F. PORTFOLIO MANAGEMENT: INVESTMENT ORGANIZATION, TECHNIQUES, POLICIES AND RESULTS

1. Portfolios Managed

Investment personnel of life insurance companies are responsible, together with supervisory investment committees and the companies' boards of directors, for management of the insurers' assets including separate account as well as general account assets.[288] In addition, the same personnel may manage other portfolios including those of affiliated life insurance companies, property and liability companies, mutual funds, venture capital funds, real estate investment trusts, and employee thrift plans. The 63 companies responding to this portion of the Study's life insurance questionnaire owned over $160 billion in general account assets at the end of 1969.[289] The investment personnel in these companies also managed $3.3 billion of separate account assets.[290] In addition, the same investment personnel managed $5.3 billion in property and liability insurer assets, the bulk of which ($4.5 billion) is accounted for by three large insurance complexes, and $192 million in affiliated life insurance company assets. However, only a relatively small portion of the mutual fund assets reported by the responding companies [291] are managed by the same personnel that manage the insurers' own assets. Of the $1.8 billion of mutual fund assets controlled by responding insurers only $107 million are managed by these insurers' investment departments. This implies that even for mutual funds created by insurers, investment management is most often conducted by a separate group. The insurers' investment department personnel do manage another $222 million in other types of portfolios.

2. Organization for Investment Decisionmaking

The ultimate power and responsibility for investment policy and practice resides in each insurer's board of directors. However, the effective policy body is usually a subcommittee of the board, which is generally composed largely of outside directors but may include two or three of the company's top officer-directors. This committee is most commonly known as the Finance Committee or the Executive Committee. It sets policy guidelines which relate to the allocation of investible funds among bonds, stocks, mortgages and other assets, establishes the interest rate and other terms which are acceptable on long-term debt acquisitions, determines diversification standards, specifies the characteristics of securities and loans approved for the portfolio and may establish limits on holdings of securities of individual issuers which are more stringent than those embodied in the state insurance statutes.[292]

---

[288] In some holding company organizations the holding company acts as investment adviser and receives a management fee. Some smaller insurers have entered into advisory contracts with investment advisory firms for a portion of their portfolio. (See ch. IV). However, normally investment personnel employed by life insurers carry out investment management functions for the insurers' assets.

[289] Table VI–91 shows that 56 of these 63 companies held $161.6 billion in general account assets on December 31, 1969.

[290] This and the following figures were supplied in Form I–52. Part C. Question 15.

[291] See Table VI–6.

[292] This discussion of the role and function of the Finance Committee is develop from responses by insurers in Form I–52, Part C. The description is believed to be an accurate characterization for most companies, but there are (unnoted) exceptions to nearly every statement made herein.

This Committee is responsible for overseeing investments in separate accounts as well as the general account, although separate accounts registered under the Investment Company Act will have a separate board. In supervising debt investments the Finance Committee will generally have to approve each privately placed corporate debt issue and each mortgage loan in excess of a specified amount prior to the company making a commitment to acquire such an investment. Smaller private placements, mortgage loans, and most publicly traded security acquisitions can be initiated by the insurer's investment officers, and reported subsequently to the Finance Committee.

A few companies reported that each common stock acquisition or disposition decision had to be approved by the Committee prior to execution of the trade, but most committees delegate specific equity security selection and trading decisions to the investment staff. The Committee exercises control over these decisions through review of each trade as it is reported to the Committee and frequently through the use of an approved list. Most companies use a "buy" list, and purchases can be made only of securities on this list. The list is altered as recommendations flow up to the Committee from security analysts and portfolio managers through the chief investment officer. Some companies also use "sell" and "hold" lists which restrict the portfolio manager with regard to which holdings may be sold without prior Committee approval.

With rare exceptions, respondents indicated that the Finance Committee does not direct the means by which trades are executed including markets and brokers utilized. The Committee generally determines the number of common stock issues held in only a broad sense through its diversification and portfolio concentration guidelines. However, a number of companies reported discussing the number of issues held with the Committee, most often with a view to reducing the number of issues held as the dollar value of the common stock portfolio grew.[293] In order to fulfill its review and authorization responsibilities many Finance Committees meet weekly.

In large companies there is also frequently a layer of committees composed primarily of top investment officers sandwiched between the Finance Committee and the portfolio managers. These may include an Allocation Committee which makes recommendations to the Finance Committee with respect to allotments of funds to the various departments (for example, bonds, mortgages, stocks, real estate). These allotments have to be made on a forward looking basis because most of life insurers' debt security and mortgage loan acquisitions result from takedowns of forward commitments. Consequently, funds are being committed many months and sometimes one or two years in advance. Allotments must be continually changed as the actual flow of investible funds differ from projections and the relative attractiveness of alternative investments changes. There is also likely to be an Investment Committee which makes decisions involving acquisition and disposi-

[293] This was confirmed in a number of cases by an examination of the number of issues reported as of the end of each year, 1965 to 1969, in Form I-26, Table I. In several instances the reduction achieved was quite dramatic, the number of issues held declining from well over 100 to less than 50.

tion of corporate debt issues, and a Mortgage and Real Estate Committee and a Common Stock Committee, each of which performs similar functions for these areas.

3. Equity Investment Decisions

a. Types of equity investments

Life companies make equity investments by means of acquiring common equity securities, debt and preferred stock issues with conversion features, rights, warrants, options or other equity "kickers", mortgage loans with equity interests attached and through direct ownership of real property. Since the Study's concern is with institutional investment in corporate common stock issues, this discussion will be primarily focused on insurers' holdings of and trading activity in these securities. The other forms of equity investment are sometimes relevant, however, as a mechanism for acquiring ownership in common shares and, in other instances, as an alternative means of attaining an increasing equity position in insurers' portfolios.

b. Statutory investment restrictions

Insurance company equity investments are severely restricted by state insurance laws. Among the states, New York has occupied an especially influential position for several reasons; namely, (1) a number of major insurers are domiciled in New York, (2) all companies licensed to do business in New York are required to "comply in substance" with New York's investment requirements and limitations [294] and (3) New York has historically had the most restrictive investment limits among the major states. Thus, New York entirely prohibited insurers from investing in general income producing real estate until 1946 and in common stocks until 1951. Subsequent authorization in these areas, as in other portions of the statutes governing insurer investments, impose quantitative limits affecting the total investment in equities and the investment in shares of any single issuer or on any parcel of property. The statutes also constrain insurers with respect to the characteristics of equity investments which are permissible.

The 1951 authorization of common stock investments limited such investments to the lesser of three percent of the insurer's admitted assets or one-third of surplus; this provision was liberalized in 1957 to the lesser of five percent of assets or one-half of surplus and in 1969, to the lesser of ten percent of assets or 100 percent of surplus.[295] For larger companies, at least, the surplus limitation is invariably the operative provision since surplus typically amounts to about six to eight percent of assets. This limitation is, of course, confined to general account investments.

New York has had an especially restrictive limit on the size of an individual common stock holding. Prior to the 1969 amendments, New York law limited an insurer's investment in the shares of a single issuer to one-fifth of one percent of the insurer's assets and to two percent of outstanding shares of the issuer. These limits were raised to one percent and five percent respectively in 1969.[296] For the purpose of this

---

[294] N.Y. Ins. Law, § 90(1) (McKinney 1966).
[295] N.Y. Ins. Law § 81(13)(c) (McKinney Supp. 1969). For purposes of this requirement, common stock investments are valued at cost.
[296] N.Y. Inc. Law § 81(13)(b) (McKinney Supp. 1969).

requirement, holdings of shares of a single issuer in all portfolios, that is, separate accounts as well as the general account, are to be summed in determining whether the limitation is being observed.

None of the quantitative limits stated above apply to insurers' investments in subsidiaries. As explained above, New York law was substantially amended in 1969 to permit investment in any business activity reasonably ancillary to the insurance business.[297]

Investment in the common stock of unaffiliated issuers is limited to firms or shares which meet the following requirements:

(1) All the obligations (debentures, bonds, etc.) and preferred stock, if any, of such issuer are eligible investments for insurers;

(2) Such firm shall have earned, during seven fiscal years prior to acquisition, a sum applicable to dividends equal, at least, to the sum which would have been sufficient to pay dividends of four percent per annum upon the par or stated value of all its common shares outstanding; and

(3) Such shares of such issuer (other than a bank, trust company or insurance company) are registered on a national securities exchange.[298]

Under New York law, insurers are generally permitted to acquire convertible securities or to receive various "equity kickers" in connection with legal investments in the form of stock warrants (detachable or nondetachable), stock options, stock, property interests or other assets of any kind. However, such "kickers" may have to be carried on the insurer's books, at zero value.[299] There are no restrictions in the New York Insurance Law on a life insurer's purchase of restricted securities, as such. Acquisition of new issues is, of course, limited by the earnings history and exchange listing requirements.

New York limits life insurers' investment in income producing real estate to ten percent of the insurer's admitted assets, and restricts acquisition of individual parcels to those whose cost does not exceed one percent of the insurer's assets.[300] However, as described above,[301] life insurers increased their real estate activity in the late 1960's through subsidiary real estate development and management firms. Also a number of companies have created real estate investment trusts for the purpose of investing in real property and/or mortgage loans on real property.[302]

In addition to investments specifically eligible, most states have enacted a statutory "leeway" or "basket" clause which permits insurers to make investments not otherwise qualifying for insurers' portfolios. In 1957, New York enacted a very modest leeway clause applicable only to investments in corporate debt obligations. This was expanded in 1958 to cover investments not qualifying under the specific provisions of any portion of Section 81. The aggregate cost of

---

[297] See sec. C.1 above. The aggregate investment in subsidiaries is limited to the lesser of 50 percent of surplus or 5 percent of admitted assets. N.Y. Ins. Law § 46–9(3), (McKinney Supp. 1969).

[298] N.Y. Ins. Law, § 81(13)(a) (McKinney Supp. 1969). Prior to 1967 there was a cash dividends paid test as well as a ten-year earnings test in this section.

[299] See N.Y. Ins. Law, § 81(14) (McKinney 1966). The applicable provision reads: "Anything so received by such insurance company in connection with such investment shall be carried on its books at no value unless such insurance company shall have acquired it pursuant to other provisions of law."

[300] N.Y. Ins. Law § 81(7)(h) (McKinney Supp. 1970).

[301] See sec. C.1.

[302] These investments are outside the asset base of the insurance company itself.

such investments was limited to two percent of an insurer's admitted assets until 1964 when this limitation was raised to three and one-half percent.[303] Until 1967, other limitations of amount that may be invested in any investment or class of investments continued to apply; however, the 1967 amendment freed leeway investments of all quantitative restrictions except the (now five percent) limit on investment in the outstanding shares of any one company. Thus, for example, under the New York leeway clause, an insurer limited by the 100 percent of surplus provision to aggregate common stockholdings in its general account of 6.5 percent of assets could hold ten percent of its assets in common stock (valued at cost) if it chose to utilize all of its leeway privilege for this purpose. In addition, the shares held under the leeway provisions would be free of the qualitative restrictions imposed; for example, they could consist of stocks that fail to meet the earnings test or are not listed on a national securities exchange.

Separate accounts are, of course, free of the aggregate limits on the proportion of portfolio assets which may be held in common stocks. However, as indicated above, separate account holdings of individual issues are counted in applying the limitation on insurers' holdings of the outstanding shares of a single issuer. In many states, including New York, any qualitative restrictions on the type of common shares which are eligible for life insurers' portfolios are applicable to separate accounts. However, such restrictions are normally offset by a relatively generous leeway clause. The New York separate account leeway provision permits ten percent of a separate account's assets to be invested outside the statutory restrictions.[304]

Most companies responding to the Study's questionnaires have found the New York statute to be the primary restraint upon their common stock investment decisions, regardless of where the companies are domiciled. While a few smaller companies domiciled in relatively liberal states and not doing business in New York have been able to substantially exceed New York's bounds, even most medium-sized insurers confine themselves to amounts and types of issues authorized by New York law.[305]

c. *Equity security investment personnel and procedures*

(*1*) *Size of investment staffs*

A full scale securities investment operation utilizes a number of skilled personnel including portfolio managers, security analysts, professional traders and economic researchers as well as various support personnel and the supervisory services of some of the highest ranking officers in the company. Tables VI–86 to VI–89 show the average number of full time equivalent employees in each of these categories for insurance companies classified into size groups.[306] Among the larger companies (Groups I and II) the most significant

[303] N.Y Ins. Law § 81(13)(b) (McKinney Supp. 1966).
[304] N.Y. Ins. Law, § 227 (McKinney Supp. 1970).
[305] In determining the solvency of insurers domiciled outside New York, but conducting business in New York, the Insurance Department values assets not qualified under New York law at zero. Thus, non-domiciled insurers can carry some non-qualified assets and remain within the "substantial compliance" requirement.
[306] Group I includes the five insurers with total assets in excess of $9 billion as of end 1969; the next five companies, all with assets of $4 billion or more make up Group II; there are 19 companies with assets in excess of $1 billion in Group III and Group IV contains 30 smaller companies. This is a different grouping from that used in analysis of the group annuity business; for a description of the sampling procedure, see Appendix A.

increase in personnel between 1964 and 1969 occurred in equity security portfolio managers, analysts and traders.[307] There was a modest overall increase in the economic research staffs of these companies.

Each of the ten largest companies had equity portfolio managers, analysts and professional traders by 1969, although one of these companies had no equity analysts or traders in 1964, and two had no analysts and two had no traders in 1964. Four of these companies had no input into securities investment activities from economic research personnel in 1969.

One of the Group III companies held no common stock in 1969. Otherwise, by 1969, each Group III company had at least one person who performed equity management and analysis functions. However, 12 of the remaining 18 had no professional traders and 15 of 18 had no economic research input. Only two of the 30 Group IV insurers employed professional equity traders by 1969 and six utilized some economic research services. The increase in equity securities investment personnel of the smaller companies between 1964 and 1969 was more modest than that of the largest companies.

(2) Educational levels of securities analysts

Of the 63 companies reporting, 22 had no trained security analysts who had earned "law degrees or advanced degrees in business administration, economics, engineering or other equivalent training directly relevant to security analysis".[308] Excepting those few companies with negligible common stockholdings,[309] most of these 22 companies depended primarily on analysis obtained from brokerage houses, investment advisory firms or other outside sources. About two-thirds of the analysts employed by the ten largest companies, and just less than half of the analysts working for Group III insurers hold advanced degrees. About a third of the full-time analysts employed by Group IV companies have earned advanced degrees.[310]

There are more analysts who have passed at least one level of the Chartered Financial Analyst ("CFA") Examinations per company among the larger companies. Thus, the ten largest insurers reported 36 analysts in this position, the 19 Group III companies had 34 analysts who had attained this level and the 34 Group IV companies had 21 such analysts. However, in this case, the smaller companies have a higher proportion of the employees working in investment research (Table VI–88, item 3, 1969) so qualified than do the large companies. Those who have passed at least the first level of the CFA exams account for about 16 percent of the investment research personnel in the ten largest companies, 20 percent in Group III companies and 24 percent in Group IV respondents. These proportions are computed from numbers of persons employed in analytical functions, regardless of the proportion of their time spent in such functions.

---

[307] Respondents were asked to apportion the time of persons who spend part-time providing any of the services specified to securities investment activities. In particular, they were directed to make this allocation especially carefully and accurately for items 1, 3 and 4 in the tables, *i.e.*, portfolio managers, analysts and traders. See Form I–52, Part C, Question 14.

[308] The language is from Form I–52, Part C. Question 16.2. Advanced degrees were defined to include any relevant degree or equivalent training beyond a college bachelors degree, *e.g.*, an LL.B, J.D., M.B.A., D.B.A., or similar degree

[309] Excepting one group III company, these companies are all in size Group IV.

[310] The variation among companies within each size group is large, however. The standard deviation is nearly as large as the mean number of full-time analysts holding advanced degrees in each group.

(3) Assignment of equity security analysts

In most companies which employ several equity security analysts, these people specialize by industry. In some larger companies which have a significant number of in-house analysts, assignments are rotated among industries to provide analysts (some of whom may become portfolio managers) with breadth of experience. In smaller investment departments, one or two persons often serve jointly as analysts and managers and therefore must be generalists dependent upon outside sources for their detailed industry and company information.

Eight relatively large companies (all having well over a billion dollars in assets) indicated that they assigned some analysts to accounts as well as, or instead of, to industries. In some cases there were analysts who were being groomed as portfolio managers and were serving as assistants to a portfolio manager. This practice also has the advantage of ensuring that someone in a decision making position is always on hand to initiate buy or sell orders. Several companies reported that assignment of analysts to accounts was made for the purpose of using the account's performance as a means of measuring the effectiveness of analysts. It was also suggested that a joint industry-account assignment proved to be efficient where insurers had accounts with significantly different investment objectives.

(4) Sources of information

There are several basic ways in which institutional investors can obtain information and recommendations which influence decisions regarding which equity securities to buy or sell. These include in-house analysis of corporate financial statements, direct contact with issuers, information and recommendations received from broker-dealers compensated by commissions generated by the institution's trading, or information and recommendations purchased from investment advisory firms or other research organizations on a continuing or on an occasional basis. Of these various sources, in-house analysis of financial statements is rated most important by companies in all size groups, including most Group IV insurers, many of which have very limited internal staffs.[311]

For smaller companies, information and recomendations purchased from broker-dealers via commission rank next in importance.[312] About 40 percent of the smaller companies indicated that information purchased from investment advisers on a continuing basis was "important". Information acquired from other research organizations or from direct contact with issuers was important to less than one-fifth of Group IV respondents.

For the largest ten companies information acquired by allocating commission business to brokerage houses and direct contact with

---

[311] Respondents were asked to rank each information source on an importance scale, *viz.*, 1) very important, always used; 2) important, used often but not always; 3) somewhat important, used sometimes but not frequently; 4) not important, used only infrequently or rarely, or 5) unimportant, never used. All Group I and Group II companies and all but one of the Group III companies rated analysis of financial statements "very important". Just over half of the Group IV insurers chose those rating. All the remaining companies which employed security analysts rated financial statement analysis "important".

[312] Twenty-six of 31 Group IV companies responding to this question indicated broker-dealer research was "important" or "very important".

issuers were ranked as about equally significant.[313] Other sources were considered about as insignificant as they were for smaller companies. Group III companies fell between the largest and the smallest companies in their evaluation of information sources. Brokerage house information rated high but distinctly second to financial statement analysis, and direct contact with issuers was considered important much less frequently than for the largest companies, but more often than was true for Group IV companies. Similarly a higher proportion of Group III companies purchased information from investment advisers than did Group I and II insurers, but this proportion was smaller than that for Group IV companies.

(5) Approaches to equity security evaluation

Respondents were asked to rank on the same importance scale three basic approaches to equity security evaluation, namely: 1) the fundamental approach, 2) the technical approach, and 3) the economic outlook approach.[314]

All but five of 63 respondents rated the fundamental approach "very important". Four of the ten largest companies also assessed the "economic outlook" approach as "very important", but only about 15 percent of the remaining firms concurred. Only five firms (including three Group IV insurers) considered the technical factors to be "very important". However, a sizeable majority of insurers in each size group regarded both technical factors and the aggregate economic outlook as being at least "somewhat important". Overall, life insurers rated the "technical approach" at about the same level of importance as did investment advisory firms. On the other hand, they placed the "economic outlook approach" on a somewhat lower level of importance than did advisory firms.[315]

4. Portfolio Composition

a. General accounts

Although most separate accounts created by life insurance companies have been intended primarily for investment in equity securities, life insurance general account investments have been constrained by tradition, insurers' fixed dollar liabilities, and the type of statutory restrictions summarized above to a primary emphasis upon fixed income obligations. However, the movement of assets into separate equity accounts has been accompanied in recent years by various forms of equity participation obtained with general account investments in directly placed corporate debt securities and mortgage loans. This section summarizes the composition of general account assets, and examines the nature and probable persistency of "equity kickers" on debt instruments.

