casualty lines which are conducted by certain companies, unless such operations are to be summarized under lines designated "other items (described fully)." While the new exhibit has not been in use long enough or widely enough for a comprehensive study of the experience with it to be made, it appears to perpetuate many of the disadvantages of the exhibit which it is intended to replace.

accounts other than the "ledger" assets and miscellaneous liabilities, and are the consequence of the annual inventory of single-entry memoranda made to determine the company's financial position at the close of the year. By thus combining the related accounts, the resulting figures show the operations on an accrual basis. However, no distinction is made as to those items properly belonging to the operations of other years.

Of all financial statements prepared by life insurance companies the one for gain and loss, perhaps, best illustrates the widely varying opinions held as to life insurance accounting presentation. Therefore, comparisons of the statement as between companies are likely to be misleading because of the lack of uniformity in the items contained in the various designations in the exhibit.

The 1938 form of gain-and-loss exhibit is subdivided into sections as follows:

INSURANCES

Lines 1 to 5: Running expenses.
Lines 6 to 16: Interest.
Lines 17 to 19: Mortality (insurances).
Line 20: Mortality (annuities, excluding disability annuities).
Lines 21 to 26: Surrenders, lapses, and changes.
Lines 27 and 28: Dividends.
Line 29: Special funds (and special reserves).
Lines 30 to 32: Profit and loss (excluding investments).

INVESTMENTS

Lines 33 and 34: Real estate.
Lines 35 and 36: Stocks and bonds.
Lines 37 to 40: Gain on other investment assets (including unlisted assets).

MISCELLANEOUS

Lines 41 to 47: Disability, double indemnity, and other sources.

SURPLUS

Lines 48 to 50: Increase or decrease.

INSURANCE—RUNNING EXPENSES

The first block under the "Insurances" section is headed "Running expenses." In this block the running expenses of the company excluding investment expenses are deducted from that portion of the gross premium income received known to actuaries as "loading." The gross premium charged on insurance policies from an actuarial point of view is made up of a so-called net premium and loading. The determination of the net premium is arrived at by selecting a mortality table and an interest rate from which factors the net premium and likewise the reserve are determined. Several mortality tables are used by insurance companies in the calculation of premiums and reserves under different types of policies.

In the ordinary department the American experience table is the principal one used. An industrial table is used for mortality calculations in the industrial department, and different tables are also used for annuities.

Theoretically, the net premium is the amount which the insurance company must collect in order to meet exactly its contractual obligations if the actual mortality experience of the company corresponds with that stated in the table and if the interest earnings of the company are exactly equal to the assumptions involved in the formula. To the net premium, therefore, there must be added an amount which will defray the expenses of operation and provide for contingencies and dividends for policyholders or stockholders as the case may be. This addition to the net premium is loading.

The function of this first block of the gain-and-loss exhibit, therefore, is to compare loading with actual insurance expense during the year under consideration. This would be a very simple and logical comparison if actual current mortality experience closely corresponded to that indicated by the tables used. Of course, it does not. The American experience table was published in 1868. This is the reason that the gain-and-loss exhibit has been referred to as a budget of 1868. The fact that the American experience table is not a satisfactory measure of current mortality has led certain low gross premium companies, including especially the nonparticipating companies, to use mortality tables approximating current experience in their premium calculations. They are, however, obliged by State laws to use tables having statutory sanction in their reserve calculations, and statutory tables are also used in the preparation of the gain-and-loss exhibit. This means in many cases that the loading appearing in the gain-and-loss exhibit is not what such companies consider their real loading at all but is merely a balancing difference between the gross premium computed on the basis of modern mortality experience and the net premium computed on the basis of the statutory mortality table. It will thus be evident that in such cases a comparison of operating expenses with an arbitrary balancing figure of this type is meaningless. The result is that companies which charge low gross premiums, and especially nonparticipating companies, are likely to show large excesses of expense over loading which is characterized as a loss from loading in line 5 of the gain-and-loss exhibit. This does not mean that such companies incorrectly estimated expenses but that their true loading is not shown in the exhibit. Of course, this makes the use of the loading figures as a measurement of management efficiency impossible.