[313] Eight of the ten companies rated broker information at least "important" and a different eight ranked direct contact with issuers as "important" or "very important". Most companies reported that analysts spent less than 20 percent of their time in contact with issuers (*i.e.*, through visits, telephone calls, etc.). However, four of the ten largest companies, four Group III companies and one Group IV company indicated that between 20 and 40 percent of analysts' time was spent in this fashion.

[314] These approaches were distinguished in Form I–52, Part C. Question 23, as follows: 1) Fundamental Approach—Analysis and projection of corporate earnings plays the central role; 2) Technical Approach—Technical analysis of market action is the central factor, and 3) Economic Outlook Approach—The projection and interpretation of various aggregate economic series and indicators (such as the money supply, GNP, etc.) plays the central role.

[315] See ch. IV. 6.7(e) for a summary of the investment advisory firm responses.

Table VI–90 provides an estimate of the breakdown of industry general account assets as of year-ends 1964 and 1969. Aggregate general account assets increased about $44 billion during this period.[316] Although common stock holdings are valued at market, most other assets are valued on an amortized cost basis. In both years, nearly three-quarters of insurers' general account assets were invested in corporate debt securities and real estate mortgage loans. Although this proportion has remained relatively stable for some years, the composition of the mortgage loan portfolio has shifted markedly away from single-family home mortgage loans to loans on apartments and commercial and business properties.[317] Table VI–90 shows that for all size groups of insurers, home mortgage loans held at end-1969 amounted to less than other types of mortgage loans. This shift has occurred in response to increasing yield differentials in favor of non-home mortgage loans including the expected return available from variable interest rate features and equity participations.

Policy loans increased proportionately more than any other asset category, from 4.8 percent of assets in 1964 to 7.1 percent in 1969. Policy loans are a contractual right of policyholders with cash value policies, and policy loan demand rises sharply in high interest rate—tight credit periods when alternative loan sources are unavailable or prohibitively expensive.[318] The policy loan increase together with a decline in the rate of mortgage loan prepayments [319] created severe cash problems for many insurers, particularly during 1966 and 1969. Although the cash flow squeeze created a greater liquidity consciousness in insurance companies, these companies continued to liquidate their holdings of U.S. Treasury obligations, a pattern which has prevailed since the end of World War II. This apparently is a result of difficulty encountered in maintaining target liquid asset positions and reflects a shift of short-term debt holdings from Treasury bills to commercial paper. Relatively unattractive yields and the heavy corporate demand for funds appear to account for the absolute decline in holdings of state and local government obligations. Common stocks as a share of general account assets increased only slightly during the five-year period from 3.6 percent in 1964 to 3.9 percent in 1969.

Tables VI–91 to VI–96 display a detailed breakdown of 1969 general account assets managed by 56 responding companies. These insurers held nearly $162 billion in general account assets.[320] Reporting insurers are classified into the four asset size groups utilized in Tables VI–86 to VI–89.

Each group of life insurers has about 40 percent of its general account assets invested in real estate mortgage loans and real property. However, the share of assets in corporate debt holdings is positively

---

[316] Insurers realized a gain of about $3½ billion in separate account assets over the same period. Much of the latter increase represented transfers of assets from general to separate accounts.

[317] Net acquisitions of home mortgage loans by life companies were actually negative (*i.e.*, repayments exceeded amounts loaned) in 1967, 1968 and 1969. See the Federal Reserve Board Flow of Funds Statistics.

[318] The interest rate is guaranteed in insurance policies at a rate no higher than a maximum established by state insurance laws. During the period in question, policyholders could typically borrow on their life insurance cash values at rates in the neighborhood of five percent, far below prevailing consumer loan rates.

[319] This is also a high interest rate—tight credit phenomenon.

[320] About $4.3 billion of the $162 billion is in Canadian insurers.

related to insurer size, while liquid assets, common equity securities and "other assets" each tend to be a larger proportion of assets in smaller companies.[321] The greater incidence of nongovernment debt obligations among larger companies reflects the importance of larger life insurers in the direct placement debt market where larger institutions are better able to negotiate loan agreements. The negative relation of liquid assets (cash, government obligations and private short-term debt issues) to asset size, in part, reflects economies of scale in cash management. The higher proportion of assets invested in common stocks among insurers under $4 billion is probably due in part to the greater emphasis upon equity investments in separate accounts, rather than general accounts, among the largest companies.[322] Perhaps more important, however, is the fact that many smaller companies who choose not to conduct business in New York State have greater statutory latitude to invest general account assets in common stocks. The variation in "preferred stock and other assets" as a proportion of total insurer assets is determined primarily by policy loans. Companies with the largest amounts of policy loans tend to be those who have specialized in life insurance sales to relatively high income groups.

Nearly 96 percent of the $850 million in cash and near cash consists of currency and demand deposits. The remainder is made up of small amounts of certificates of deposit and other commercial bank time and savings deposits and savings deposits in non-bank institutions. In addition to these deposits, responding life insurers held $822 million in short-term [323] debt obligations, about three-quarters of which represented commercial paper or other obligations of nongovernment issuers (see Table VI-92). Holdings of debt obligations of foreign governments amounted to about $2.8 billion or nearly as much as U.S. Treasury debt holdings. State and local government obligations appear to be least popular with the larger companies.

An examination of Table VI-93 confirms that direct placements are significantly more important to larger insurers. Thus, about 81 percent of long-term debt securities of nongovernment U.S. issuers held in the general accounts of the five largest insurers consist of restricted issues,[324] while comparable percentages of the next three size groups shown are 70 percent, 62 percent and 35 percent, respectively. About $2 billion of nongovernment long-term debt issues held by life insurers contained equity provisions in the form of conversion fea-

[321] See Table VI-91. The percentage distribution for each of these asset categories by size group is:

	Size group (percent)				
	I	II	III	IV	All
Cash, government securities, etc.	4.0	5.2	7.8	7.8	5.4
Nongovernment long-term debt	41.1	37.4	30.3	29.2	37.1
Common stock and warrants	3.2	2.9	5.8	4.7	3.8
Preferred stock and other assets	10.2	14.2	16.9	15.5	12.8

[322] One of the ten largest companies had over five percent of its general account assets in common stocks and two others had over four percent of assets so invested.

[323] Less than one year to maturity at issue.

[324] Restricted securities are defined as any securities that could not have been offered to the public for sale as of the reporting date without first being registered under the Securities Act of 1933. Some privately placed securities may subsequently have become registered so the percentages in the text may slightly understate the importance of private placements.

tures, warrants or other options to acquire an equity position. These issues account for less than four percent of all private long-term debt issues held. About 11 percent of preferred shares held are convertible, but less than one-half of one percent of non-home mortgage loans contained equity features. During the late 1960's, however, equity features on debt securities and mortgage loans were much more common than these proportions might suggest. The extent and nature of these provisions are described in the next section.

(1) Equity investments

Table VI–94 breaks out some special types of common equity investments including American Depository Receipts ("ADR's") and shares of foreign issuers, restricted common stock issues,[325] investment company shares, shares of affiliated companies [326] and warrants, rights and options.[327] None of these categories is a significant portion of common equity security holdings. Of the $373 million in ADR's and foreign issues reported, $263 million is in the portfolios of responding Canadian insurers. Restricted common stock issues amount to just 2.2 percent of common equities reported, but, interestingly, this proportion is higher than that reported for separate accounts.[328] Only 14 percent of the amount of private long-term debt securities of U.S. issuers held by separate accounts consists of restricted securities as compared with 73 percent of general account holdings.[329] The relatively small holdings of restricted securities in separate accounts probably reflects a greater concern with marketability of separate account assets than is required in the general account.[330]

Life companies hold less than $100 million of investment company shares in their general accounts. Most investment company shares are prohibited investments, except within leeway provisions, under the laws of those states, including New York, which require that common shares be registered on a national securities exchange. Unlike property and liability insurers, a very modest share of life insurers' common stock holdings (3.5 percent) consist of shares of affiliated companies.[331] Life insurer holdings of warrants, rights and options may be understated since these assets are generally required to be carried at zero value for statement purposes and some respondents may not have provided estimated market valuations for such holdings.

Common stock holdings are broken down by exchange listing for year-end 1964 and year-end 1969, respectively, in Tables VI–97 and VI–98 for a slightly different group of 56 life insurance companies. One Canadian company is dropped from the third size group because

---

[325] Restricted securities are defined as any securities that could not have been offered to the public for sale as of the valuation dates, without first being registered under the Securities Act of 1933.

[326] Affiliated companies include any companies controlled by, controlling or under common control with the reporting insurers.

[327] Options received in connection with a debt investment are shown here if they are detachable.

[328] In fact, only $4 million of the $2.7 billion of separate account common stockholdings are restricted. See Tables VI–106 and 107.

[329] See sec.B for a description of the asset composition of separate accounts.

[330] Most separate account assets are in unregistered accounts and therefore are unaffected by the Commission's releases dealing with acquisition of restricted securities by registered investment companies. In these releases, which do affect registered separate accounts, the Commission has expressed concern as to the acquisition of restricted securities by investment companies and the valuation of such securities. See SEC Investment Company Act Release No's. 5847 (October 21, 1969), 6026 (April 13, 1970) and 6121 (July 20, 1970).

[331] The extent of property and liability insurer holdings of affiliated company shares is described in sec. I.1.c.

of its substantial holdings of common shares of Canadian and other non-U.S. issuers not listed on U.S. exchanges. In general, every effort was made to exclude foreign issues and investment company shares from this report but small amounts of such issues may remain. These tables indicate that the largest insurers are very heavily invested in shares listed on the New York Stock Exchange, and that the proportion of NYSE listed stocks to total holdings declined only slightly over the five-year period. The 96.5 percent ratio of NYSE listed shares to total common stock holdings for the five largest insurers in 1969 is very large compared to the 75 percent ratio of NYSE listed shares to all common shares of U.S. issuers outstanding. The other insurer size groups fall close to or somewhat below the 75 percent figure. The increase in the proportion represented by NYSE listed shares in these companies' portfolios which took place over the 1964–1969 period is probably due to the listing of some bank and insurance stocks rather than to changes in the portfolio policies of the insurers. This assumption is corroborated by the decline in the proportion of their portfolios represented by unlisted bank and insurance stocks.

Excepting the five largest companies, the proportion of "riskier" stocks held, that is, those which are listed on the American Stock Exchange, or solely on regional exchanges or are unlisted is surprisingly high (12 to 14 percent of common stocks held). In fact, this proportion is substantially higher than that found in insurers' separate accounts,[332] despite the fact that separate accounts are primarily equity oriented, and contain interests of contractholders who desire high rates of investment return. Some portfolio managers evidently feel that the general account common stock portfolio is an excellent spot to place some higher risk issues since it represents such a small portion of all general account assets.

(2) Equity "kickers" on debt investments

During recent years life companies have been successful in obtaining additional compensation on directly placed corporate debt obligations and on mortgage loans secured by apartments, or commercial business or other nonresidential properties. This additional compensation can take many forms including common stock, real property, instruments convertible into common stock, warrants, various options to purchase equity securities or real property, provisions for shaing in the income or capital gains realized by the borrower and interests in residual values. These "kickers" are sometimes provided without any payment by the insurer but other times a purchase payment is made although the payment price is generally very favorable and may be nominal.

Table VI–99 shows total commitments made by the responding insurers during 1969 to acquire debt securities, unsecured loans and multi-family residential and non-residential real estate mortgage loans. A commitment is a firm agreement by an insurer to purchase or otherwise acquire securities or mortgage loans at a date (which may be many months in the future) specified in the contract. Also shown in Table VI–99 is the portion of these commitments which contained equity "kickers" in the form of stock or conversion features or war-

[332] For all separate accounts the comparable proportion is 7.2 percent. See Tables VI–108 and VI–109 below.

rants, options or rights to purchase equity securities. As the table indicates, each size group of insurers obtained such equity extras on somewhere between a quarter to three-eighths of the dollar volume of new debt securities. This form of equity participation is significantly less common in mortgage lending.[333]

Nine companies indicated that on privately placed loans where an equity "kicker" was not received, the insurer sometimes received incremental interest payments (over and above the fixed interest) based most frequently upon the gross or net income of the borrower. This form of additional compensation is very common in mortgage lending. Forty-three of 61 reporting companies[334] indicated that incremental interest payments were provided for on mortgage loan commitments. In terms of dollar value, nearly half of the mortgage loan commitments reported in Table VI-99 had incremental interest payment provisions. As one respondent explained:

> This type of participation permits the investor to share in the income derived from the property without sharing the possible risks involved in equity ownership.

Although incremental interest is the most common means of obtaining additional compensation on mortgage loans, numerous other means have been developed. Twenty-three companies reported examples of such provisions. Most often these involved ownership in the real property underlying the loans or options to purchase such property or arrangements to share in any capital gains realized from the sale of such property. Sometimes the real estate itself will be acquired by a real estate development company subsidiary of the insurer and this subsidiary may be a co-developer of a housing or commercial project. Since the primary return to the developer from many residential housing development ventures is in the form of capital gains realized upon sale of the housing and service facilities constructed, life insurers are quite interested in obtaining a share of these gains where possible. Among the many varieties of deals are those in which the insurer purchases the land involved from the developer, leases it back to the developer, and obtains as a condition of providing mortgage financing a substantial equity interest (often 50 percent) in the buildings or other improvements which are being financed. The insurer can end up receiving ground rent, mortgage payments, preferred dividends on its equity holding and its share of capital gains upon sale of the project.[335] Depending on the arrangement this return may represent investment return to the general account, a separate account, a real estate development subsidiary or a real estate investment trust subsidiary. Often these is some sort of joint venture among two or more such entities.[336]

---

[333] In many instances respondents reported only stock, warrants, etc., which were "gifted," not kickers which were purchased, even though some purchases are made at quite favorable prices. As a result, Table VI-99 probably understates the prevalence of these types of kickers.

[334] Including the ten largest companies and 15 of 19 Group III respondents.

[335] Some insurers have been criticized for over-reaching for returns in such ventures. For an example of such criticism and a description of some insurers' activities, see two recent *Fortune* articles: "The Future Largest Landlords in America." *Fortune*, July 1970, at 90ff and Eleanore Carruth, "Look Who's Reaching Into Real Estate," *Fortune*, October 1968, at 160ff.

[336] Because of requirements for prior Commission approval of joint transactions involving investment companies (see Rule 17d-1(a) under the Investment Company Act) mutual funds and registered separate accounts rarely, if ever, participate in such joint ventures.

Illustrative of the loan provisions reported by respondents, in addition to those included in Table VI-99, are the following samples from:

(1) Group I and II companies:

"The $12,000,000 mortgage loan commitment [included in Table VI-99] provides, in addition to an option to buy stock under certain circumstances, a right to share in certain capital gains. This type of provision is designed primarily for situations in which a large tract of land is to be developed and sold in smaller parcels."

"In addition to the equity "kickers" [reported in Table VI-99] kickers attached to debt securities and mortgage loan commitments included a share of pre-tax earnings and interest in real estate being financed."

"In 1969, about $65 million of mortgage loan commitments were made in which the "kicker" consisted primarily of a right to share in capital gains."

"Most mortgage commitments including real estate provide for us to receive a participation in the gross or net income derived from the property and in most cases [the insurer] purchases the land and leases it back to the developer for a term of 50-75 years. In some instances a subsidiary of [the insurer] is a co-developer."

(2) Group III companies:

"During 1968 and 1969 four security commitments were made with "other type" kickers [that is, not reported in Table VI-99]. One included a 25 percent interest in the residual value of railroad locomotives. Three included a 25 to 30 percent interest in the real property securing the loan, to be invested after the loan was paid in full."

"In connection with one mortgage we are to receive $10,000 annually for the life of the loan, to be held by the mortgagee for its own account and not applied to reduction of principal or interest and upon full payment shall receive $50,000 annually thereafter for a term of 20 years."

"In one loan commitment the kicker required 5 percent of net income after debt service attributable to the subject property. This type of kicker is not preferred by this company due to the potential conflict in agreement upon expenses to be charged against gross income."

"Kicker includes land purchases with contingent rent or rent tied to the cost of living index."

"Kicker includes an option to purchase in the future part or all of the equity at the now appraised value."

"Kicker includes participation in net proceeds from refinancing or sale of the property."

"We committed $880,000 on a commercial loan for 25 years which provided that [the insurer] might purchase 50 percent of the equity for $10,000 at the end of the 25 year term."

"Most of our mortgage loan commitments on multi-family residential properties as well as on business, commercial, farm or other nonresidential properties contained kickers providing [the insurer] with a share in either net or gross profits."

"During 1969 we made one loan which included a 10 percent interest in all profits of the venture. However, direct ownership interest in the financed real property is a much more important type of kicker."

"Most equity kickers are in the form of partial ownership and/or a percentage of profits."

"On one loan we obtain a 50 percent equity interest on certain real property after repayment of the loan in ten years."

(3) Group IV companies:

"One "kicker" on a debt security provided that [the insurer] was to share in the lessee's returns if at the expiration of our loan the lessee exercised his option to renew his lease of the land securing our loan."

"Additional types of kickers relative to loan commitments involve the purchase of land underlying physical improvements on which mortgage commitments were made. However, in most instances they provided additional rental based on either gross or net income from the property and also provided for a participation in profit upon sale of the property. The leases contain no options to repurchase the land so that upon termination of the lease [usually 50 years or longer] ownership of the entire property vests with the fee holder."

"Participation in the form of a percentage of Gross Income is being included in practically all commercial mortgage commitments."

"The most common "kicker" employed by [the insurer] was ownership [or participation in ownership] of residuals in leased real estate utilized to secure the loan. Roughly 20 percent of the debt security commitments in 1969 contained this provision. Roughly 15 percent of mortgage loan commitments contained the right to share in gross or net profits of the enterprise financed."

"In various commitments [the insurer] has received—

(1) a 50 percent beneficial interest in the Land Trust which owns the property.

(2) a 50 percent ownership in a property.

(3) at maturity or prepayment a real estate interest as a condition to participating in a secured note."

"Equity kickers [other than reported in Table VI–99] were almost entirely concentrated in the Mortgage Division and were of the following types:

(1) a percentage of the gross [or net] rentals of the properties on which loans were made.

(2) ownership of the land on which the improvement is situated.

(3) actual equity participation which is purchased in the entire project."

"Other mortgage loan kickers include:

(1) an investment in which [the insurer] receives a 15 percent undivided right to the residual value of personal property upon expiration of the lease.

(2) the insurer has purchased land and leased the land back to the seller for a fixed minimum rental plus additional rental based on a percentage of gross profits received by the seller-lessee or a percentage of profits of the property. This type of provision is very important in mortgage commitments."

It is relevant to inquire whether these additional compensation provisions and particularly the equity interest features are temporal phenomenon which will quickly disappear when the high interest rate—tight credit conditions of the late 1960's ease or whether this increase in equity features on debt obligations reflects more fundamental long-term economic trends and consequently such provisions are likely to continue to be successfully negotiated by interested investors, and by life insurers in particular. The Study solicited the views of respondent insurers on this question by asking them to indicate which of the following statements *best* characterized their opinions with respect to the reasons for and permanence of equity features on debt investments:[337]

(1) Equity "kickers" are primarily a "high interest rate" phenomenon. If interest rates on mortgage loans and long-term debt issues should return to levels of (say) the early 1960's, then the frequency of equity kickers will decline to something like the level of the early 1960's.

(2) As far as life companies are concerned, the increased prevalence of equity features is associated with a long-term increase in life companies' involvement in equity investments in order to provide policy holders with protection against inflation or for other reasons. No significant decline in the frequency of equity kickers should be expected to accompany a significant decline of interest rates.

---

[337] See Form I–52, Part D, Question 37.

(3) The prevalence of equity kickers during 1969 partially reflected high interest rate levels, but also reflected a permanent trend in life company investment attitudes toward more activity in equities. Some significant decline in the frequency of equity kickers should be expected to accompany a decline of interest rates to levels of the early 1960's, but equity kickers would remain much more common than was the case in the early 1960's.

Forty-nine of 60 respondents to this question selected statement (3).[338] The other responses were about equally divided between statements (1) and (2). These responses suggest that life insurers' taste for equity kickers has been stimulated and that they will negotiate hard for such provisions wherever possible. Some respondents indicated that as interest rates ease this may induce them into lower quality—higher risk debt investments.[339]

---

[338] This is 82 percent of respondents. The minimum proportion of respondents in any of the four size groups to select statement (3) was 77 percent.
[339] Judging from survey data on direct placement commitments and yields collected by the Life Insurance Association of America, it would appear that less than 20 percent of 1968–1969 commitments were of 'A' quality or better on Moody's scale. The heavy concentration of direct placements has been in the 'Baa–Ba' quality ranges.

Table VI-86

Investment Department Personnel in Various Capacities
Group I Companies

EMPLOYMENT CATEGORY		Average Number of Full-Time Equivalent Persons Per Company			
		Officers, Directors and Highly Compensated Employees *		Other Employees	
		Dec. 31, 1964	Dec. 31, 1969	Dec. 31, 1964	Dec. 31, 1969
1. Portfolio Managers	1.1 Bonds	7.2	7.8	0.0	0.2
	1.2 Equities	1.4	3.2	0.0	0.0
2. Economic Research Staff		1.8	2.6	3.8	3.4
3. Investment Research Staff (Security Analysts)	3.1 Bonds	17.2	21.4	10.8	3.8
	3.2 Equities	2.6	8.8	1.2	3.4
4. Professional Traders	4.1 Bonds	0.5	0.5	0.1	0.2
	4.2 Equities	0.7	1.3	0.3	0.2
5. Clerical, Secretarial, Bookkeeping		2.0	2.8	48.6	57.8
6. Executives *(not included above)*		6.2	7.2	X X X X X X X X	X X X X X X X X X
7. Other		5.4	7.4	11.0	11.4
TOTAL PERSONNEL OF INVESTMENT DEPARTMENT		45.0	63.2	75.8	80.4

Source: Form I-52, Part C, Table V.

* Defined in 1964 to include employees earning at least $10,000 per year, and in 1969 to include employees earning at least $12,000 per year.

Table VI-87

Investment Department Personnel in Various Capacities
Group II Companies

EMPLOYMENT CATEGORY		Average Number of Full-Time Equivalent Persons Per Company			
		Officers, Directors and Highly Compensated Employees *		Other Employees	
		Dec. 31, 1964	Dec. 31, 1969	Dec. 31, 1964	Dec. 31, 1969
1. Portfolio Managers	1.1 Bonds	2.6	3.9	0.6	0.0
	1.2 Equities	0.8	2.6	0.2	0.2
2. Economic Research Staff		0.0	0.4	0.0	0.4
3. Investment Research Staff (Security Analysts)	3.1 Bonds	4.8	6.4	2.2	1.0
	3.2 Equities	1.9	8.3	1.8	1.0
4. Professional Traders	4.1 Bonds	0.3	0.2	0.1	0.2
	4.2 Equities	0.4	1.4	0.3	0.8
5. Clerical, Secretarial, Bookkeeping		1.0	0.6	17.2	27.5
6. Executives (not included above)		4.0	5.1	X X X X X X X X	X X X X X X X X X
7. Other		1.6	2.6	1.4	7.7
TOTAL PERSONNEL OF INVESTMENT DEPARTMENT		17.4	31.6	23.8	38.8

Source: Form I-52, Part C, Table V.

* Defined in 1964 to include employees earning at least $10,000 per year, and in 1969 to include employees earning at least $12,000 per year.

Table VI-88

Investment Department Personnel in Various Capacities
Group III Companies

EMPLOYMENT CATEGORY		Average Number of Full-Time Equivalent Persons Per Company			
		Officers, Directors and Highly Compensated Employees *		Other Employees	
		Dec. 31, 1964	Dec. 31, 1969	Dec. 31, 1964	Dec. 31, 1969
1. Portfolio Managers	1.1 Bonds	1.3	1.4	0.0	0.0
	1.2 Equities	0.6	1.1	0.0	0.0
2. Economic Research Staff		0.1	0.2	0.2	0.2
3. Investment Research Staff (Security Analysts)	3.1 Bonds	2.5	3.4	2.7	1.7
	3.2 Equities	1.1	2.2	1.2	1.4
4. Professional Traders	4.1 Bonds	0.2	0.3	0.2	0.1
	4.2 Equities	0.1	0.3	0.2	0.3
5. Clerical, Secretarial, Bookkeeping		0.3	0.5	11.1	13.7
6. Executives *(not included above)*		1.7	1.8	X X X X X X X X	X X X X X X X X X
7. Other		0.9	1.2	0.3	0.5
TOTAL PERSONNEL OF INVESTMENT DEPARTMENT		8.8	12.5	15.9	17.8

Source: Form I-52, Part C, Table V.

* Defined in 1964 to include employees earning at least $10,000 per year, and in 1969 to include employees earning at least $12,000 per year.

Table VI-89

Investment Department Personnel in Various Capacities
Group IV Companies

EMPLOYMENT CATEGORY		Average Number of Full-Time Equivalent Persons Per Company			
		Officers, Directors and Highly Compensated Employees *		Other Employees	
		Dec. 31, 1964	Dec. 31, 1969	Dec. 31, 1964	Dec. 31, 1969
1. Portfolio Managers	1.1 Bonds	1.0	0.9	0.1	0.2
	1.2 Equities	0.5	0.7	0.1	0.1
2. Economic Research Staff		0.1	0.1	0.0	0.0
3. Investment Research Staff (Security Analysts)	3.1 Bonds	0.7	0.7	0.5	0.6
	3.2 Equities	0.2	0.4	0.1	0.4
4. Professional Traders	4.1 Bonds	0.0	0.0	0.0	0.0
	4.2 Equities	0.0	0.0	0.0	0.0
5. Clerical, Secretarial, Bookkeeping		0.3	0.3	3.3	3.7
6. Executives (not included above)		1.1	1.1	X X X X X X X X	X X X X X X X X X
7. Other		0.2	0.4	0.3	0.3
TOTAL PERSONNEL OF INVESTMENT DEPARTMENT		4.1	4.6	4.5	5.2

Source: Form I-52, Part C, Table V.

* Defined in 1964 to include employees earning at least $10,000 per year, and in 1969 to include employees earning at least $12,000 per year.

Table VI-90

Composition of Life Insurance
Company General Account Assets
(Year-End 1964 and 1969)
(millions of dollars)

	Asset Categories	1964	1969
1.	Cash and Near Cash Item: Total	$ 1,486	$ 1,582
2.	U.S. Government Debt Securities: Total	5,592	4,104
3.	U.S. State & Local Governments & Their Agencies' Obligations: Total	3,774	3,220
4.	Foreign Government Securities; Central, Provincial, Local, Their Agencies & International Agencies: Total	2,707	2,889
5.	Non-Government, Short-Term & Long-Term Debt Securities: Total	55,882	70,924
6.	Preferred Stock: Total	2,516	3,341
7.	Common Stock: Total	5,326	7,573
8.	Loans Secured by Real Estate Mortgages: Total	55,149	71,991
9.	Real Estate Owned: Total	4,528	5,911
10.	Policy Loans	7,140	13,825
11.	Other Assets	5,261	8,313
12.	TOTAL ASSETS	$149,361	$193,671

Source: Estimated from Institute of Life Insurance data on total industry assets and separate account assets.

Table VI- 91

Asset Holdings - End-1969
General Accounts
(in millions of dollars)

Size Groups	Number of Accounts	Cash and Near Cash	Govt. Securities & Short-Term Non-Govt. Debt	Non-Govt. Long-Term Debt	Common Stock and Warrants	Mortgages and Real Estate	Preferred Stock and Other Assets	Total Assets
Over $9 billion	5	358.6	3110.3	35479.8	2730.5	35926.7	8815.6	86421.5
$4 - 9 billion	5	142.7	1187.5	9624.5	742.9	10353.0	3653.2	25703.8
$1 - 4 billion	18	242.0	2651.9	11213.7	2136.8	14538.8	6246.6	37029.8
Less than $1 billion	28	106.3	861.0	3636.1	589.0	5327.4	1930.4	12450.2
Total	56	849.6	7810.7	59954.1	6199.2	66145.9	20645.9	161605.4

Note: Cash and Near Cash includes currency and demand deposits, certificates of deposit and other time and savings deposits. For composition of the other asset categories, see Table VI-92 to VI- 96.

Source: Responses to Form I-21, General Accounts

Table VI- 92

General Accounts
Asset Composition - End-1969
Government Securities and
Short-Term Non-Government Debt
(in millions of dollars)

Size Groups	Number of Accounts	U.S. Govt. Short-Term	U.S. Govt. Long-Term	U.S. Govt. Total	U.S. State and Local Govt.	Foreign Govt.	Non-Govt. Short-Term	Non-Govt. Short-Term Foreign	Non-Govt. Short-Term Total	Govt. Securities and Short-Term Non-Govt. Total
Over $9 billion	5	94.5	1433.9	1528.4	274.8	894.5	396.9	15.7	412.6	3110.3
$4 - 9 billion	5	3.9	509.1	513.0	173.7	473.8	23.0	4.1	27.0	1187.5
$1 - 4 billion	18	44.0	517.0	561.0	704.1	1198.5	179.2	9.1	188.3	2651.9
Less than $1 billion	28	12.4	266.1	278.5	288.7	224.8	68.5	0.5	69.1	861.0
Total	56	154.7	2726.2	2880.9	1441.3	2791.5	667.6	29.4	697.0	7810.7

Note: U.S. Government debt securities encompass U.S. Treasury federal agency and federal corporations issues including direct, guaranteed and non-guaranteed obligations. "Short-Term" is one year or less to maturity <u>at issue</u>. "Long-Term" is all other debt securities in the particular class.

Source: *Responses to Form I-21, General Accounts.*

Table VI-93

General Accounts
Asset Composition - End-1969
Non-Govt. Long-Term Debt Securities
(in millions of dollars)

Size Groups	Number of Accounts	Restricted U.S. Issues With Equity	Other U.S. Issues With Equity	Total U.S. Issues With Equity	Restricted U.S. Issues Without Equity	Other U.S. Issues Without Equity	Total U.S. Issues Without Equity	Foreign Issuers	Total Non-Govt. Long-Term Debt
Over $9 billion	5	987.4	126.8	1114.2	27923.7	4263.8	32187.5	2178.1	35479.8
$4 - 9 billion	5	320.3	55.0	375.3	6401.2	2041.4	8442.6	806.7	9624.5
$1 - 4 billion	18	311.5*	89.7*	404.6	6681.3	2888.2	9569.5	1239.6	11213.8
Less than $1 billion	28	67.6*	62.1*	140.1	1217.4*	1702.5*	3358.4	137.6	3636.1
Total	56	1686.8	333.6	2034.3*	37193.2	10895.9	53557.9	4361.9	59954.2

* Information missing because of non-reporting of detailed breakdowns by some respondents. Consequently these items do not sum to their relevant subtotals.

Note: Restricted issues are any securities that could not have been offered to the public for sale without first being registered under the Securities Act of 1933. "Issues With Equity" are those with equity provisions in the form of convertibles, warrants or other options to acquire an equity provision.

Source: Responses to Form I-21, General Accounts.

Table VI-94

General Accounts
Asset Composition - End-1969
Common Stock and Warrants
(in millions of dollars)

Size Groups	Number of Accounts	ADR's and Foreign Issuers	Restricted U.S. Issuers	Investment Company Shares	Affiliated Company Shares	Other U.S. Issuers	Total Common Stock	Warrants Rights and Options	Common Stock and Warrants Total
Over $9 billion	5	69.1	39.8	37.4	10.0	2526.7	2682.9	47.5	2730.5
$4 - 9 billion	5	8.8	27.6	7.3	46.6	633.1	723.4	19.6	742.9
$1 - 4 billion	18	286.9	47.5	33.7	121.5	1620.9	2110.6	26.2	2136.8
Less than $1 billion	28	8.2	19.6	9.4	37.7	506.9	581.7	7.3	589.0
Total	56	373.0	134.4	87.8	215.8	5287.6	6098.6	100.6	6199.2

Note: ADR's are American Depository Receipts.
Restricted issues are securities that could not have been offered to the public for sale, as of the valuation dates, without first being registered under the Securities Act of 1933.
Affiliated companies include any company controlled by, controlling or under common control with the reporting insurance companies.

Source: Responses to Form I-21, General Accounts.

Table VI-95

General Accounts
Asset Composition - End-1969
Mortgage Loans and Real Estate Owned
(in millions of dollars)

Size Groups	Number of Accounts	Mortgage 1- to 4-Family	Other Mortgage Without Equity	Mortgage Without Equity Total	Mortgage With Equity	Total Mortgage	Real Estate Owned	Mortgage Loans and Real Estate Total
Over $9 billion	5	14072.7	19179.4	33252.1	9.6	33261.6	2665.1	35926.7
$4 - 9 billion	5	2605.8	6963.1	9568.8	82.9	9651.7	701.2	10353.0
$1 - 4 billion	18	4583.8	8849.2	13433.0	25.6	13458.6	1080.2	14538.8
Less than $1 billion	28	2224.9*	2718.6*	4971.3	35.1	5006.4	321.2	5327.5
Total	56	23487.1	37710.3	61225.2	153.2	61378.4	4767.7	66145.9

* Information missing because of non-reporting of detailed breakdowns by some respondents. Consequently these items do not sum to their relevant subtotals.

Note: Loans "with equity" are those with equity provisions in the form of convertibles, warrants and other options to acquire an equity position.

Source: Responses to Form I-21, General Accounts.

Table VI-96

General Accounts
Asset Composition - End-1969
Preferred Stock and Other Assets
(in millions of dollars)

Size Groups	Number of Accounts	Convertible Preferred U.S. Issue	Non-Conv. Preferred U.S. Issue	Total Preferred	Policy Loans	Due From Affiliated Company	Accounts Receivable From Brokers	All Other	Other Assets Total	Preferred Stock and Other Assets Total
Over $9 billion	5	82.3	796.2	880.4*	4805.4	0.4	0.0	3129.4	7935.2	8815.6
$4 - 9 billion	5	48.2	284.1	364.3*	1932.9	5.0	1.7	1349.3	3288.9	3653.2
$1 - 4 billion	18	61.1	903.6	979.4*	3666.0	0.6	0.0	1600.6	5267.2	6246.6
Less than $1 billion	28	52.3	265.6	318.0*	1111.2	2.0	0.7	498.6	1612.4	1930.4
Total	56	243.9	2249.5	2542.1*	11515.4	8.1	2.4	6577.9	18103.8	20645.9

* Excluding preferred stock of foreign issuers which totaled $48.8 million.

Source: Responses to Form I-21, General Accounts.

Table VI- 97

Holdings of Common Stock by Exchange Listing
Life Insurance General Accounts

End-1969

Size Group	Number of Accounts	NYSE Listed		AMEX Listed		Banks and Insurance Companies		Other		Total	
		$millions	%	$millions	%	$millions	%	$millions	%	$millions	%
Over $9 billion	5	2578.0	96.5	18.6	0.7	7.4	0.3	68.6	2.6	2672.6	100
$4-9 billion	5	541.4	77.8	22.1	3.2	60.7	8.7	72.0	10.3	696.2	100
$1-4 billion	17	1184.9	75.9	31.7	2.0	183.1	11.7	162.0	10.4	1561.6	100
Other	29	415.3	71.1	18.2	3.1	85.6	14.6	65.4	11.2	584.5	100
TOTALS	56	4719.6	85.6	90.7	1.6	336.7	6.1	367.9	6.7	5514.9	100

Source: Responses to Form I-24, General Accounts

53-940 O - 71 - pt. 2 -- 38

Table VI-98

Holdings of Common Stock by Exchange Listing
Life Insurance General Accounts

End-1964

Size Group	Number of Accounts	NYSE Listed		AMEX Listed		Banks and Insurance Companies		Other		Total	
		$millions	%	$millions	%	$millions	%	$millions	%	$millions	%
Over $9 billion	5	1681.9	98.9	4.8	0.3	0	0	14.8	0.9	1701.4	100
$4-9 billion	5	494.4	70.4	4.8	0.7	135.4	19.3	67.4	9.6	702.1	100
$1-4 billion	17	942.7	75.4	5.4	0.4	210.5	16.8	91.4	7.3	1250.1	100
Other	29	313.8	70.1	5.1	1.2	95.1	21.3	33.6	7.5	447.6	100
TOTALS	56	3432.7	83.7	20.2	0.5	441.0	10.8	207.2	5.1	4.1	100

Source: Responses to Form I-24, General Accounts

Table VI-99

New Commitments Made During 1969 With Equity Kickers

Insurer Size Group	Debt Securities			Mortgage Loans: Multi-Family Residential			Mortgage Loans: Non-Residential		
	Total ($mil.)	With Kickers ($mil.)	Percent	Total ($mil.)	With Kickers ($mil.)	Percent	Total ($mil.)	With Kickers ($mil.)	Percent
Over $9 bil.	$2,028	$496	24.5	$1,379	$ 8	0.6	$2,407	$195	8.1
$4-9 bil.	$ 776	$221	29.5	$ 454	0	0	$ 606	$ 26	4.3
$1-4 bil.	$ 965	$361	37.4	$ 259	0	0	$ 888	$ 31	3.5
Other	$ 362	$ 86	23.8	$ 149	$11	7.6	$ 289	$ 36	12.4

Note: "Equity Kickers" include any stock or similar security; or any instrument convertible into such a security; or any right to convert into such a security; or any warrant, option or right to purchase such a security.

Source: Responses to Study Questionnaire Form I-52, Part D, Question 34.

b. Separate accounts

As has been observed above, separate accounts have primarily been used as vehicles for investment in equity securities. However, Table VI–100 shows that the proportion of separate account assets held in common stocks declined from 87.5 percent in 1965 to 75.9 percent in 1969. Most of this decline occurred in 1969. This change is largely offset by an increase in the proportion of cash and "bonds" (most of which are actually short-term debt issues)[340] from 9 percent in 1965 to 19 percent in 1969. Most of this increase also occurred in 1969. Part of this shift is due to the establishment of accounts designed for investment in debt securities or in a balanced debt-equity portfolio[341] but much of the shift reflects the decline of equity prices during 1969 and bearish expectations regarding the short-term price movement.[342]

---

[340] See the breakdowns of separate account debt security holdings in Tables VI–103 and VI–104.

[341] Nine of the 25 debt and debt-equity mix accounts containing $116 million of the $366 million in these accounts as of end-year 1969 were established in 1969. (See Table VI–77). Also, new accounts of all types tend to have a higher proportion of liquid assets and a lower proportion of common stock than more seasoned accounts. (See sec. E.1.b.(3)(a).)