INTEREST

The next block of the gain-and-loss exhibit is designated "Interest." This block in effect shows the gross interest, dividends, and rents received during the year on an accrual basis from which is deducted the investment expense of the year. This leaves a balance of "Net interest (including rents) on investments." From this net interest income is further deducted a sum entitled "Interest required to maintain reserves." This latter item is the amount of money which, at the rates of interest assumed in the company's various reserve calculations, must be added to the reserves during the year. Thus, the intent of the block is to provide a comparison between the interest assumptions involved in the reserve calculations and the interest actually earned during the year. As interest assumptions, in general, have been somewhat less than companies have been able to earn on

their investments, the final result of the calculations of this block is generally a gain from interest, although losses from interest on this basis are not unknown.[8]

There are two principal qualifications which should be borne in mind in considering this block. In the first place, especially in the case of nonparticipating companies, the interest assumptions involved in calculating reserves are not necessarily the same as those used in premium calculations, and to the extent that this is true, the comparison of net interest earned with interest required to maintain reserves may not give an entirely true picture. However, as in such cases the interest assumptions involved in the actual premium calculations are likely to be greater than the interest assumptions in reserve calculations, the figures have a tendency to show a gain from interest which is larger than would be the case if the actual premium assumptions were used as the basis for calculations in the block.

The second difficulty arises in connection with the determination of the amount of net interest on investments. This, it will be remembered, is a result of gross interest income less investment expenses. Gross interest income may be inflated by the capitalization of uncollected interest, which of course will result in an overstatement of the gain from interest. Unfortunately, also, the companies have no definite standards for determining total investment expenses for the year. While the usual items of investment expense can be definitely allocated as such, there is some variance of opinion with respect to the amount of general overhead which should be carried as investment expense. Some companies figure this as one-fourth of 1 percent of the book value of the mean of the invested assets held at the beginning and end of the year. Other companies use smaller fractions of 1 percent. It will readily be seen that by the use of different factors the amount of overhead charged to investment expense will vary and the figure for net interest on investments will be correspondingly affected.

An unusual method of using a contingency reserve improperly to adjust income from interest, dividends, and rents and misclassify net profits from sales, and adjustments of assets is shown by a memorandum written by the actuary of the Union Central Life Insurance Co., January 26, 1928, and stamped "Approved" by the president of that company on the following day.[9] The memorandum discusses the treatment of an item "Net profits from sales or adjustments of assets" in the amount of $1,513,477.82 applicable to the year ended December 31, 1927, and reads in part as follows:

> Since precedents existed both for including in the earnings the profits referred to and, on the other hand, for excluding them it seemed logical to include such portion of them as might be, in the judgment of the company, properly included in the earnings, the balance being applied to a contribution to the contingency reserve. It had already been decided to add to the contingency reserve, the same amount as the profits referred to and, this reserve being not a ledger account but merely a memorandum account, there would be no objection to applying an arbitrary amount of the profits to this fund, and deriving from the general surplus the balance required to make the total up to the figure determined.

[8] The Lincoln National Life Insurance Co., for instance, showed a loss from interest during the years 1935, 1936, and 1937, and the Travelers Insurance Co., showed a loss from interest in 1936. Pt. 10A, R. 83.

[9] This memorandum was obtained from the files of the Union Central.

It was decided to incorporate $1,000,000 of the profits in the special reserve, taking the balance requisite from the general surplus, adding the remainder of the profits to the interest and rents earned as a basis for calculation of the interest rate.

A calculation based on the above produces a rate of 6.124 percent as follows:

Total interest and rents earned	$14, 207, 434. 02
Net profits from sales and adjustment of assets	1, 513, 477. 82
	15, 720, 911. 84
Less contribution to special reserve	1, 000, 000. 00
Balance of earnings used in calculating interest rate	14, 720, 911. 84

Balance of earnings	14, 720, 911. 84	=6.124 percent
Mean ledger assets	240, 380, 610. 24	

During the years 1933 to 1938, inclusive, the company capitalized and took into interest income $10,954,000 of uncollected accrued interest on mortgages.[10]

MORTALITY (INSURANCES)

In this block, there is stated in dollars and cents the difference between the mortality expected under the assumptions involved in the tables used for reserve calculations and the actual death losses incurred during the year. In view of the fact that the tables used for reserve calculations such as the American experience table ordinarily do not accurately reflect current mortality, a substantial gain from mortality ordinarily appears in this section of the gain and loss exhibit The adoption of a new mortality table would result in a substantial portion of the gain from mortality being shown as a gain from loading in the first block of the gain and loss exhibit designated "Running Expenses."