[342] The existence of this factor was corroborated by discussions with managers of accounts whose common stock/asset ratio declined significantly during 1969.

Table VI-100

Asset Composition of Separate Accounts in U.S. Insurers
December 31, 1969

	1969	1968	1967	1965
Bonds	$ 637,860,981	$ 233,055,002	$ 113,923,782	$ 19,542,611
Preferred Stock	48,231,056	30,438,011	8,550,624	166,310
Common Stock	2,745,253,148	1,914,898,263	1,054,750,879	237,775,197
Mortgages	35,625,724	20,377,163	14,444,292	8,047,734
Real Estate	1,308,028	1,299,695	0	0
Cash	51,633,881	47,771,097	12,847,178	4,557,928
Other	98,876,852	20,893,296	2,253,272	1,675,969
Total	$3,618,789,670	$2,268,732,527	$1,206,770,027	$271,765,749

Source: Institute of Life Insurance

This section examines in detail the composition of assets held by separate accounts as of the end of 1969, and summarizes the characteristics of common equity securities found in these accounts. In the following tabular presentations separate accounts are classified according to whether the stated investment objective contemplated primary emphasis upon common stock or whether the primary investment media was intended to be something other than common stock. The later category is defined to include accounts which primarily invest in investment company shares as well as accounts specializing in debt securities, mortgage loans, temporary cash investments or in a mix of debt and equity instruments. Accounts are also classified according to whether or not they are registered under the Investment Company Act and whether they are commingled or limited to a single participant. Finally, accounts are classified into two groups according to asset size of the insurance company. "Large companies" include the fifteen insurers [343] with total assets in excess of $2 billion as of end 1969, and all other insurers are classified as "small companies."

Tables VI-101 and VI-102 display, in broad categories, the asset composition of separate accounts as of end-year 1969. Table VI-101 shows that about 81 percent of the $3.25 billion of assets held in the accounts primarily intended for common stock investment were in fact invested in common stock (including investment company shares) and warrants. Most of the remaining assets (about 15 percent) were invested in relatively liquid form, that is, in cash, government securities or nongovernment short-term instruments.

By way of contrast, assets in accounts not primarily intended for common stock were fairly evenly spread among liquid assets (24 percent), long-term nongovernment debt securities (29 percent), equity securities (24 percent) and mortgage loans and real estate (21 percent). There were 41 accounts [344] with $325 million in this category. The relatively high proportion of liquid assets is due in part to the fact that several liquidation and temporary cash investment accounts are included in this category.

Nearly 90 percent of the assets in "common stock" accounts are in accounts with large companies. However, the treatment of PALIC as a small company results in two-thirds of registered account assets being defined as residing in small companies. In the "non-common stock" accounts, 57 percent of the assets are in large companies. "Common stock" commingled accounts which are not registered have a somewhat higher proportion of their assets invested in common equities (84 percent) than single-client accounts (75 percent) or registered accounts. Essentially all of the cash and near cash assets reported consisted of currency and demand deposits. No time or saving deposits and only $200,000 in certificates of deposit were reported among the $55.3 million of cash items. The composition of other liquid assets is shown in Tables VI-103 and VI-104. About $453 million or 87 percent of the categeory "government securities and short-term nongovernment debt" is invested in short-term debt instruments of private U.S. issuers. Ad-

[343] There is one Canadian company among these 15. PALIC is considered as a small company in this classification even though it is a subsidiary of a large company. PALIC accounts are included in the registered category. CREF is excluded from the tables.

[344] Eight of these 41 accounts are with Canadian insurers; 12 of the 137 "common stock" accounts are from Canadian respondents. There were four Canadian companies in the sample.

ditional holdings of short-term debt issues of the U.S. Treasury and private foreign issuers raise this proportion to 96 percent. Only very small amounts are invested in long-term Treasury obligations, debt issues of state and local governments and foreign government securities.[345]

As inspection of Tables VI–101 and VI–102 shows, the 178 reporting accounts held $132.3 million in long-term debt securities issued by non-governmental enterprises, of which $93 million (70 percent of the total) were located in "non-common stock" accounts. Of the $132.3 million, about $103 million represented obligations of U.S. issuers, of which about 30 percent ($30.5 million) consisted of issues containing an equity provision.[346] The 178 accounts held $46.7 million of preferred stock, some $42.1 million of which were convertible issues.[347] Somewhat surprising is the fact that only 14 percent of the $103 million in long-term debt of U.S. issuers is accounted for by restricted securities.[348] As suggested above (section (a)) this may reflect a greater concern with marketability of long-term debt issues in separate accounts than is required in the general account.

No mortgage loans were held by "common stock" accounts. A negligible amount of real estate holdings ($1.3 million) were reported by these accounts. Some $69.5 million in mortgage loans were held in "non-common stock" accounts. These loans are further categorized in Table VI–105. No mortgage loans contained equity provisions. About 31 percent of the loans were on 1–4 family residential properties. Most of these loans (89.5 percent) were made by accounts in Canadian companies. Furthermore, over half (53.4 percent) of the remaining mortgage loans on apartment and commercial properties were made by Canadian companies. In general, the Canadian companies in our sample have gone much further than U.S. insurers in using separate accounts as a means of tailoring debt investments to the investment objectives of separate account participants. The four Canadian companies reported assets of $109 million in "non-common stock" accounts (one-third of all reported assets in these accounts) as against $102 million in "common stock" accounts (three percent of all assets reported in these accounts).

As indicated above, the remaining assets (other than common equities which are discussed next), consist primarily of preferred stock issues. These account for $46.7 million of the $72 million shown in Tables VI–101 and VI–102. Another $13.1 million is represented by accounts receivable from brokers.

Tables VI–106 and VI–107 break out restricted securities, detachable warrants, rights and options, investment company shares and American Depository Receipts ("ADR's") and foreign corporation issues from total common stock holdings. None of these selected categories represent sizeable amounts of investments. The largest,

---

[345] One-half the foreign government securities shown and 40 percent of the short-term debt of private foreign issuers were held in accounts of the four Canadian insurers. None of the state and local government debt holdings were held in accounts in which state and local government retirement systems had participating interests.

[346] Defined to include convertibles, warrants and other options to acquire an equity provision.

[347] Preferred stock is included in "other assets" in Tables VI–101 and VI–102.

[348] Defined by the questionnaire as privately placed debt issues that could not have been offered to the public for sale as of December 31, 1969 without first being registered under the Securities Act of 1933.

ADR's and foreign issues, amounts to about four percent of common equity holdings. About 62 percent of the $113 million in these issues is accounted for by separate accounts of Canadian insurers. Although a number of insurers have established investment companies as channels for investment of separate account funds, the total holdings of investment company shares reported amounted to only $35 million. Also, only negligible amounts of warrants, rights and options were reported.

Tables VI–108 and VI–109 classify separate account common stock holdings by exchange listing. Shown separately is the value of stocks listed on (1) the New York Stock Exchange and (2) the American Stock Exchange. Of the remaining stocks, bank and insurance company stocks are segregated. Separate accounts are classified in the same manner utilized in the preceding tables. The reporting sample is somewhat smaller than that used in the preceding tables, but over 95 percent of the common stock reported above is represented in Tables VI–108 and VI–109.[349]

The proportion of NYSE listed stocks is sometimes used as a crude measure of the quality of an equity portfolio. By this standard, separate accounts in the aggregate are of relatively high quality since about 92 percent of common equities held are listed on the New York Stock Exchange. If banks and insurance company stocks are added the proportion of "high quality" issues is 93 percent.[350]

However, there is evidence of substantial variation in the quality of equities held (by this measure) among various account types and size categories. In general, registered accounts reported a significantly lower proportion of "higher quality" stocks than nonregistered accounts. Within each category small companies reported a lower proportion of "high quality" stocks in their separate accounts than did large companies. Overall the "lower quality" stocks were divided almost evenly between stocks listed on the American Stock Exchange and stocks which are unlisted or listed solely on regional exchanges.

The tendency for registered accounts and smaller accounts to have larger proportions of their common stock holdings invested in shares not listed on the New York Stock Exchange is confirmed by the multiple regression results shown in Table VI–110. Also included as explanatory variables in this equation were the insurers' size as measured by general account assets, the proportion of the separate account's assets invested in common stocks and a variable which indicates whether a separate account is commingled or established for a single client. The values of the dependent variable (the ratio of non-NYSE shares to total common stock holdings) and the explanatory variables other than the account category classifications were transformed into logarithms before the regression equation was estimated. This specification is similar to that used to explain the proportion of separate account assets held in common stocks (see Table VI–79 above).

[349] Accounts that were required to complete Form I–21 from which data in the preceding tables were derived, but not Form I–24 (the source for Tables VI–108 and VI–109) included accounts established solely for Canadian or other foreign customers, liquidation accounts and accounts in excess of the largest 15 accounts in any single company.

[350] Some small amounts of listed investment company shares are included in the tables. However, a systematic effort was made to exclude all investment company shares from the unlisted category. The Study believes that this effort was close to 100 percent successful.

Both the account size, measured here by the value of common stock holdings and the insurer size variables have statistically significant negative coefficients indicating that smaller accounts and accounts managed by smaller insurers do tend to hold higher proportions of non-NYSE stocks. The coefficient on the registered variable [351] is positive, as expected, and nearly significant by conventional standards. There does not appear to be any relation between the proportion of an account's common stock in non-NYSE shares and (1) whether the account is commingled or not (given its registration status), or (2) the proportion of the account's assets held in common stocks.

---

[351] As before the "registered" and "commingled" variables take on the value of '1' if the account is registered (commingled) and '0' if it is not.

Table VI-101

Asset Composition of Separate Accounts
Primarily Intended for Common Stock

December 31, 1969
($millions)

Account Categories	Number of Accounts	Cash and Near Cash	Gov't. Securities and Short-Term Non-Gov't. Debt	Non-Gov't Long-Term Debt Securities	Common Stock and Warrants	Mortgages and Real Estate	Other Assets	Total Assets
1. Registered								
a. Large Companies	9	1.6	1.0	2.9	30.1	0	2.4	38.0
b. Small Companies	11	5.0	6.7	3.2	56.9	0	2.6	74.5
c. All Registered	20	6.6	7.7	6.1	87.0	0	5.0	112.5
2. Non-Registered Commingled								
a. Large Companies	22	18.2	233.2	17.2	1675.4	0	32.9	1976.7
b. Small Companies	29	4.9	26.1	2.4	145.7	0	4.1	183.3
c. All Non-Registered Commingled	51	23.0	259.3	19.6	1821.1	0	37.0	2159.9
3. Single Client								
a. Large Companies	48	18.9	175.4	11.1	662.7	1.3	20.7	890.4
b. Small Companies	18	0.8	8.4	2.7	76.9	0	3.2	91.7
c. All Single Client	66	19.7	183.8	13.8	739.6	1.3	23.9	982.0
4. TOTALS	137	49.3	450.8	39.5	2647.7	1.3	65.9	3254.4

Notes and Source: See following page.

Notes and Source for Table VI-101

Notes: "Large Companies" consist of 15 life insurers with total assets in excess of $2 billion as of December 31, 1969. "Small Companies" consist of the remaining respondents to questionnaire package Form I-50.

"Cash and Near Cash" is defined to include currency and demand deposits, certificates of deposit and other time and savings deposits.

"Government Securities" include U.S. Treasury, Federal Agency and Corporation direct, guaranteed and non-guaranteed obligations, state and local government debt obligations and debt securities issued by foreign governments.

"Short-Term Debt Securities" are defined as those with one year or less to maturity <u>at issue</u>.

"Long-Term Debt Securities" are defined as those with more than one year to maturity <u>at issue</u>.

"Nongovernment Debt Securities" include securities issued by nongovernmental entities, foreign or domestic. Loans secured by real estate are excluded.

"Other Assets" include preferred stock, accounts receivable from brokers, amounts due from affiliated companies and assets not elsewhere counted.

Source: Responses to Form I-21, Separate Accounts.

Table VI-102

Asset Composition of Separate Accounts Not Primarily Intended for Common Stock

December 31, 1969
($millions)

Account Categories	Number of Accounts	Cash and Near Cash	Gov't. Securities and Short-Term Non-Gov't. Debt	Long-Term Non-Gov't Debt Securities	Common Stock and Warrants	Mortgage and Real Estate	Other Assets	Total Assets
1. Registered								
a. Large Companies	3	0	0	0	1.1	0	0	1.5
b. Small Companies	2	0	0	0	4.4	0	0	4.4
c. All Registered	5	0	0	0	5.5	0	0	5.5
2. Non-Registered Commingled								
a. Large Companies	8	3.3	40.2	32.7	0	47.9	1.7	125.9
b. Small Companies	4	0.5	10.1	20.2	32.3	0.6	2.4	66.1
c. All Non-Registered Commingled	12	3.8	50.3	52.9	32.3	48.5	4.1	192.0
3. Single Client								
a. Large Companies	15	1.1	11.5	15.8	20.7	7.6	1.9	58.7
b. Small Companies	9	1.1	10.8	24.1	19.2	13.3	*	68.6
c. All Single Client	24	2.2	22.3	39.9	40.0	21.0	1.9	127.3
4. TOTALS	41	6.0	72.6	92.8	77.8	69.5	6.1	324.8

Notes and Source: See Table VI-101.

* Greater than zero but less than $50,000.

Table VI-103'

Holdings of Government Securities and Private Short-Term Debt Obligations by Separate Accounts Intended Primarily for Common Stock

December 31, 1969
($millions)

Account Categories	U.S. Gov't. Debt		U.S. State and Local Gov't. Debt	Foreign Gov't. Securities	Non-Gov't. Short-Term Debt		Total
	Short-Term	Long-Term			U.S. Issues	Foreign Issues	
1. Registered							
a. Large Companies	0	0	0	0	1.0	0	1.0
b. Small Companies	2.8	0	0	0	3.9	0	6.7
c. All Registered	2.8	0	0	0	4.9	0	7.7
2. Non-Registered Commingled							
a. Large Companies	1.9	0	0	0.2	226.8	4.2	233.2
b. Small Companies	4.3	0.7	0.3	0	18.6	2.2	26.1
c. All Non-Registered Commingled	6.2	0.7	0.3	0.2	245.5	6.5	259.3
3. Single Client							
a. Large Companies	1.8	2.1	*	0.1	153.1	18.3	175.4
b. Small Companies	7.1	0	0.6	0.1	0.2	0.5	8.4
c. All Single Client	8.9	2.1	0.6	0.2	153.3	18.7	183.8
4. TOTALS	17.9	2.8	0.9	0.4	403.7	25.2	450.8

Notes and Source: See Table VI-101.

* Greater than zero but less than $50,000.

Table VI-104

Holdings of Government Securities and Private Short-Term Debt Issues by Separate Accounts Not Intended Primarily for Common Stock

December 31, 1969
($millions)

Account Categories	U.S. Gov't. Debt		U.S. State and Local Gov't. Debt	Foreign Gov't. Securities	Non-Gov't. Short-Term Debt		Total
	Short-Term	Long-Term			U.S. Issues	Foreign Issues	
1. Registered							
a. Large Companies	0	0	0	0	0	0	0
b. Small Companies	0	0	0	0	0	0	0
c. All Registered	0	0	0	0	0	0	0
2. Non-Registered Commingled							
a. Large Companies	0	0	0	8.8	30.7	0.6	40.2
b. Small Companies	0	0.4	0.3	1.8	6.9	0.7	10.1
c. All Non-Registered Commingled	0	0.4	0.3	10.6	37.7	1.3	50.3
3. Single Client							
a. Large Companies	0	0.4	0	0.1	11.0	0	11.5
b. Small Companies	0	0.7	0	2.5	0.5	7.0	10.8
c. All Single Client	0	1.1	0	2.7	11.5	7.0	22.3
4. TOTALS	0	1.5	0.3	13.3	49.2	8.3	72.6

Notes and Source: See Table VI-101.

Table VI-105

Mortgage Loans Held in Separate Accounts

December 31, 1969
($millions)

Account Categories	1-4 Family Dwellings	Other Loans Without Equity Provision	Loans With Equity Provision	Total Mortgage Loans
1. Non-Registered Commingled				
a. Large Companies	19.7	28.3	0	48.0
b. Small Companies	0	0.6	0	0.6
c. All Non-Registered Commingled	19.7	28.9	0	48.5
2. Single Client				
a. Large Companies	0	7.6	0	7.6
b. Small Companies	2.1	11.2	0	13.3
c. All Single Client	2.1	18.8	0	21.0
3. TOTALS	21.8	47.7	0	69.5

* Equity provision is defined to consist of convertibles, warrants or other options to acquire an equity provision.

Source: Responses to Form I-21 Separate Accounts.

Table VI-106

Holdings of Common Equities of Separate Accounts
Primarily Intended for Common Stock

December 31, 1969
($millions)

Account Categories	American Depository Receipts and Foreign Issuers	Restricted Securities	Investment Company Shares	Other Common Stock	Total Common Stock	Warrants Rights and Options	Total
1. Registered							
a. Large Companies	0.1	0	0	30.0	30.1	0.1	30.1
b. Small Companies	2.6	0.5	0	53.9	56.9	*	56.9
c. All Registered	2.7	0.5	0	83.9	87.0	0.1	87.0
2. Non-Registered Commingled							
a. Large Companies	68.7	2.1	14.8	1589.1	1674.7	0.7	1675.4
b. Small Companies	1.8	1.3	0	142.6	145.7	*	145.7
c. All Non-Registered Commingled	70.5	3.3	14.8	1731.7	1820.4	0.7	1821.1
3. Single Client							
a. Large Companies	18.6	0.1	0	643.7	662.4	0.3	662.7
b. Small Companies	2.8	0	13.2	60.8	76.8	0	76.9
c. All Single Client	21.3	0.3	13.2	704.4	739.2	0.3	739.6
4. TOTALS	94.5	4.1	28.0	2520.0	2646.6	1.2	2647.7

* Greater than zero but less than $50,000.

Note: Restricted Securities are defined to include any securities that could not have been offered to the public for sale as of December 31, 1969 without fees being registered under the Securities Act of 1933.

Source: *Responses to Form I-21, Separate Accounts.*

Table VI-107

Holdings of Common Equities of Separate Accounts
Not Primarily Intended for Common Stock

December 31, 1969
($millions)

Account Categories	American Depository Receipts and Foreign Issuers	Restricted Securities	Investment Company Shares	Other Common Stock	Total Common Stock	Warrants Rights and Options	Total
1. Registered							
a. Large Companies	0	0	1.1	0	1.1	0	1.1
b. Small Companies	0	0	4.4	0	4.4	0	4.4
c. All Registered	0	0	5.5	0	5.5	0	5.5
2. Non-Registered Commingled							
a. Large Companies	0	0	0	0	0	0	0
b. Small Companies	2.1	0	0	30.2	32.3	0	32.3
c. All Non-Registered Commingled	2.1	0	0	30.2	32.3	0	32.3
3. Single Client							
a. Large Companies	0.6	0	1.6	18.5	20.7	0	20.7
b. Small Companies	15.9	0	0.2	3.1	19.2	*	19.2
c. All Single Client	16.5	0	1.8	21.6	39.9	*	40.0
4. TOTALS	18.6	0	7.3	51.9	77.8	*	77.8

* Greater than zero but less than $50,000.

Source: Responses to Form I-21, Separate Accounts.