MORTALITY (ANNUITIES, EXCLUDING DISABILITY ANNUITIES)

The above subtitle is given to line 20 of the gain and loss exhibit which is "(gain or loss) from mortality under annuities (excluding disability annuities)." This line shows the difference between the actual reserve released by reason of death of annuitants and those which were "expected" under the assumptions involved in the tables of annuity mortality used in the calculation of annuity reserves. In principle, the items are similar to the gain "from mortality under insurance policies" which is the final line of the preceding block. The general improvements in actual mortality which have had the general effect of producing gains from mortality under insurance policies have had the opposite effect with respect to annuities so that line 20 not infrequently reveals a loss.

[10] Pt. 10A, R. 177. See also pt. 28, Supplementary Data.

SURRENDERS, LAPSES, AND CHANGES

In determinations of net premiums and reserves, no factors are included to take account of lapses, surrenders, or changes in policies. Therefore, in order to account for this phenomenon, it was necessary to insert a block in the gain and loss exhibit. The block entitled, "Surrenders, Lapses, and Changes" occupies lines 21 to 26, inclusive, and first shows the "Reserves on policies surrendered during the year for cash value or on account of which extended or paid up insurance was granted (incurred basis)." From this is deducted the amount paid in cash or applied on policy loans previously granted or set up as initial reserves on extended insurance or paid up insurance resulting from nonforfeiture benefits contained in the policies. The difference between these two items provides "(gain or loss) from policies surrendered for cash or on account of which extended or paid up insurance was granted during the year."

Line 24 shows "(gain or loss) from changes and restorations made during the year." In this line are included the reserve adjustments which take place when lapsed policies are restored in accordance with the contractual rights of the policyholder under such circumstances, and also the adjustments resulting from conversions, changes in plan, changes of amount, etc. The final item in the block is a line which shows reserves released from lapsed policies upon which no cash or other value was allowed. This is the gain from lapses. There is usually a substantial gain from lapses and surrenders but the amount shown by the gain and loss exhibit is an unreliable measure of the amount of such gain. This results from the fact that the "Full level premium method of computing reserves" produces a very imperfect reflection of the rate at which assets are built up from the operation of life insurance contracts. In order to establish reserves on the full level premium basis, it is necessary to "borrow" from surplus in early policy years to establish such reserves. In later years the net assets obtained from the operation of life insurance contracts accumulate more rapidly than reserves so that the amounts "borrowed" from surplus are gradually returned. The amount of this so-called borrowing is nowhere included as a definite amount in either the accounts of the companies or in their statements so that it is impossible from either the statements or the accounts to determine the true gain from surrenders. However, it is a well-known fact that if a life insurance company grows rapidly, the necessity for putting up reserves on new policies causes the company's surplus to decline. It is this general effect which is described hereinbefore as "borrowing" from surplus. The result of this situation is that the gain from lapses and surrenders which takes place in the early years in which a policy is in force as shown in the gain and loss exhibit is a combination of real and apparent gain and is larger than the true gain involved. In later policy years the reverse is true. No gain from surrenders will appear in the gain and loss exhibit after the end of the period in which surrender charges are assessed although a substantial gain to the company actually results. An example may make this more clear. For illustration there has been selected an ordinary whole life policy issued

by the Northwestern Mutual at age 40 in the face amount of $1,000, and at an annual gross premium of $31.56: [11]