53-940 O - 71 - pt. 2 -- 39

Table VI-108

Holdings of Common Stock by Exchange Listing
Separate Accounts Primarily Intended for Common Stock
End 1969

Account Groups	Number of Accounts	NYSE Listed		AMEX Listed		Banks and Insurance Companies		Other		Total	
		$million	%	$million	%	$million	%	$million	%	$million	%
1. Registered											
a. Large Companies	9	23.8	78.9	1.6	5.3	1.2	4.0	3.6	11.8	30.2	100
b. Small Companies	9	42.2	74.1	6.3	11.0	0.6	1.1	7.9	13.8	56.9	100
c. All Registered Accounts	18	66.0	75.8	7.9	9.1	1.8	2.1	11.5	13.2	87.1	100
2. Non-Registered Commingled											
a. Large Companies	21	1551.7	94.8	47.6	2.9	4.7	0.3	32.4	2.0	1636.3	100
b. Small Companies	22	108.7	77.8	9.7	6.9	6.5	4.7	14.7	10.5	139.7	100
c. All Non-Registered Commingled	43	1660.4	93.5	57.3	3.2	11.2	0.6	47.1	2.7	1776.0	100
3. Single Client											
a. Large Companies	47	591.2	90.7	32.3	5.0	5.4	0.8	22.9	3.5	651.8	100
b. Small Companies	15	40.5	87.4	0.3	0.6	2.7	5.9	2.9	6.2	46.3	100
c. All Single Client	62	631.7	90.5	32.6	4.7	8.2	1.2	25.7	3.7	698.1	100
4. Totals											
a. Large Companies	77	2166.7	93.5	81.5	3.5	11.3	0.5	58.9	2.5	2318.1	100
b. Small Companies	46	191.4	78.8	16.3	6.7	9.8	4.0	25.5	10.5	242.9	100
c. Totals	123	2358.1	92.1	97.8	3.8	21.1	0.8	84.4	3.3	2561.2	100

Source: Responses to Form I-24, Separate Accounts.

Table VI-109

Holdings of Common Stock by Exchange Listing
Separate Accounts Not Primarily Intended for Common Stock
End 1969

Account Groups	Number of Accounts	NYSE Listed		AMEX Listed		Banks and Insurance Companies		Other		Total	
		$million	%	$million	%	$million	%	$million	%	$million	%
1. Registered											
a. Large Companies	3	0		0		0		0		0	
b. Small Companies	2	0		0		0		0		0	
c. All Registered Accounts	5	0		0		0		0		0	
2. Non-Registered Commingled											
a. Large Companies	6	0		0		0		0		0	
b. Small Companies	3	29.7	92.6	0	0	1.4	4.2	1.0	3.2	32.1	100
c. All Non-Registered Commingled	9	29.7	92.6	0	0	1.4	4.2	1.0	3.2	32.1	100
3. Single Client											
a. Large Companies	7	11.4	73.1	2.0	12.6	0.1	0.9	2.1	13.3	15.6	100
b. Small Companies	4	0		0		0		0		0	
c. All Single Client	11	11.4	73.1	2.0	12.6	0.1	0.9	2.1	13.3	15.6	100
4. Totals											
a. Large Companies	16	11.4	73.1	2.0	12.8	0.1	0.6	2.1	13.5	15.6	100
b. Small Companies	9	29.7	92.5	0	0	1.4	4.4	1.0	3.1	32.1	100
c. Totals	25	41.2	86.2	2.0	4.2	1.5	3.1	3.1	6.5	47.8	100

Source: Responses to Form I-24, Separate Accounts.

Table VI-110

Regression Statistics for Analysis of the Proportion of Common Stocks Held in Non-NYSE Shares

Dependent Variable: Log (Non-NYSE/total common stock)

Independent Variables	Regression Coefficients	't' Values
Log account common stock	-.142	-2.27
Log insurer size	-.227	-2.66
Log ratio: account common stocks to assets	-.125	-0.30
Registered	.561	1.93
Commingled	-.072	-0.34

Constant = 5.161

$\bar{R}^2$ = .264

5. Trading in Common Equities

a. Separate account turnover and activity rates

As life companies have increased their holdings of common equity securities in recent years, they have also increased their trading activity in these securities. In this section annual turnover and activity rates for common equities are displayed for the period 1965–1969 and classified according to characteristics of the accounts managed. Turnover is defined as the *lesser* of acquisitions or dispositions of these securities during a calendar year divided by the average market value of beginning-year and end-year holdings expressed as a percentage. Activity is defined as the *average* value of total acquisitions *plus* dispositions during the year divided by the same average holdings. The activity rate is necessarily always greater than or equal to the turnover rate.[352] Except where otherwise indicated, transactions include both acquisitions and dispositions for cash and non-cash transactions arising through the exercise of puts, calls, rights, warrants or conversion privileges, exchanges of securities, or additions to or withdrawals from the account of equity securities by contractholders or the insurer.[353]

Tables VI–111 through VI–113 show common equity turnover and activity rates for separate accounts for each year 1965 to 1969 inclusive, classified by type of account, size of account and age of account. The clearest pattern to emerge from an examination of these tables is the very substantial increase in turnover rates over the period with the most dramatic increase occurring in 1968. This timing lags behind the increased turnover of common equities by mutual funds by about two years, but is roughly in line with that of bank managed corporate pension funds and property and liability insurers. Similar trends and timing appear to be confirmed for each of the various types of accounts shown in Table VI–111,[354] for accounts in the various size categories of Table VI–112 [355] and for accounts of various ages (Table VI–113).

In general, activity rates also increased over the period, but the overall percentage increase is smaller than that observed for turnover rates and this pattern is less pervasive than was the case for turnover rates. Thus, for example, there is no particular trend in activity rates for nonregistered commingled accounts, or for the oldest accounts or for the largest accounts.[356] However, where large year-to-year increases in activity occur, they occur most frequently during 1968.

---

[352] Since the denominators are identical in each case and the numerators can be identical only if acquisitions equal dispositions.

[353] See the Instructions for I–26. For reporting purposes, short sales were treated as acquisitions, purchases to cover short sales as dispositions, and holdings are the gross sum of all long and short positions.

[354] Except that the turnover increase in accounts registered under the Investment Company Act appears earlier and the 1968 increase is of similar magnitude to that of the previous two years.

[355] Except the largest size category in which the most significant increase in turnover is delayed until 1969.

[356] As we have seen, there is a tendency for the largest accounts to be older accounts and to be commingled accounts exempt from registration. Of $2.3 billion in nonregistered commingled account assets as of end-1969, nearly $1.9 billion are contained in accounts established prior to 1965.

Some year-to-year increase in turnover may be a normal expectation during the first few years of an account's life. This may be especially true of rapidly growing accounts, as initially portfolio managers concentrate upon investing the new money inflow and creating the desired composition of portfolio assets. Active trading may be deferred until the portfolio is well established.[357] However, the magnitude of the increase in turnover rates and the consistency of the timing of large increases in 1968 for a variety of account ages and sizes, suggest that a more aggressive trading policy was responsible for much of the observed increases. To the extent that this increased aggressiveness reflected an increased concern with investment returns, it may be somewhat surprising that registered accounts, which primarily contain interests of individual contractholders, seem to have higher turnover rates than nonregistered commingled accounts[358] which contain interests of cost-conscious employers funding pension and profit-sharing plans. However, this observed difference between types of accounts may disappear when other variables such as account age and size are taken into account simultaneously.[359] It does appear, for example, from Table VI–112 that turnover declines with account size, and there is a suggestion in Table VI–113 that the oldest (and perhaps the newest) accounts tend to have lower turnover rates.

These questions involving the relationship between trading activity and account characteristics cannot be resolved by comparing turnover rates with each of the relevant variables one at a time. Rather, a multivariate statistical analysis in which each relationship can be examined while holding other factors constant is required. Tables VI–114 and VI–115 report results of multivariate regression analyses designed to accomplish this objective.

A number of explanatory variables were utilized and several forms of the regression equation were specified. Account size is measured by the average market value of the account's common stockholdings for the year in which turnover is being measured.[360] The year the account began operation is used to measure the age of the account. The size of the managing insurer is measured by the insurance company's total general account assets. Dummy variables are used to indicate whether the account is (i) registered, and (ii) commingled.[361] The investment intentions variable is an index which measures the extent to which an account is primarily intended for investment in equities, in debt or in a balanced debt/equity portfolio.[362] Several ratios which

[357] However, the opposite behavior may be expected if new assets placed in accounts are in the form of securities transferred from another funding agency. In this circumstance, new managers frequently liquidate and reconstitute the portfolio. This has occurred in life companies, apparently particularly with single customer accounts. For commingled accounts, insurers sometimes utilize special liquidation accounts (not included in these tables) to redeem securities received so that cash proceeds are placed in the permanent accounts.

[358] See Table VI–III.

[359] See the discussion of the multivariate regression results below.

[360] That is, the average of beginning-year and end-year holdings.

[361] The registered characteristic is a "1" if the account is registered, a "0" if it is not; similarly, the value for a commingled account is "1", for a single client account, "0".

[362] A higher value of the index scale indicates a more debt-oriented account.

measure the importance of common stocks in the whole portfolio and of riskier stocks in the common stock portfolio are included; namely, the ratio of common stock holdings to the account's assets and the ratios of non-NYSE stocks and of AMEX plus unlisted stocks[363] to an accounts total common stock holdings. Finally, turnover may be affected by the number of stocks in the portfolio, by the degree of discretion possessed by the insurer in investment and broker selections and by the investment management fee charged. Consequently, these variables were included in some equations.[364]

Regressions were run on two sets of data. The regressions reported in Table VI–114 were performed on all account years for which data on each of the variables included were available. Thus, the same account appears as a separate observation each year its data are available. Since turnover is apparently quite sensitive to the year in which it is measured, the reporting year is included as a variable.[365] The regressions reported in Table VI–115 are based on 1969 data only. Regression equations were estimated in linear, semi-log and log-log forms. The last form is probably *a priori* the most plausible specification where size measures (for example, the dollar value of account common stock holdings) are employed as independent variables.

The regressions clearly confirm that the observed increase in turnover rates over the 1965–1969 period occurred over a wide variety of accounts and is not due to changing mixes of account characteristics. Indeed, most account and insurer characteristics contribute little if anything, to an explanation of the variations in turnover rates among accounts. The sign on the account common stock size coefficient is nearly always negative and in the log-log form is significant, suggesting that there is some tendency for larger accounts to have lower turnover. It is possible that this relationship exists primarily because few very large accounts have exceptionally low turnover rates. In the log-log specifications there is a suggestion that younger accounts have lower turnover but this is not a very robust finding. When account size and age as well as other variables are held constant, the account type (that is, whether the account is registered or not or is a commingled or a single client account), does not appear to affect turnover significantly. Thus the apparent indication (Table VI–111) that non-registered commingled accounts have lower turnover rates appears to reflect the size and age of these accounts, not the fact of their being commingled and unregistered.

No other variables are consistently significant. However, the brokerage designation and investment discretion coefficients are significant

---

[363] Actually, stocks listed solely on a regional securities exchange or unlisted excluding bank and insurance stocks. The non-NYSE variable does include bank and insurance stocks.

[364] The brokerage designation variable takes on the value "1" if the insurer has full discretion and the value "0" if there is some client designation of brokers. The investment discretion variable takes on the value "0" if the insurer has full discretion and the value "1" if contractholders exert some influence.

[365] The maximum number of years for which data are available is, of course, five (1965–1969). An account's turnover, account size, reporting year, average number of common stocks held and fee rate take on different values each year. The other variables assume a unique value, independent of time, including the ratios which could be computed only as of the end of 1969.

where these variables are included. The signs on these coefficients are to be interpreted to mean that turnover is higher on accounts in which the insurer always selects brokers and on accounts where the insurer has sole investment discretion. This is suggestive but confidence in these findings is limited by the relatively small number of cases in which insurers do not have full authority to select investments and brokers. The negative sign on the common stock/account assets variable appears to be due, at least in part, to the fact that some relatively aggressive accounts shifted part of their portfolios from common equities to debt obligations during 1969.

To conclude, the results indicate that although there is a good deal of variation in turnover rates among separate accounts,[366] this variation is not strongly related to the account and insurer characteristics examined here. The increase in turnover rates observed during 1965 to 1969 occurred over a wide range of accounts with different characteristics and different managers.

---

[366] For example, the mean turnover ratio for 69 accounts included in the 1969 turnover regression was .49 and its standard deviation was .39.

Table III

Separate Account Turnover and Activity Rates
Classified by Account Type and Year Measured

Account Category	Turnover Rates (%)					Activity Rates (%)				
Year	1965	1966	1967	1968	1969	1965	1966	1967	1968	1969
Registered	12.63	22.48	32.25	41.48	40.94	15.94	53.86	72.50	96.62	94.71
Non Registered Commingled	3.02	3.59	8.50	21.54	27.23	42.42	45.48	39.42	43.87	44.88
Single Client	0.73	4.19	12.97	51.20	40.27	32.47	24.97	32.36	62.86	65.73
Totals	2.50	3.81	9.51	26.53	30.75	39.64	40.43	38.12	47.62	51.29

NOTE: Turnover and Activity rates are dollar weighted. Turnover rate is defined as the lesser of purchases or sales divided by the average common stock holdings for the year. Activity rate is defined as the average of purchases and sales divided by the average common stock holdings for the year. The number of accounts represented in each category for each successive year (beginning with 1965) are: Registered, 1, 3, 6, 9 and 16; nonregistered commingled, 16, 23, 27, 31 and 36; single client, 6, 12, 22, 29 and 44. Source: Computed from responses to Form I-26 and Form I-21, separate accounts.

Table VI-112

Separate Account Turnover and Activity Rates
By Year Measured and Account Size

Account Size (mils $)	Turnover Rates (%)					Activity Rates (%)				
	1965	1966	1967	1968	1969	1965	1966	1967	1968	1969
0 - 1	13.07	18.27	26.41	30.94	39.77	62.71	45.27	60.65	67.65	76.78
1 - 5	4.82	8.37	17.88	39.95	52.81	37.53	32.15	48.53	65.64	74.53
5 - 10	3.58	5.23	19.63	38.92	45.91	39.16	25.04	42.50	69.52	75.40
10 - 50	0.33	2.38	13.80	52.64	49.80	38.89	32.12	36.34	66.56	74.84
50 - 100	—	—	2.48	44.02	10.62	—	—	40.98	67.21	50.62
Over 100	—	3.14	3.58	7.51	21.32	—	59.49	35.46	29.59	37.95
Totals	2.50	3.81	9.51	26.53	30.75	39.64	40.43	38.12	47.62	51.29

NOTE: Account Size is defined as the average market value of common equity security holdings for each year. The accounts included are the same as those in Table VI-111. Source: See Table VI-111.

TABLE VI-113

Separate Account Turnover and Activity Rates
By Year Measured and Year Account Established

Year Account Established	Turnover Rate (%)					Activity Rate (%)				
	1965	1966	1967	1968	1969	1965	1966	1967	1968	1969
Pre 1965	2.50	2.74	8.44	19.47	26.42	39.64	42.27	37.00	40.77	43.66
1965		9.60	15.62	76.31	71.71		30.46	39.10	93.06	89.54
1966			12.92	33.49	44.48			55.07	56.84	71.39
1967				39.25	54.43				72.26	85.02
1968					17.33					56.50
Totals	2.50	3.81	9.51	26.53	30.75	39.64	40.43	38.12	47.62	51.29

NOTE: The accounts included are the same as those in Table VI. 111

SOURCE: See Table VI-111

Table VI- 114

Regression Statistics for Separate Account Turnover Analysis

	Dependent Variables					
	Turnover		Turnover		Log Turnover	
Independent Variables	Regression Coeff.	t value	Regression Coeff.	t value	Regression Coeff	t value
Account Common Stock Holdings	-485.80	-1.26				
Log Account Common Stock Holdings			.005	0.18	-26.3	4.66
Year Reporting	.131	5.74	.124	4.93		
Log Year Reporting					54.220	11.12
Year Established	.038	1.95	.030	1.43		
Log Year Established					-4.838	1.79
Registered	.028	0.30	.064	0.70	-.602	1.94
Commingled	.023	0.40	.051	0.92	.027	0.15
Insurer Assets	4.00	0.96				
Log Insurer Assets			.096	3.02		
Investment Intentions					-.312	0.56
Average Number of Common Stocks	-.001	0.03	-.003	1.76		
Common Stocks/ Assets Ratio	-.282	-1.39	-.477	2.39		
Non NYSE/Common Stock Ratio	.310	1.69	.555	2.85		
Brokerage Designation			.027	4.22		
Investment Discretion	-.327	-3.05	-.342	3.23		
Fee Rate			13.54	1.95		
Constant	-10.71		-11.58		-205.43	
R^2	.34		.37		.33	

Table VI- 115

Regression Statistics for 1969 Turnover Data
Separate Accounts

	Dependent Variables			
	Turnover		Log Turnover	
Independent Variables	Regression Coefficient	t value	Regression Coefficient	t value
Account Common Stockholdings	-.0256	0.43	—	—
Log Account Common Stockholdings	—	—	-.3283	2.49
Insurer Assets	-.0010	1.55	—	—
Log Insurer Assets	—	—	.1322	0.82
Year Established	.0019	.062	—	—
Log Year Established			-12.76	2.04
Registered	-.2206	1.30	-.6659	1.44
Commingled	-.1778	1.54	-.2575	0.81
Ratio: AMEX & Other to All Common Stock Held	.2194	0.76	.1670	0.18
Constant	0.56		54.83	
$\overline{R}^2$	.07		.14	

b. Separate account's investment performance, volatility and turnover

The Study collected data on separate accounts which permitted computation of rates of return for a number of the reporting accounts. Where available, unit values, distributions per unit and frequent market valuations of each account's assets were obtained. Where unit values are not utilized, a schedule of contributions and other payments into the account and distributions and other withdrawals from the account was requested. Market valuations were to be provided at least monthly and more frequently when large transfers of assets into or out of the account occurred.[367]

Usable data for computing total investment return were obtained from 80 accounts. Because most existing separate accounts were created at various points during the period 1965–1969, the time period covered varies among accounts; for a few the rate of return is calculated on only a little more than one year's experience while at the other extreme returns are computed on a few accounts for the entire five years, 1965–1969. For the most accounts returns are computed over the life of the account, that is, somewhere between one and five years. Table VI–116 reports average monthly rates of return for several groups of separate accounts. These groupings are based upon the volatility of the accounts.

An account's volatility is a measure of the sensitivity of the market value of the account's assets to movements in general market prices of the same types of assets. Since most separate accounts are primarily equity accounts the market standard employed, for present purposes, is the Standard and Poor's 500 index. A volatility (Beta) coefficient of unity implies that a ten percent change in the market index would result on the average in a ten percent change, in the same direction, in the market value of the account's assets. A volatility coefficient of 0.2 means that on the average a 10 percent change in market level will result in a two percent change in the account's asset value; and a coefficient of 2.0 means that a ten percent change in market level will on the average result in a 20 percent change in the account's asset value.[368] An account having a volatility or Beta coefficient of 0.2 is likely to be an income account with a substantial holding of debt obligations; an account with a Beta coefficient in excess of 2.0 is likely to have a growth or capital gains objective. The market return on the Standard and Poor's index (including dividends) is reported in Table VI–116 for each group of accounts. Also reported is the average volatility (Beta) coefficient for each group of accounts.

Use of the volatility concept makes it possible to segregate that portion of an account's return which results from portfolio management from that portion which simply reflects movements in the general level of stock prices. This can be done by comparing the re-

---

[367] A large contribution or withdrawal was defined as one amounting to ten percent or more of the account's assets. See the Instructions to Form I–22.