Policy year	Asset share	Policy reserve	Cash value	True gain	Gain from lapse or surrender gain and loss exhibit basis
1	$8.34	$15.86	0	$8.34	$15.86
2	18.51	32.14	$16.14	2.37	16.00
3	37.71	48.85	34.85	2.86	14.00
4	57.18	65.99	53.99	3.19	12.00
5	76.75	83.54	73.54	3.21	10.00
6	96.20	101.52	93.52	2.68	8.00
7	115.96	119.88	113.88	2.08	6.00
8	136.00	138.64	134.64	1.36	4.00
9	156.30	157.76	155.76	.54	2.00
10	176.81	177.20	177.20	.39	0
11	199.43	196.95	196.95	2.48	0
12	222.43	216.97	216.97	5.46	0
13	245.78	237.23	237.23	8.55	0
14	269.46	257.72	257.72	11.74	0
15	293.45	278.40	278.40	15.05	0
16	317.71	299.23	299.23	18.48	0
17	342.21	320.19	320.19	22.02	0
18	366.94	341.24	341.24	25.70	0
19	391.89	362.34	362.34	29.55	0
20	417.03	383.47	383.47	33.56	0

The first column of this indicates the number of years the policy has been in force. The second column headed "Asset share" is the sum of the gross premiums collected to or including the year involved plus interest income, less claims, expenses, and dividends. In other words, the asset share is the estimated amount of the premium remaining and investment income in the hands of the company after all disbursements and expenses. The third column is the policy reserve computed on the net level-premium basis from the American experience table of mortality with interest at 3 percent. The fourth column is the cash value which the company has agreed to pay in its policy contract upon lapse or surrender of the policy at any given policy year.

Upon examination of the table it will be seen that if the policy lapses during the first policy year (that is, before payment of the second annual premium), the company's gain will be the asset share or $8.34. This is shown in the true-gain column. In order to put up reserves on a net-level premium basis, however, the company has set up a reserve of $15.86. This, as has been explained, has involved borrowing the difference between the reserve and the asset share, or $7.52 from surplus. If the policy is lapsed in the first policy year, the full amount of the reserve will appear in the gain-and-loss exhibit as a gain from lapses so that the gain-and-loss exhibit will show a gain of $15.86 instead of the true realized gain of $8.34. If the policy is surrendered in the second policy year, the company will have collected two annual premiums, received more interest, and paid for death claims and expenses for 2 years after which process a net fund or asset share of $18.51 will remain. This is shown in column 2. The terminal policy reserve shown in the schedule will by

[11] Replies to Commission's sales questionnaire, exhibits O and P.

this time amount to $32.14, and the company has agreed in its policy to pay a cash value on surrender of $16.14, which is shown in the fourth column. Therefore, if the policy is surrendered during the second policy year, the true gain to the company will be the difference between the asset share of $18.51 and the cash value paid of $16.14, or $2.37. The gain-and-loss exhibit, however, would show a gain from surrenders which is the difference between $32.14 shown as reserve and $16.14 cash value, or $16. It is evident, therefore, that in the early policy years on this basis, the company actually has substantially less gain from lapse and surrender than is indicated by the figures in the gain-and-loss exhibit. In the later years, however, the reverse is the case. In the twentieth policy year, for instance, the asset share has grown to $417.36, whereas the policy reserve computed on the net level-premium basis amounts to only $383.47. As the cash value equals the reserve in policies issued by the Northwestern Mutual, beginning in the tenth policy year, no profit will show from surrenders of policies in the tenth and succeeding policy years. However, the asset share continues to increase in excess of the reserve so that an actual gain results from the surrender of policies in years succeeding the tenth. In the case of the twentieth year, as will be seen from the table, the true gain to the company on the policy involved has been $33.56 over the period in which it has been in force, whereas no gain from its surrender will be shown in the gain-and-loss exhibit.

DIVIDENDS

The next block shows dividends to stockholders and policyholders. The method of handling of policyholders' dividends employed in the statements as previously mentioned[12] does not correctly allocate dividend apportionments to the respective years.

SPECIAL FUNDS

The caption for line 29 reads "[In or de] crease in special funds and reserves during the year." This is one of the most misunderstood sections of the form because of its failure to define what a special fund or a special reserve is. This has been commented on previously. Because of the designation given it is frequently impossible to tell whether these so-called special funds are really true contingency reserves which may be regarded as an earmarking of surplus or whether they are reserves to supplement policy reserves which rightfully belong with policy reserves as additional liabilities, or asset valuation accounts which should more properly be considered as not admitted assets, or otherwise deducted from the asset side of the balance sheet, or whether they are current or accrued liabilities. Obviously the proper position of these accounts in the balance sheet should be the key to their handling in the gain-and-loss exhibit. Unfortunately, as has already been shown, they are improperly stated and classified in the balance sheet, and consequently misclassified in the gain-and-loss exhibit. Assuming, however, that the accounts were properly defined and stated in the balance sheet (which, of course, is possible but rarely occurs in practice), the treatment of the

[12] See supra, p. 425.

increases or decreases therein in the gain-and-loss exhibit should be as follows:

True contingency reserves—earmarked surplus: Such "reserves" should appear as additions to or deductions from surplus after net income from insurance and investment has been established.