[368] The volatility coefficient is discussed in the app. IV, sec. F. dealing with measurement of investment performance.

turn on an account to the return realized by a standard, unmanaged account having the same volatility. The standard account is obtained by an appropriate mix (that is, one that produces the desired volatility) of a risk free security (thirty day Treasury bills) and the market portfolio, represented by the Standard and Poor's index including dividend.[369] The performance measure (Alpha) displayed in Table VI-116 is the sum of each accounts monthly rate of return less the rate earned on an unmanaged portfolio of equivalent volatility over the same time period, divided by the total number of accounts. Thus, the table shows that during the period covered (the latter part of the 1960's), relatively low volatility accounts performed somewhat worse than unmanaged portfolios having the same volatility while higher volatility accounts performed somewhat better than the standard. This pattern is similar to that observed for accounts managed by other institutions.[370] Some caution in comparing accounts' performance does need to be exercised since each account's experience is for a unique time period, although by controlling for variations in the return on broadly-based market indices and on short-term debt securities this excess return measure is *relatively* free from distortions caused by the heterogeneity of time periods.[371]

Of primary interest, however, is not the excess return attributable to management *per se*, but the relation between this performance measure and account characteristics such as turnover, the total value of account common stock holdings and the asset size of the insurer which manages the account. Although a significant negative relation is found between performance (Alpha) and turnover for mutual funds and bank collective funds,[372] no significant relation between these two variables appears to exist for separate accounts. This conclusion is confirmed by the multiple regression results reported in Table VI-117 which show that when other variables are held constant there is no apparent relation between turnover and performance. The results do confirm that a positive relation between performance and volatility exists when other variables are taken into account. However, although inspection of Table VI-116 suggests that small insurers tend to have more volatile portfolios, and consequently, better performance during this period, this conclusion does not hold up in the regression analyses where performance and insurer size are positively related. The diversification variable included in the regression measures the extent to which variance in an account's return is explained by movements in the market index. The negative value of this coefficient implies that relatively undiversified accounts. (that is, those having a greater degree of variation independent of market experience) performed better

---

[369] Leveraging (borrowing) is required to produce a combination with volatility greater than that of the market portfolio. See the discussion in ch. IV.

[370] See the performance results for mutual funds in Chapter IV and for bank managed collective investment funds in ch. V.

[371] The average number of observations shown in Table VI-116 represents the average number of market valuations available per account less one.

[372] See the performance analysis in ch. IV and V, respectively

during the late 1960's. This is consistent with the finding for bank collectivee funds.[373]

In the other regressions reported on, none of these variables contribute to explaining the variance among accounts in 1969 turnover rate. All 't' values are less than one. The performance (Alpha) and volatility (Beta) variables were also added as independent variables to regressions of the sort reported above where pooled cross section and time series data are utilized. Neither variable was significant in any of the specifications and neither added to the variance explained by reporting year, account size and other independent variables. In conclusion, although the Study does not find turnover to be negatively related to investment performance for separate accounts during the latter half of the 1960's, neither is there any evidence that higher turnover is associated with better performance.

---

[373] See the performance analysis in ch. V. However, the result here is of uncertain validity since the value of the diversification measure is sensitive to the number of observations per account, and the number of observations varies considerably among accounts.

TAB__ VI-116

SUMMARY OF INVESTMENT RETURN DATA FOR THE SEPARATE ACCOUNTS CLASSIFIED BY VOLATILITY

Volatility Range	Number of Account	Average Number of Observations Per Account	Monthly Account Return Percent Per Month	Monthly Market Return Percent Per Month	Performance Measure (Alpha) Percent Per Month	Volatility Measure (average Beta)	Portfolio Turnover (1969)	Account Size (Average Common Stock Holdings) $ Millions	Advisor Size (Average Assets) $ Billions
0-0.4	3	40.7	.53	.46	-.09	.20	75.4	1.3	2.0
0.4-0.8	13	41.3	.32	.22	-.06	.64	43.7	23.2	14.8
0.8-1.0	30	48.1	.42	.31	.08	.93	34.9	11.1	5.5
1.0-1.2	24	52.0	.54	.40	.16	1.08	60.4	48.7	4.2
over 1.2	10	27.1	.36	.25	.30	1.36	64.8	2.9	2.8
TOTAL	80	45.3	.44	.32	.10	.95	49.2	23.0	6.2

NOTE: All averages are unweighted.

TABLE VI - 117

REGRESSION COEFFICIENTS AND 't' VALUES FOR DESCRIBING THE RELATIONSHIP BETWEEN PERFORMANCE AND TURNOVER AND OTHER ACCOUNT CHARACTERISTICS

	Dependent Variable			
	Performance (alpha)		Turnover	
Independent Variable	Regression Coefficient	t Value	Regression Coefficient	t Value
Performance (Alpha)			8.05	0.56
Turnover Rate	0.00053	0.56		
Volatility (Beta)	0.92	5.30	0.90	0.04
Account Common Stock Holdings	-0.00023	-0.50	-0.056	0.99
Total Assets of Managing Insurer	0.0000090	1.94	-0.00031	0.52
Diversification Measure (R^2)	-.81	-4.23	22.19	0.85
	$\bar{R}^2 = .25$		$\bar{R}^2 = 0$	

53-940 O - 71 - pt. 2 -- 40

c. General account turnover and activity rates

Turnover and activity rates for general account common equity securities are displayed in Tables VI–118 to VI–127. These measures are classified according to size of the common equity portion of general account portfolios as of the end of each of the five reporting years, 1965 to 1969. Average turnover and activity rates are also shown on both a dollar weighted and an unweighted basis, and turnover and activity rates are computed for cash transactions only as well as for all transactions. The latter computation is made to test a view expressed by insurance industry advisors to the Study that increases in turnover and activity rates during the late 1960's were significantly affected by equity security swaps related to mergers and the formation of holding companies.

The general pattern of change in turnover and activity rates over the five-year period can best be seen by examination of Table VI–128, which reports general account and separate account rates on a comparable dollar weighted basis.[374] From this table it is clear that (1) there was a year-to-year increase in turnover rates for general accounts as a group over the 1965–1969 period, but (2) this increase was much more modest than that recorded by separate accounts, and (3) the largest increase occurred during 1968, as it did with separate accounts.[375] General account activity rates increased to about the same proportion as turnover rates over the period. Table VI–128 makes it possible to trace changes in the relative impact of separate accounts on the overall weighted turnover and activity rates for life insurers' common equity securities. Thus, for example, although general account activity rates increased from 10.6 percent to 19.5 percent between 1965 and 1969, these insurers' activity rates as a whole increased from 11.4 percent to 27.3 percent during the period. This difference is explained by the growth of, and higher activity rates generated by, separate accounts.

There are at least two possible reasons why turnover rates for general account equity securities are less than comparable rates for separate accounts. One reason is that contractholders in separate accounts are primarily cost-conscious employers who seek relatively aggressive investment management in the hope of obtaining substantial investment returns.[376] A second possible explanation is that while most separate accounts are free from income and capital gains taxation, insurers do incur taxes upon gains made from security sales in the general account. Twenty-two of 60 responding insurers reported that capital gains tax considerations had affected general account investment decisions with regard to whether or not to sell an equity security during the previous two years.[377] However, only two of the ten largest

[374] This table reports accounts for those companies which reported transactions for both their general and separate accounts.

[375] The last conclusion is also valid if only cash transactions are considered.

[376] In some instances, separate account turnover may have been increased by the receipt of securities into the account which are quickly liquidated and reinvested.

[377] The questionnaire was completed by respondents in the Spring of 1970, so the two-year period commenced in the Spring of 1968.

companies reported such a constraining influence. Two additional companies, both among the ten largest, did report that capital gains tax considerations had affected the timing, but not the volume, of equity security sales. Typical of the responses from those who reported the existence of a tax restraint were the following:

"We are reluctant to sell common stocks which would involve capital gains unless we are about to create offsetting losses. This would affect both the volume and timing of common stock sales."

"All sales are coordinated to provide that no capital gains taxes will be paid on our investment transactions. In other words we would be unwilling to sell an equity security at a profit unless there was a reasonable certainty that the profit could be offset through the realization of loss on bonds or other stocks."

Thus, tax considerations do appear to contribute to reducing turnover rates on general account equity security portfolios. However, the potential impact on dollar weighted turnover rates is lessened by the fact that eight of the largest ten companies appear not to be much constrained in their trading activity by tax considerations.

The evidence summarized in Tables VI–118 to VI–127 indicates that the largest common equity accounts (that is, those with over $200 million in such securities), do consistently have substantially lower turnover rates than the remaining accounts taken as a group. The pattern within some other size groups is erratic as the population of particular groups changes from year to year as a result of growth in the value of accounts' equity security holdings. Thus, for example, unweighted average turnover rates for accounts in the less than $10 million category actually declined between 1965 and 1969 as five accounts grew out of this group. Thus for 1969, unweighted average turnover rates are lowest for the smallest size and the largest size categories. Perhaps because of this pattern, a significant negative relation between turnover and the value of general account common stock holdings is not confirmed by regression analysis.[378] This is illustrated in Table VI–129 where statistics on regression analyses performed on 1969 data are reported. Both linear and log-log forms of the regression relationship between turnover and account size were utilized. In addition to absolute size, the ratio of common stock holdings to total general account assets proved to be insignificant. However, the proportion of the common stock portfolio consisting of stocks other than NYSE listed, bank or insurance stocks does appear to be significantly and positively related to turnover rates.

[378] The fact that unweighted rates are consistently higher than dollar weighted rates suggests that an inverse relation between portfolio size and turnover exists.

TABLE VI-118

LIFE INSURANCE
GENERAL ACCOUNTS
COMMON EQUITIES

TURNOVER RATES
1965

Account Size (Millions of Dollars)	Number of Accounts	Unweighted Rates		Weighted Rates	
		Cash Transactions	All Transactions	Cash Transactions	All Transactions
0 - 10	19	17.60	22.21	12.77	14.99
10 - 50	11	6.67	7.16	6.53	7.09
50 - 100	12	13.21	13.80	11.85	12.36
100 - 200	6	5.55	5.95	5.76	6.18
Over 200	6	5.20	6.17	5.04	5.71
All Companies	54	11.68	13.69	6.67	7.27

SOURCE: Computed from data received in Study questionnaire, Form I-26.

TABLE VI-119

LIFE INSURANCE
GENERAL ACCOUNTS
COMMON EQUITIES

ACTIVITY RATES

1965

Account Size (Millions of Dollars)	Number of Accounts	Unweighted Rates		Weighted Rates	
		Cash Transactions	All Transactions	Cash Transactions	All Transactions
0 - 10	19	29.96	32.51	21.90	23.37
10 - 50	11	11.21	11.74	10.55	11.09
50 - 100	12	17.52	18.20	16.06	16.69
100 - 200	6	7.19	7.64	7.45	7.88
Over 200	6	7.57	8.57	7.68	8.52
All Companies	54	18.36	19.68	9.59	10.28

SOURCE: Computed from data received in Study questionnaire, Form I-26.

TABLE VI-120

LIFE INSURANCE
GENERAL ACCOUNTS
COMMON EQUITIES

TURNOVER RATES
1966

Account Size (Millions of Dollars)	Number of Accounts	Unweighted Rates		Weighted Rates	
		Cash Transactions	All Transactions	Cash Transactions	All Transactions
0 - 10	21	9.35	28.49	12.09	18.39
10 - 50	11	6.75	7.92	6.66	7.80
50 - 100	11	7.06	8.86	6.66	8.42
100 - 200	6	7.62	9.69	7.21	9.29
Over 200	6	5.87	6.39	7.04	7.51
All Companies	55	7.80	15.99	7.05	8.22

SOURCE: Computed from data received in Study (questionnaire), Form I-26.

TABLE VI-121

LIFE INSURANCE
GENERAL ACCOUNTS
COMMON EQUITIES

ACTIVITY RATES

1966

Account Size (Millions of Dollars)	Number of Accounts	Unweighted Rates		Weighted Rates	
		Cash Transactions	All Transactions	Cash Transactions	All Transactions
0 - 10	21	30.39	41.91	26.14	30.78
10 - 50	11	11.35	12.33	11.27	12.24
50 - 100	11	11.21	13.01	11.05	12.85
100 - 200	6	18.64	20.55	18.55	20.44
Over 200	6	8.18	9.21	9.47	10.71
All Companies	55	19.04	24.32	11.99	13.49

SOURCE: Computed from data received in Study questionnaire, Form I-26.

TABLE VI-122

LIFE INSURANCE
GENERAL ACCOUNTS
COMMON EQUITIES

TURNOVER RATES
1967

Account Size (Millions of Dollars)	Number of Accounts	Unweighted Rates		Weighted Rates	
		Cash Transactions	All Transactions	Cash Transactions	All Transactions
0 - .10	21	14.19	15.30	15.39	16.98
10 - 50	11	11.52	12.36	11.99	12.92
50 - 100	9	16.03	19.55	15.43	18.83
100 - 200	8	7.07	8.80	6.74	8.56
Over 200	6	8.63	9.21	8.57	9.16
All Companies	55	12.31	13.80	9.53	10.83

SOURCE: Computed from data received in Study questionnaire, Form I-26.

TABLE VI-123

LIFE INSURANCE
GENERAL ACCOUNTS
COMMON EQUITIES

ACTIVITY RATES

1967

Account Size (Millions of Dollars)	Number of Accounts	Unweighted Rates		Weighted Rates	
		Cash Transactions	All Transactions	Cash Transactions	All Transactions
0 - 10	21	29.83	32.68	32.34	34.71
10 - 50	11	17.91	18.86	18.67	19.71
50 - 100	9	21.22	24.67	20.27	23.60
100 - 200	8	15.64	17.35	15.15	16.94
Over 200	6	10.46	11.51	10.57	11.97
All Companies	55	21.86	24.07	14.01	15.74

SOURCE: Computed from data received in Study questionnaire, Form I-26.

TABLE VI-124

LIFE INSURANCE
GENERAL ACCOUNTS
COMMON EQUITIES

TURNOVER RATES
1968

Account Size (Millions of Dollars)	Number of Accounts	Unweighted Rates		Weighted Rates	
		Cash Transactions	All Transactions	Cash Transactions	All Transactions
0 - 10	16	10.96	15.16	12.26	18.90
10 - 50	10	26.34	27.35	20.78	21.77
50 - 100	12	16.17	21.11	16.60	21.89
100 - 200	10	16.47	20.56	15.07	18.66
Over 200	8	10.04	12.51	9.90	11.43
All Companies	56	15.68	19.20	12.40	14.91

SOURCE: Computed from data received in Study questionnaire, Form I-26.

TABLE VI-123

LIFE INSURANCE
GENERAL ACCOUNTS
COMMON EQUITIES

ACTIVITY RATES

1968

Account Size (Millions of Dollars)	Number of Accounts	Unweighted Rates		Weighted Rates	
		Cash Transactions	All Transactions	Cash Transactions	All Transactions
0 - .10	16	37.50	41.39	38.89	44.97
10 - 50	10	35.77	37.67	28.21	30.03
50 - 100	12	20.68	29.73	20.97	31.33
100 - 200	10	20.73	24.70	19.74	23.17
Over 200	8	15.36	20.39	13.90	16.76
All Companies	56	27.43	32.25	16.98	20.92

SOURCE: Computed from data received in Study questionnaire, Form I-26.

TABLE VI-126

LIFE INSURANCE
GENERAL ACCOUNTS
COMMON EQUITIES

TURNOVER RATES
1969

Account Size (Millions of Dollars)	Number of Accounts	Unweighted Rates		Weighted Rates	
		Cash Transactions	All Transactions	Cash Transactions	All Transactions
0 - 10	14	14.62	16.65	19.29	22.40
10 - 50	12	25.87	29.35	25.87	29.15
50 - 100	14	18.91	22.39	19.15	22.57
100 - 200	9	16.17	20.42	14.72	18.36
Over 200	8	12.39	14.35	10.96	12.58
All Companies	57	17.97	21.01	13.62	16.00

SOURCE: Computed from data received in Study questionnaire, Form I-26.

TABLE VI-127

LIFE INSURANCE
GENERAL ACCOUNTS
COMMON EQUITIES

ACTIVITY RATES

1969

Account Size (Millions of Dollars)	Number of Accounts	Unweighted Rates		Weighted Rates	
		Cash Transactions	All Transactions	Cash Transactions	All Transactions
0 - 10	14	27.55	30.30	31.67	36.28
10 - 50	12	33.62	39.47	33.93	37.80
50 - 100	14	25.53	29.92	25.85	30.08
100 - 200	9	19.84	23.66	18.10	21.33
Over 200	8	15.27	17.04	13.33	14.83
All Companies	57	25.39	29.23	17.15	19.52

SOURCE: Computed from data received in Study questionnaire, Form I-26.

TABLE VI-128

Turnover and Activity Rates for General Accounts and Separate Accounts Combined
Annually: 1965-1969

Year	Turnover Rates: General Accounts	Turnover Rates: Separate Accounts	Turnover Rates: Combined Accounts	Activity Rates: General Accounts	Activity Rates: Separate Accounts	Activity Rates: Combined Accounts	Activity Rates: Memo: Regular SEC Activity Reports
1965	7.5%	2.5%	7.4%	10.6%	39.6%	11.4%	13.6%
1966	8.2	3.8	8.0	13.5	40.1	15.2	15.8
1967	10.9	9.4	10.7	15.8	37.8	18.5	18.5
1968	14.9	26.3	16.9	20.9	47.3	25.5	26.2
1969	16.1	30.5	19.7	19.5	51.0	27.3	29.0

NOTE: Turnover and Activity Rates are dollar weighted. All columns except the last report rates computed for insurers which completed trading questionnaires for both their general and separate accounts. The last (memo) column reports industry figures reported regularly by the Commission in its Statistical Bulletin.

Table VI-129

Regression Statistics for 1969
General Account Turnover Analysis

Independent Variable	Turnover: Regression Coeff.	Turnover: "t" value	Log Turnover: Regression Coeff.	Log Turnover: "t" value
Account Common Stock Holdings	-.014	1.06		
Log Account Common Stock Holding			.0079	0.09
Ratio: AMEX plus Other to Common Stock Holdings	.431	2.82	2.55	3.13
Ratio: Common Stock to Assets.	-.528	0.79	-5.17	1.36
Constant	-0.205		-2.14	
$\overline{R^2}$	.16		.17	

6. Problems of Preferential Treatment in the Management of Various Types of Accounts

a. The problem

The proliferation of investment accounts managed by some life insurance companies' investment personnel, including a general account, various types of separate accounts, mutual funds, real estate investment trusts, venture capital funds and portfolios of various insurance or other types of affiliates raises questions with regard to how conflicts among differing interests are and should be handled in the management of multiple accounts.[379] Several groups of interests may be involved and affected by investment decisions. These include the stockholders of the insurance company, the management of the insurance company and the various groups of shareholders, policyholders or contractholders which have participating interests in the various accounts. Stockholders are, of course, absent from the group of parties involved in decisions made by mutual insurers.

There are a number of types of investment decisions which can involve choices having differential impacts upon these various parties. For example, conflicts may arise when an insurer is a creditor to a particular company in its general account but an equity shareholder of the company in a separate account. If the company experiences financial difficulty, enforcement of indenture provisions may be wise from a creditor's viewpoint, but may impair the shareholder's position. The creation of a real estate investment trust by an insurer raises questions with respect to how attractive real estate loans will be allocated between the real estate investment trust and the insurer's own (general or separate) accounts. Similarly, when more than one account is engaged in a program of purchasing or selling the same security, allocation problems can arise. Another type of allocation decision which was quite prominent in the 1960's involved allotments of new equity issues among various accounts under management.