Reserves to supplement policy reserves: These should be treated as deductions in arriving at net income from insurance in the same fashion as increases or decreases in policy reserves.

Asset valuation accounts—allowances for reductions in value of assets: These should appear in the subdivisions showing the changes in the investment assets to which they properly relate.

Current or accrued liabilities: Increases or decreases in these liabilities should be included with similar increases or decreases in other liabilities so that the change in such liabilities would be properly classified as insurance or investment expense.

Actually, of course, this classification is not followed in the convention blank or by companies in their annual reports, and varying items appear in this subdivision which properly belong elsewhere in the statement. For instance, it is obvious that if increases or decreases in current or accrued liabilities are treated as increases or decreases in special funds and special reserves, insurance and investment expenses cannot have been correspondingly stated without allowances for such unpaid items of expenses, taxes, etc.

Illustrations as to the varying types of accounts reported for the year 1938 under the caption of "Special funds and special reserves," by the companies named, are:

The Metropolitan Life Insurance Co.:
- General voluntary reserve.
- Special group life reserve for epidemics, etc.
- Reserve to cover all other possible items.

Penn Mutual Life Insurance Co.:
- Reserve for mortality fluctuation.
- Reserve for asset fluctuation (these accounts include surplus).

The Union Central Life Insurance Co.:
- Contingency reserve for sales contracts, purchase money mortgages, and fire losses.
- Reserve for mortgage loans.
- Interest delinquent at end of 1937, waived in 1938.

Pacific Mutual Life Insurance Co.:
- Balance old survivorship fund.
- Reserve for reorganization expense.
- Policy liabilities—address of payee unknown.
- Contingency reserves.

The Mutual Life Insurance Co. of New York:
- Estimated amount due or accrued for taxes.
- Fund for depreciation of securities and general contingencies (this includes surplus).
- Reserve for unpaid expenses.
- Reserve for catastrophe hazard under workmen's compensation law.
- Reserve for future expenses on paid-up annual dividend policies.
- Reserve for reinsurance deducted—companies not licensed in New York.

New York Life Insurance Co.:
- Estimated amount due or accrued for taxes.
- Due from State for overassessment of taxes.
- Special investment reserve.
- Reinsurance reserve from schedule X—unlisted assets.

The Prudential Insurance Co. of America:
- Net contingency reserves (policy), required by the State of New Jersey, including accidental death and total and permanent disability benefits.

John Hancock Mutual Life Insurance Co.:
- Reserve for unrealized profits on sale of real estate.
- Contingency reserve for group insurance.
- Contingency reserve for asset fluctuation.

The Northwestern Mutual Life Insurance Co.:
- Estimated reserve for undetermined taxes.
- Unapportioned surplus retained as a contingency reserve (this includes surplus).

It will thus be seen that the block entitled "Special funds" is somewhat of a dumping ground for unclassified or misclassified items and renders adequate interpretation of the statement difficult if not impossible.

PROFIT AND LOSS

The next block of the gain and loss exhibit following "Special funds" is designated "Profit and loss (excluding investments)." This section does not in any sense show the profit or loss of the business excluding investments, but is simply another place to put miscellaneous and unclassified items. Usually the amounts of income and expenses reported there are relatively small and cover such items as recoveries of doubtful reserves, miscellaneous losses, income from unrealized assets, suspense, etc. This block completes the first section of the gain and loss exhibit entitled "Insurances" and precedes the three remaining sections which are classified as "Investments," "Miscellaneous," and "Surplus."

The evident purpose of the statement in showing separate sections for "Insurances," "Investments," "Miscellaneous," and "Surplus" was to separate the business according to its natural divisions. However, the misuse of the subdivision for "Special fund" and, as will be seen later, the misuse of the section entitled "Miscellaneous" has rendered the classification useless and even misleading.