This section will focus on the last two types of allocation decisions on which the Study gathered a limited amount of information. Problems arising in the treatment of various accounts can reflect varying degrees and types of conflicts. In many cases, the insurers' management or stockholders may be largely unaffected by the resolution of an allocation problem, that is, simply a matter of equitable treatment of accounts is involved. In other instances, however, the growth and net income of the insurer, and thereby the welfare of management and/or stockholders, may be affected. Thus, for example, it may be in the interest of management to give preferential treatment to a separate account which contains substantial interests of one or more investment performance-conscious employers who are likely to increase the flow of pension plan contributions to the insurer if the separate account performance is superior and reduce contributions or withdraw assets from the account if performance is unsatisfactory.

b. Allocation of securities in a joint acquisition or disposition program

When more than one account is buying or selling the same security over a period of time, allocations among accounts may matter because

---

[379] As observed below, conflicts and problems of achieving some standard of equity in treatment of various interests arise also when only a single account is managed, where that single account contains interests of many participants, shareholders or contractholders with varying investment objectives.

if the trades are being placed on the basis of information, or if the trading itself is of sufficient scale to have price impacts, then early trades in the purchase or sale program are more likely to receive better prices. Insurance respondents were asked to "describe any policy of your company governing the allocation of purchase or sale transactions among various accounts, other than registered investment companies; [380] where an acquisition or disposal program requires a period of days or weeks to complete; for example in a purchase program, how is it determined which account will receive which day's purchases and at what price." [381]

Just over half of the respondents, including the preponderance of smaller companies in the sample indicated that they had no policy governing allocations in joint transactions, usually because no problem had arisen. The lack of any problem was explained in some cases by the fact that only one account (the general account) was being managed, or that separate accounts were relatively new, or that the accounts were sufficiently small and/or only stocks with a large floating supply were held or purchased so that any purchase or sale decision always could be completed within a single day.[382] One large company replied that it had a policy of always completing multiple account purchase or sale programs during a single day.

Four companies responded that they had a policy of avoiding conflicts by having the different managers for the various accounts enter separate orders which are placed separately (and chronologically). Thus, one of these companies stated:

"Without exception, purchases and sales, for the Company's General Account and Separate Investment Account are made individually for each account. *No* commingled transactions are made. No allocation of any purchase or sale of securities among the two accounts has ever been made."

Most of the largest companies reported that they had a policy of trying to allocate each day's trades in the most equitable way possible; generally, in proportion to the size of each account's order or its position to be liquidated. Under this policy each account receives the average price of transactions executed during the day and normally all accounts share proportionately in the quantity discount. Fourteen companies responded that equitable treatment of accounts was their goal. Typical replies included the following:

"In a program being carried out over an extended period of time, each account receives its pro rata share of each day's activity based on the ultimate position desired for the account in the case of purchases, or based on the relative size of the position in the case of sales. Variations from this procedure are necessary on purchases when an account does not have sufficient cash to participate fully. Also allocations are not generally made which would result in less than round lot purchases for an account in a single day. Each participating account receives the average price of our transactions in a stock for the day.

"It is our policy to pro rate purchases and sales to all unregistered accounts at an average price. The exception would be if one small account has an order for

---

[380] Because of impending discussions between the Commission staff and industry representatives concerning the applicability of Section 17(d) of the Investment Company Act (which requires prior Commission approval of joint transactions involving registered investment companies) to simultaneous purchase or sale programs involving more than one account, including a registered account, the Study agreed to exclude registered accounts and funds from the reach of this question. However, some insurers did respond with regard to their registered accounts as well as other accounts.

[381] See Form I-52, Part C, Question 27.

[382] In a few cases, the insurers had carried out purchase or sale programs, but had not yet formulated an allocation policy.

200 shares and a large account has a 100,000 share order. We would then complete the small order first."

"Policy is, to the extent practicable, to allocate purchases or sales proportionately among various accounts all at the same price."

"Our usual procedure is to allocate each day's purchases between our main account and our separate account. The transaction price is determined, to some extent, by the number of shares and prices shown on invoices, but an effort is made to equalize the price for each account if the difference in transaction prices is material. Small price differentials are usually in favor of the separate account . . . Commission expense is prorated so that the separate account receives the same quantity discount as the main account."

"Each day's transactions are handled on an aggregate basis, and allocated to the portfolios involved on an average price basis."

"Purchase and sale transactions for various accounts are executed in the order received. If more than one account is buying or selling the same security at the same time the executions are prorated between accounts based upon the size of the account."

A fourth type of response was received from eleven companies. These answers suggested that some sort of conscious priority was established, with small accounts, or registered accounts, or separate accounts generally or "performance-minded" portfolios receiving the highest priority. Examples of these replies include:

"There is a priority given to Separate Accounts."

"The most favorable executions are placed in the most performance-minded portfolios."

"Since our separate amount includes specific pools of money, we give it preferred status in the execution of buy or sell transactions over the general account."

"When the purchase or sale of a certain security is authorized for all accounts at the same time, the Variable Annuity accounts, being registered investment companies, are satisfied before the general account. However, it is up to the portfolio manager to determine which Variable Annuity account should be satisfied first. The portfolio manager bases his decision on which of the variable annuities' programs the purchase or sale best satisfies."

"Allocations if needed are given preference in inverse ratio to size of accounts. . . . such a situation has not occurred to date. Since it could happen, however, the policy has been established to complete transactions for the smaller account first."

"Should such a conflict arise where the same security was to be acquired, or disposed of, in more than one account in a specified period of time, preference would be given in order to the Mutual Fund, Separate Account and General Account."

"In a purchase program, we assign the lowest cost purchases bought during a day's trading to portfolios where there is outside ownership or beneficial interest. Thus we give priority to those portfolios that benefit others than the stockholders of [the insurer]. On sales we give the best prices to outside portfolios. Once we have given priority to the outside accounts, the remainder of purchases or sales are prorated among the "in-house" portfolios involved." [383]

It would be useful to design a statistical basis for testing the presence or absence of preferential treatment among accounts in the allocation of securities. One approach to such a test can be illustrated here by use of the limited experience which is available for life insurance companies.

Study questionnaire Form I–1 collected monthly data on the purchase and sale of about 800 equity security issues for the 21-month

---

[383] Follow-up inquiry of this respondent insurer confirmed that "out-side" accounts refer to separate accounts serving as funding media for pension-benefit plans. The "in-house" accounts consist primarily of the general accounts of the respondent and affiliated insurers.

period, January 1968 to September 1969. Among the institutional respondents to this questionnaire were the 26 largest life insurers measured by the market value of common stock of U.S. issuers held as of December 31, 1968. Four of these companies were Canadian.[384] The life insurance responses permit the Study to segregate within each company the trading in three distinct classes of accounts, *viz.*, (1) the general accounts; (2) all separate accounts established for a single customer, and (3) all commingled separate accounts. Data were not available on other accounts under management.

Of the 26 companies reporting trading data, six were dropped from the analysis for lack of any reported joint transactions between any two of these three categories of accounts.[385] A "joint transaction," for this purpose, occurred whenever any two of the three categories of accounts in a company purchased (or sold) the same security during the same month.[386]

Thus, 20 companies reported one or more instances when more than one account group purchased (sold) the same security in the same month. Over the 21-month period there were 326 matches where an insurer's general account and single client separate account acquired or disposed of the same security in the same month. There were 802 such matches between general accounts and commingled separate accounts and 752 between single client and commingled separate accounts.

Most of these matches were concentrated in a few companies. Thus the five insurers who had more than 100 matches over the period account for nearly 70 percent of all matches. Each of these insurers reported that their allocation policy was to treat accounts equitably. In fact, less than ten percent of the matches came from insurers which reported a policy of favoring specific types of accounts.

Each time a match was found the average price paid (received) by each account group was computed as the ratio of the dollar value of the account's purchases (sales) to the number of shares purchased (sold) during the month. Treating the three account groups two at a time the percentage price difference between account groups was computed and unweighted and dollar-weighted mean percentage differences were calculated for all matches over the 21 months for each company and for all companies combined.[387] The weighted means, of

[384] TIAA–CREF were also included in this sample. For purposes of the analyses that follows TIAA is treated as a "general account" and CREF as a commingled separate account.

[385] Four of the U.S. insurers had no separate accounts in operation during the period. One Canadian insurer did not segregate its separate account trading and a second Canadian company reported no months in which joint transactions occurred.

[386] Some companies, of course, have only two categories of accounts; a general account and one or more commingled separate accounts.

[387] Percentage price differences were computed as the ratio of the absolute price difference (preserving the positive or negative sign) to the average of the two prices times 100. The unweighted means are computed as the algebraic sum of all percentage differences divided by the number of stock-month matches. The weighted mean is weighted by the total dollar value of each transaction match for the two accounts combined. Thus if Pij = the percentage difference on stock transaction j for company i; Gij = the market value of shares bought (sold) in the *jth* transaction by the *ith* company's general account; Sij = the market value of shares bought (sold) in the *jth* transaction by the *ith* compay in all single-client separate accounts; and Ni = the number of stock-month matches for company i, then the weighted mean is equal to

$$\frac{\sum_{j=1}^{Ni} Pij(Gij+Sij)}{\sum_{j=1}^{Ni} (Gij+Sij)}$$

course, attach more importance to price differences produced by large trades while unweighted means attach the same significance to each trade regardless of size. Standard deviations and 't' statistics were computed for each of the means. These measures are used to determine whether the mean percentage differences are statistically significant.[388]

A final measure of the extent of preferential treatment is simply the percentage of positive (negative) price differences found in each of the comparisons between account groups. These percentage counts are summarized for all matches for all 20 companies combined in Table VI–130. Positive price differences in this table represent those cases in which the first of the two account groups identified in any pairing received more favorable [389] prices on joint transactions. Negative differences mean the second account group identified received the more favorable prices. Thus, commingled separate accounts received more favorable prices on 50 percent of joint transactions with single client accounts, while single client accounts received the better price on 44.7 percent of such trades and identical prices were received by both account types on 5.3 percent of joint trades. Similarly, a positive mean percentage difference indicates that single client accounts received better prices on the average than commingled accounts and a negative mean indicates that commingled accounts were favored. All the mean percentage differences are very small, the standard deviations are very large relative to the mean values and the 't' statistics all have very low values which means that there is no evidence of systematic price discrimination between any of the account groups examined.

Examination of similar summary statistics for each of the 20 companies uncovered some cases in which the percentage of positive versus negative price differences deviated substantially from a 50–50 split, but these cases favored different account classes in different companies and in no case do 't' statistics indicate that the mean price differences are significant.[390] Thus, on the basis of this limited experience there is no evidence that life insurers favor general account, single client separate account or commingled separate account portfolios in allocating acquisitions or dispositions of securities where the same security is bought (sold) for more than one of these classes of accounts in the same month.[391] It is, of course, possible that within the aggregates of separate account classes used in this analysis, preferential treatment is given, but these results provide no basis for assuming that to be the case.

---

[388] Percentage price differences are significant when standard deviations (the variation about the mean) are small relative to the mean value. In accordance with conventional standards of statistical significance the 't' statistics which are the ratio of mean percentage differences to the standard deviation indicate that the price differences are significant when the 't' values are greater than 2.0 or less than −2.0.

[389] More favorable meaning, of course, lower prices on acquisitions and higher prices on dispositions.

[390] In fact, there are no instances in which 't' statistics have values outside the range from +1 to −1.

[391] Attempts at providing preferential treatment could, of course, fail because of poor forecasts of price movements. This analysis can only distinguish attempts which are successful in favoring the intended account classes.

Table VI-130

Price Discrimination Analysis: Summary Statistics For All Companies

Statistic	Groups 1-2	Groups 1-3	Groups 2-3
Matches	326	802	752
Zero Differences	12	19	40
Percent of Total	3.7%	2.4%	5.3%
Positive Differences	162	398	336
Percent of Total	49.7%	49.6%	44.7%
Negative Differences	152	385	376
Percent of Total	46.6%	48.0%	50.0%
Unweighted Means	-0.02	0.04	0.01
Unweighted Std. Dev.	3.01	3.04	2.09
Unweighted T-Value	-0.01	0.01	0.01
Weighted Means	0.10	-0.16	-0.03
Weighted Std. Dev.	2.81	2.71	1.91
Weighted T-Value	0.04	-0.06	-0.01

Note: Group 1 - General Accounts; Group 2 - Single-Client Separate Accounts; Group 3 - Commingled Separate Accounts. A zero difference is defined as a percentage price differential of less than +.005 percent.

Source: Data reported by 20 life insurance companies on Questionnaire Form I-1.

c. Allocation of new issues among accounts

Another means of giving preferential treatment to particular types of accounts is through allocation of limited quantities of economically attractive securities, such as new common stock issues,[392] among the accounts. During the 1960's, prices of new issues often rose to substantial premiums above their initial offering price in after-market trading. Consequently, acquisition of shares in the initial offering frequently proved to be quite profitable.

Insurance company respondents were asked to describe any policy they followed in the allocation of such attractive securities, "... among various accounts with similar investment objectives, other than registered investment companies." [393] Of 60 companies responding, 35 indicated that they had no policy because they managed only one account, or had only one account whose objectives were considered in keeeping with the purchase of new issues,[394] or never purchased such securities, or simply had not gained enough experience managing multiple accounts to have formulated a policy. Of the remaining companies, a dozen reported that they had a policy of treating accounts equitably which usually was defined to mean allocating scarce issues in proportion to the size of the various accounts' portfolios, or (because amounts involved were small), establishing a rotation system. Three others indicated that *pro rata* allocation was their basic policy but where the amount of a new issue which was obtainable was small, they would place it in one of the smaller accounts. Finally, ten companies replied that some sort of preferential treatment existed as a matter of policy; most often meaning that small separate accounts were favored.

Responses which illustrate the various stated policies include the following:

"As a practical matter we have done very little in new issues. Our policy is, to the extent practicable, to allocate limited quantities of these issues proportionately among various accounts all at the same price."

"When more than one account is purchasing a security which is economically attractive and in limited supply we allocate the amount available to us to each account on a rotating basis."

"New issues of common stock are distributed to accounts on a rotating basis weighted by asset size."

"Portfolio managers state their requirements with respect to new issues to our securities transactions personnel prior to the offering being made. These requirements are then filled as nearly as possible on a pro rata basis."

"... a determination would be made as to the number of shares desired in each account and available securities would be allocated on a percentage basis, although distribution on a round lot basis would normally be made."

"We try to allocate such issues pro rata in proportion to the size of the accounts. There are instances where one Portfolio Manager may want a particular issue and another Portfolio Manager may not want it. If the number of available shares of a security is so small as to create a practical problem of allocation on

---

[392] The Study defines a "new stock issue" as an initial offering of stock of a company which previously had no publicly traded stock.

[393] See form I–52, Part C, Question 28. Registered investment companies were excluded from this request for the reason outlined in note 382, above. Some insurers did include registered investment companies in their response.

[394] The Study's question was phrased in terms of allocation among accounts with similar objectives. It could be argued that new issues were appropriate short-term investments for portfolios in which such issues would not be considered appropriate as longer term holdings, because gains could frequently be realized through sale in the after-market. Differences in the tax status of accounts, of course, affect the net returns which could be obtained in this fashion.

a pro rata basis, the security will be divided on what appears to be an equitable basis under the circumstances."

". . . the size of the [general] account is 100 times the aggregate of the separate accounts. Therefore, these problems have not become significant. When they do, however, any allocation of securities purchased or sold will be made on a proportionate basis where possible."

"The mutual fund requires that securities of any company have a record of at least three years continuous operation. Naturally, this restriction precludes the use of new issues in the mutual fund where the issuer has not been in existence for at least three years. The rest of the portfolios receive in turn their equal share of the economically attractive issues as they become available over a period of time."

"Although the investment objectives of the general account and separate account are not exactly the same, there are occasions when new issues could be purchased for each of the accounts. In actual experience to date there has been no problem since new issue purchases have been allocated proportionately according to size of account. If a quantity of stock available is not sufficient to accomplish this, it would be placed in the account whose objectives were best suited by the particular issue. In the event that no distinction could be made on this basis, the allocation would be made to that account for which the size of the purchase was most suitable."

"Allocation of new issues among accounts has not presented any particular problem. Where an issue would generally qualify for the investment objectives of more than one account, allocation of available quantities would generally be in proportion to the normal size of investment units in the respective accounts. With some exceptions, the normal buying unit for new issues qualified for the general account is small enough that needs can be filled. Where the total issue is small or the available supply doesn't approach the normal general account buying unit, we may not attempt to buy, or divert the available supply to a smaller account."

"Generally, we have not been buyers of new issues of the so-called "hot companies" where allocation of securities is a problem. If we can only obtain a small position, i.e., less than $200,000, of a common stock or convertible debenture it has been purchased by the separate account. On larger purchases it is divided between the accounts."

"We do not buy initial offerings of common stock. However, in the case of a thinly capitalized company which we feel is attractive, the size of an account determines whether the stock will be used in that account, i.e., a stock would not be allocated normally to a large account if the total holding obtainable would amount to only a small fraction of one percent of the overall account. In the case of accounts of equal size where it appears there will be sufficient stock for only one or two accounts, we would allocate that issue to one or two accounts and the next comparable issue to other accounts."

"Limited quantities of securities are placed in companies where their size in proportion to the total size of the portfolio represents a significant position."

"These are assigned to portfolios where there is an outside ownership or beneficial interest.[395] Thus, we give priority to those portfolios that benefit other than the stockholders of [the insurer]."

"On limited quantities of securities available, the smaller unregistered accounts receive the allocation. The amount received might be meaningful to a small portfolio, yet not have any appreciable effect on a larger one."

"Economically attractive securities—new stock issues—are infrequently purchased. In the few instances that such shares have been acquired, the amount purchased has been so small as to be an appropriate holding for only the smallest account."

"Allocations, if needed, are given preference in inverse ratio to size of accounts."

"The portfolio manager determines which Variable Annuity account should receive the securities. The portfolio manager bases his decision on which of the variable annuities' program the securities best satisfy."

---

[395] See *id.*

A possible reason for preferential treatment of separate accounts and mutual funds not explicitly stated in any of the insurer responses is that these accounts tend to have higher turnover rates.[396] Since the availability of new issues may depend upon the amount of brokerage business produced, an equitable allocation policy might be considered by insurers to be one in which allotments are made proportionately to brokerage commissions generated.

In relating the allocation of new issues among accounts to the size of accounts, the most reasonable size measure is the market value of common stock holdings. The Study's analysis of new issue activity collected detailed information on purchases of 84 equity security issues during the 18 months beginning with January 1968.[397]

Institutional investors purchased $58.6 million of these issues at offering of which $3.7 million were purchased by (15) life insurance companies. Most of these life insurers were relatively small companies not included in the Study's sample of life insurers. In fact, the Study had complete reports on common stock holdings of various types of accounts from only six of the 15 insurers.[398] Table VI–131 shows that these six insurers accounted for 39 percent of the amount of these issues purchased by life insurers. However, nearly all of the life insurance company purchases not accounted for by the six companies were purchases made for general accounts, and (to a more limited extent), registered separate accounts. Thus, it would appear that there were no allocation decisions facing the remaining nine insurers in most of their new issue purchases.

The six companies for which we have complete data on common stock holdings by portfolio type include four of the ten largest insurers, three of whom indicated that they had a policy of allocating new issues among accounts in proportion to size or "rotated" accounts in allocating such issues. The fourth reported that small unregistered accounts received preference.[399] The other two had no stated policy.

Table VI–132 compares the allocation of new issues among accounts for the six companies combined with the allocation of all common stock holdings among accounts. Investment companies received the greatest share of new issues relative to their size; each separate account type also received disproportionately large shares while general accounts and "other" accounts (most of which are general accounts of affiliated life insurers or portfolios of affiliated property and liability insurers) received small shares relative to the value of their common stock holdings. Thus, although general (and "other") accounts received nearly 60 percent of new issues acquired by the 15 companies, these accounts fared much less well among the subset of six insurers which had a greater variety of accounts from which to choose in allocating new issues.