INVESTMENTS

The second section of the gain and loss exhibit entitled "Investments" includes blocks entitled "Real estate" and "Stocks and bonds." These sections show the gain or loss from the sale and maturity of such assets and also the gain or loss resulting from adjustments in book values, nonledger asset values, and not admitted asset values (other than those treated under "Miscellaneous").

MISCELLANEOUS

This section shows gains or losses from total and permanent disability benefits and accidental death benefits included in life policies, excluding loading. Gains or losses from not admitted assets other

than those shown in the above section on "Investments" also appear and another line shows the net gain or loss resulting from the operation of the accident and health or casualty department, and this section has remaining lines for gains and losses from all other sources, and as though this were not enough, provides a special classification for "Balances unaccounted for." The treatment of disability and double indemnity for accidental death as miscellaneous items rather than as operations in connection with insurance is somewhat baffling. The items showing the net gain or loss from the casualty or accident and health department are simply balancing items to permit a tie-up with surplus of the entire company as the gain and loss exhibit does not consider operations of the accident and health or casualty department in detail. The reason for the dividing items showing asset gains or losses between "Investments" and "Miscellaneous" is not apparent.

Although no specific line is included in the exhibit for such an item many companies insert "Increase in reserve due to change in basis" under the "Miscellaneous" section.

The heterogeneous character of the miscellaneous classification is further emphasized by the following types of accounts reported in the year 1938 as "Miscellaneous—from all other sources" by the companies named:

New York Life Insurance Co.:
- Increase in reserve, due to change in basis.

The Mutual Life Insurance Co. of New York:
- Increase in unadmitted reinsurance reserves.
- Transferred to annuity and disability reserves for retirement plan.

New England Mutual Life Insurance Co.:
- Federal tax refund.
- Loss from change in reserve basis, annuities.

Penn Mutual Life Insurance Co.:
- Agents' balances previously charged off (recoveries).
- Agents' balances charged off.
- Remittances in advance of agents' reports.

The Equitable Life Assurance Society of the United States:
- Gain from assets not admitted.
- Decrease in unadmitted reinsurance reserves.
- Loss on accident and health department.
- Change in valuation basis for annuities.

Metropolitan Life Insurance Co.:
- Health and welfare work.
- Company's contribution to employees' insurance and retirement plans.
- Gain from assets not admitted:
  - Agent's debit balances.
  - Premium notes, policy loans, and other policy assets in excess of net value and of other policy liabilities on individual policies.
  - Home office buildings division inventory.
  - Printing and binding division, plant and inventory.
  - Suspense—unadjusted items.
- Changes in valuation basis.

John Hancock Mutual Life Insurance Co.:
- Company's contribution to employees' retirement-pension plan.

The Prudential Insurance Co. of America:

Contribution and increase in reserve on account of employees' retirement pension.

Net gain on account of accident and health branch.

Increase in reserve due to change to a more stringent valuation basis.

Pacific Mutual Life Insurance Co.:

Transfer to corporate accounts.

The Union Central Life Insurance Co.:

Reserve adjustment.

Decrease in resisted policy claims.

Connecticut General Life Insurance Co.:

Special reserve for policies issued at less than net rate.

Underwriting and Investment Exhibit

The schedule performing a similar function to that of the gain and loss exhibit for the accident and health or casualty lines of business is known as the underwriting and investment exhibit, which is not a part of the life insurance convention blank at all, but is a part of the miscellaneous convention blank which covers casualty and accident and health insurance. This form does not involve the stating of figures based on actuarial assumptions but is a more or less simple recital of premium income less losses and expenses incurred together with miscellaneous items of profit and loss. It also provides for showing all dividends declared and increases and decreases in "special reserves." It is remarkable that accident and health business conducted by many companies (including 8 of the 26 largest life insurance companies) is accorded so little attention in the life convention blank. Some companies show operations of this department in the exhibit of changes in surplus, others do not.[13] It would appear that information regarding operations of all lines of business should appear in reasonable detail in the company's annual report whether the business is "life" insurance or not.

[13] Metropolitan and Prudential so show it; Equitable, whose experience has not been favorable, does not.

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