---

[396] See sec. F.5 above for a comparison of general account and separate account turnover rates.

[397] See ch. XIV.

[398] That is, only six of the 15 were respondents to both questionnaires Form I–50 and I–52.

[399] This insurer accounted for 11 percent of the amount purchased by the six companies.

Table VI - 131

Purchases of New Issues at Offering by Life Insurance Companies

Account Type	Dollar Value of Shares Purchased 15 companies	6 companies	Percent Accounted for by 6 Companies
General Account	$2,202,090	$ 182,570	8.3%
Registered Separate Accounts	$ 347,131	$ 135,175	38.9%
Non-Registered Separate Accounts	$ 612,350	$ 612,346	100.0%
Investment Companies	$ 429,880	$ 385,420	89.7%
Other Accounts	$ 132,274	$ 131,974	99.8%
TOTAL	$3,723,725	$1,447,485	39.9%

Source: Responses to Questionnaire Form I-72.

Table VI-132

Allocation of New Issues by Account Type

Account Type	Account Common Stock Holding ($millions)	Percentage of Common Stock Holdings by Account	New Issues Purchased (dollars)	Percentage of New Issues Purchased by Account
General Account	$1,135.4	41.7%	$ 182,570	12.6%
Registered Separate Accounts	$ 33.1	1.2%	$ 135,175	9.3%
Commingled Non-Registered Separate Accounts	$ 346.2	12.7%	$ 419,210	29.0%
Single-Client Separate Accounts	$ 191.8	7.0%	$ 193,136	13.3%
Mutual Funds	$ 52.7	1.9%	$ 385,420	26.6%
Other Accounts	$ 964.5	35.4%	$ 131,974	9.1%
TOTALS	$2,723.7	100.0%	$1,447,485	100.0%

Source: Responses to Questionnaire Forms I-50, I-52 and I-72.

d. Concluding comments on treatment of various accounts

The purpose of this section has been to highlight certain conflict situations which can arise from the management of multiple accounts and to tentatively explore means of detecting preferential treatment. As reasonable standards of equity in the treatment of various accounts are established, means of testing for specific types of favoritism may need to be developed. The empirical tests used here and the results displayed are meant to be suggestive only.

Also, it does not necessarily follow that life insurers are placing themselves in more serious conflict situations by multiplying the number of accounts under management. Problems of equitable treatment among policyholders and contractholders have long existed as a result of insurers placing a very heterogeneous collection of interests in a single commingled general investment account.

When interests of customers with widely varying investment needs are pooled into a single investment account, then no given customer can be well served by an investment decision without compromising some other customers' interests. In addition, of course, the choice of a method used to credit investment return to various customers' contracts involves serious questions of equitable allocation. Thus from this perspective, the breaking of the one large commingled account insurers traditionally maintained into separate accounts, each of which serves a group of interests with relatively homogeneous investment objectives, is a constructive step which permits investment policies to be tailored to the needs of those contractholders with interests in an account. On the other hand, the creation of multiple accounts does raise allocation problems among accounts of the sort which have been highlighted in this section. However, these problems of equitable treatment of various accounts are much more in the open than the judgments made in managing large commingled accounts, and the possibility of defining and achieving standards of fairness is more feasible in a multiple account environment.

G. SUMMARY AND CONCLUSIONS

1. Coverage and Focus

The analyses of life insurance companies focused upon life insurers in their capacity as investment managers. In so doing the chapter has documented the competitive pressures and opportunities which have produced a greater emphasis upon the industry's investment management function and has analyzed the evolution of life insurers as investment managers in four parts. First, changes in the structure of the industry and in the growth rates of various lines of business were described with emphasis upon the expansion of insurers' activities through affiliates and the development of equity based products designed for sale to individuals. Second, the chapter documented the responses of life companies during the late 1950's and the 1960's to the declining share of pension-benefit plan assets managed by insurers and provided measures of the joint success achieved by these responses in returning life insurers to a more competitive position in this portion of their business. Among the several responses was the creation

of special separate investment accounts tailored to serve, in particular, the equity investment needs of pension-benefit plans. The development, growth, and characteristics of separate accounts were analyzed in a third major section of this study.

Finally, the analysis concluded with an examination of life insurers' investment organization, management practices, and policies.

2. Development of Individual Equity Based Products

a. Industry structure and recent developments

At the end of 1969, there were over 1,800 legal reserve life insurance companies operating in the United States with total assets of $197 billion. In addition, Canadian life insurers, several of which are included in the Study samples of life companies, held $15.8 billion. By number, over 91 percent of life insurers are organized as stock companies. However, the 156 mutual companies account for better than two-thirds of industry assets.

The insurance industry is relatively highly concentrated; a smaller number of firms account for a higher proportion of industry assets under management than is true for bank trust departments or the investment advisory industry. Fifty percent of industry assets are held by only seven insurers. Separate account assets and group annuity reserves are even more concentrated. However, concentration in the industry has been slowly declining for many years with the entry of new firms and the higher growth rates achieved by younger firms.

In recent years, life companies have found that the environment in which they function has become more intensely competitive due to (1) the aggressive competition of bank trust departments, and recently, investment advisory complexes, for management of pension-benefit plan assets; (2) mutual funds encouraging individuals to save through mutual fund shares rather than cash value insurance; (3) other financial institutions developing full financial service packages, including insurance; and (4) industrial and conglomerate corporations invading the insurance business. Insurers have responded to these pressures by (1) expanding and diversifying their activities through subsidiaries and via the creation of holding companies; (2) offering group and individual variable annuity products; (3) entering the mutual fund business; (4) preparing the way for variable life insurance; (5) developing equity funding arrangements and modern flexible contracts for pension-benefit plans, including offering administrative and investment services to pension-benefit plans without insurer assumption of mortality and morbidity risks; and (6) building up their investment skills, concentrating more effort on the management of invested assets, and in particular, increasing their activity in various types of equity investments.

b. Financial integration

Stock and mutual insurers have expanded their activities through the creation of subsidiaries. In most instances these subsidiaries are engaged in businesses reasonably ancillary to the insurance business, including investment management. However, those stock companies which are interested in making full use of existing capital, increasing their means of raising funds, and diversifying widely have created

upstream holding companies to accomplish these objectives. The acquisition or creation of noninsurance affiliates accelerated rapidly during 1968–69. In fact, over three-quarters of the noninsurance affiliations reported by the Study's sample of life insurers as of the end of 1969, had been consummated during those two years.

Not surprisingly, State insurance regulators have viewed this proliferation of noninsurance activities with concern, particularly where control of insurers by noninsurance enterprises results. At the heart of this concern is the fear that extensive conflicts of interest are being created between controlling persons and policyholders and other shareholders of the insurers involved.

c. Individual equity based products

Life insurers' decisions to offer mutual fund shares or variable annuities, or both, dramatically changed industry marketing strategies by introducing substantial customer participation in equity investment risks. As a result, some insurers are offering financial services which they recognize may compete with, rather than complement, the sale of insurance products. Most life insurers having made the decision to offer individual equity based products have chosen between mutual funds and variable annuities as the initial product, although virtually simultaneous introduction of both products has occurred.

Most respondent companies indicated that in deciding to enter the mutual fund field, three considerations were highly important: (1) developing a financial package more salable than traditional products in an inflationary environment, (2) increasing agents' income, and (3) increasing sales of individual insurance policies. In addition, exactly half of the 26 respondent companies which were offering fund shares regarded mutual funds as one step in the desired direction of creating a diversified financial institution.

Variable annuities are preferred over mutual funds by some insurers because they are viewed as a traditional product in modified form. The essence of a variable annnuity based on investment performance of an equity portfolio is that the annuitant assumes the investment risk. Individual variable annuities are securities which must be registered under the Securities Act of 1933 and the separate account used as a funding medium is an investment company required to register under the Investment Company Act of 1940. The Commission has provided insurers offering variable annuities under tax qualified pension-benefit plans substantial exemptions under these acts. The recently enacted Investment Company Amendments Act of 1970 provides statutory exemptions. Variable annnuities and separate accounts are also regulated under state insurance law.

For several reasons, including the time and resources required to retrain insurance agents, neither mutual funds founded by life insurers nor variable annuity policies have as yet made much of an impact. Sales of both these products are also undoubtedly affected by agents' compensation scales on various products. Differences in compensation appear to induce many agents to continue to concentrate their efforts on life insurance products, rather than on mutual funds or individuals (fixed or variable) annuities, except in specialized markets where tax considerations significantly affect buyers' purchase decisions.

Variable life insurance, defined to mean insurance contracts in which benefits vary with the investment performance of a separate account, are not being sold by any of the respondent U.S. insurers. Such policies are sold in Canada, England and Holland, and U.S. companies have been actively preparing to offer variable contracts by examining questions of actuarial design, working to obtain State authorization to offer such products and discussing the applicability of the federal securities laws to such products with the commission. The potential impact of variable life insurance appears to be much greater than that of variable annuities, and unlike insurers' entry into mutual funds, will directly affect the pace of insurance company investment in equities.

3. Life Insurance Companies as Funding Agents for Employee Pension-Benefit Plans: The Group Annuity Business

a. Life insurers and the competition for management of pension-benefit plan assets

In the early World War II period, at the point when collective-bargaining agreements began to play a major role in pension-benefit plan design, private pension-benefit plan funding was split about equally between insured contracts and various noninsured trusteed arrangements. Insurers subsequently fell behind noninsured funding media (primarily bank trust departments) in the competition for management of pension-benefit plan assets. In response to the deterioration in their competitive position insurers increased the flexibility of contracts and broadened the investment services offered so that, by the latter half of the 1960's, they had substantially improved their competitive position.

Insurers' competitive problems in this area were caused by (1) their inability to offer investment management, and particularly equity investment management, tailored to the needs of employers funding pension-benefit plans, (2) inflexibilities in group annuity contracts, (3) their inability to credit a competitive rate of investment return to pension-benefit plan customers, and (4) tax inequities. The development of separate investment accounts, more flexible deposit administration contracts, the investment year method of crediting investment return to contract holders and amendments to the tax statutes have removed these disabilities.

Insurers generally feel that they have regained a competitive posture in the business of managing pension-benefit plan assets. They regard their ability to offer a package of actuarial, administrative, and investment services as the most important competitive advantage they hold over banks and other noinsurance funding media which do not offer actuarial services in particular. Also of considerable importance is insurers ability to offer investment, mortality, and other guarantees. Insurers find their greatest competitive disadvantage results from banks' ability to develop close relationships with employers through their commercial banking business. The competitive environment also is significantly affected by banks' ability to establish closer relationships than insurers with pension consulting firms.

One possible index of the current intensity of competition for management of pension-benefit plan assets is the incidence of split fund-

ing, the allocation of a plan's assets among more than one investment manager. However, the desire to obtain aggressive competitive asset management is not the only reason employers choose to adopt split funding. In fact, some split funding between insurers and banks exists because group annuity contractual restrictions prohibited employers from fully terminating their insured contracts during the 1950's when many employers were shifting their plan funding from insurers to bank trust departments. Nevertheless, knowledge of the frequency of split funding and insurers' consciousness of the fact of split funding is of assistance in understanding the nature of competition for pension-benefit plan asset management.

On the whole, replies to Study questionnaires suggest a high degree of consciousness on the part of insurers of split funding. Twenty-five percent of the plans reported on by the respondent insurers were known by them to be split funded. As expected, the percentage is highest for the largest respondents, and declines with respondents' size. The responses also show that where a plan is split funded, nearly 60 percent of the time a bank is the competing funding agent, while other insurance companies are the other managers most of the rest of the time.

b. Growth and change in the group annuity business

The most dramatic change in the composition of group annuity contracts, evident during the period 1950 to 1969, is the increase in the more flexible deposit administration contracts at the expense of deferred annuities. This shift is especially pronounced since 1965. The growth in deposit administration contracts ocurred both as a result of substantial shifts in reserves from existing deferred annuity contracts and from the attraction of new deposit administration customers.

The concentration of business among a few large companies is greater in the group annuity line than in other lines of business in the life insurance industry. However, some modest dilution of concentration appears to be occurring.

c. Changes in funding medias the development and use of separate accounts

Separate accounts were developed initially for the purpose of providing a funding vehicle for pension-benefit plans funded by cost-conscious employers. Favorable investment results can substantially reduce the cost to employers of providing retirement benefits to employees. Separate accounts also are used to fund group and variable annuities, but variable benefits have not proved to be popular with most employers.

During the four years 1966–69, the proportion of group deferred annuity and deposit administration contract reserves funded in separate accounts grew from about 1 percent to 11 percent. By yearend 1969, the largest insurers in the group annuity business reported that cases accounting for over half of their group annuity reserves were making some use of separate account funding. However, only 14 percent of the number of outstanding group annuity contracts issued by these companies were taking advantage of the availability of sep-

arate accounts, indicating a much higher incidence of separate account use among the larger customers.

d. New business and terminated business

Growth of an insurer's group annuity business occurs both through growth of reserves in existing contracts and from newly acquired business net of terminated business. Although the primary source of growth for the industry as a whole derives from existing business, net new business makes a substantial contribution in some companies and analysis of the characteristics of new customer and terminating customers provides some clues to the trends in the demand for various insurer services.

The study found that most new cases have first been brought to the issuing insurer's attention by the insurer's representatives or by consulting actuaries. Banks, investment advisers or other noninsurance financial institutions seldom are sources of pension business to insurers.

The majority of new group annuity cases acquired by respondent companies during 1968–69 represented newly created pension-benefit plans. About 23 percent of the new cases in terms of estimated contributions (8 percent of the number of new cases) were removed from banks or other noninsurance funding agents.

The frequency of separate account funding in new cases is of particular interest since the availability of equity funding through separate accounts has been presumed to be of major significance in determining the ability of insurance companies to compete for pension business. The Study found that a significantly higher proportion of new customers as compared to existing cases, appear to make use of separate account funding. The larger cases appear more likely to make use of separate accounts than the smaller ones.

The primary reason pension plans terminated their contractual relationship with the responding insurers, or significantly reduced their contributions, was to shift assets to another funding agent, usually a trustee bank. This shifting among funding agents accounted for 50 percent of the number of cases lost or reduced, and 80 percent of the estimated loss in contributions, indicating that the loss of larger plans must usually have been due to the desire to employ another funding agent.

4. Separate accounts: Development, growth, characteristics and management fees

The Study collected information on nearly 200 separate accounts in existence as of yearend 1969. These included accounts holding 94 percent of the $3.6 billion in separate accounts in U.S. insurers plus $215 million in separate account assets of Canadian insurers. Separate accounts can be distinguished according to (1) whether or not the account is registered with the Commission under the Investment Company Act of 1940, and (2) whether the account commingles the assets of a number of contract holders or is established solely for a single customer. All registered accounts are commingled accounts. Nearly half the sample accounts (with one-third of the reported assets) are

single client accounts, about 60 percent of which were established in 1968–69.

All registered accounts are relatively small, most having assets of less than $10 million at the end of 1969, reflecting that the registered accounts are relatively new and primarily serve to fund contracts sold directly to individuals. In the nonregistered commingled account category, 54 of 70 accounts had assets of less than $25 million each, but five accounts, each with over $100 million in assets, contained about two-thirds of all nonregistered commingled account assets. Of these five large accounts, four were established in 1962 and the fifth in 1963. Most single client accounts are relatively small; accounts of less than $25 million make up 78 percent of single client accounts and contain 40 percent of assets in this account category. Nearly 98 percent of the assets in sampled separate accounts represent interests of tax qualified pension-benefit plans.

Most separate accounts have been established to provide equity funding through investment in common stocks. However, 25 of the 166 sampled unregistered accounts were intended to invest primarily in debt securities (eight accounts), mortgage loans (two) or in a mix of debt instruments and equity securities (15).

Among accounts with a common stock orientation, larger accounts, older accounts and commingled accounts tend to have higher proportions of their assets invested in common stock than do other accounts.

Insurers have in recent years been issuing contracts in which the investment features are much more significant than had previously been the case, and under which assets can be much more freely transferred to other funding agents. The investment and transferability features are often especially prominent in contracts which include the utilization of separate accounts as funding media. In some separate accounts this flexibility has been accompanied by dilution of insurers' responsibility to select investments and brokers as funding employers have retained some discretion in these decisions for themselves or for an investment adviser.

In nearly all cases investment management fees charged to separate accounts are based upon the net asset value of the account or upon each contract holder's interest in the account. In commingled accounts the fee rate is most commonly stated as a flat percentage of the account's assets. Where a schedule is used, as is the case for about one-third of the unregistered commingled accounts, the charge is usually levied against each participating contract holder separately. Graduated rate schedules are the norm for single customer accounts.

Multivariate regression analysis revealed that the size of a separate account and the size of the managing insurer jointly have a significantly negative impact upon investment management fee rates—fee rates are significantly lower for large accounts and accounts managed by larger insurers. Thus, at least to some extent, economies realized from account size and insurer size are passed on to customers. The results also indicate that when account size and other variables are given, commingled accounts pay higher fee rates than single client accounts. However, contrary to expectations, this analysis showed no observable tendency for registered accounts to charge higher fees once

their size, commingled status and other characteristics are taken into account. The results of this analysis also suggest that fee rates had an upward time trend over the 1966–69 period.

5. Portfolio Management: Investment Organization, Techniques, Policies and Results

a. Portfolios managed

Investment personnel of life insurance companies are responsible, together with supervisory investment committees and the companies' boards of directors, for management of the insurers' assets including separate account as well as general account assets. The 63 companies responding to the Study's life insurance intrinsics questionnaire held over $160 billion in general account assets at the end of 1969. The investment personnel in these companies also managed $3.3 billion of separate account assets. In addition, the same investment personnel managed $5.3 billion in property and liability insurer assets, the bulk ($4.5 billion) accounted for by three large insurance complexes, and $192 million in affiliated life insurance company assets. However, only a relatively small portion of the mutual fund assets reported by the responding companies are managed by the same personnel that manage the insurers' own assets.

b. Organization for investment decisionmaking

The ultimate power and responsibility for investment policy and practice resides in each insurer's board of directors. However, the effective policy body is usually a subcommittee of the board and is generally composed largely of outside directors, but may include two or three of the company's top officer-directors. This committee, most commonly known as the finance committee or the executive committee, sets the insurer's investment policy guidelines.

The committee exercises control over equity security selection and trading decisions through review of the trades and frequently through the use of one or more approved lists. With rare exceptions, respondents indicated that the finance committee does not direct the means by which trades are executed, including markets and brokers utilized.

c. Equity investment decisions

(1) Statutory investment restrictions

Insurance company equity investments are severely restricted by State insurance laws, and among the States, New York has occupied an especially influential and restrictive position. The statutes governing insurer investments impose quantitative limits affecting both total invesment in equities and investment in shares of any single issuer or on any parcel of property. The statutes also constrain insurers as to the characteristics of permissible equity investments. New York companies are limited to common stock investments not exceeding the lesser of 10 percent of assets or 100 percent of surplus. This limitation is, of course, confined to general account investments. In addition to specifically eligible investments, most States have a statutory "leeway" or "basket" clause which permits insurers to make investments not otherwise qualifying for insurers' portfolios.

Separate accounts are, of course, free of the aggregate limits on the proportion of portfolio assets which may be held in common stocks. In many States, including New York, any qualitative restrictions on the type of common shares which are eligible for life insurers' portfolios are applicable to separate accounts. However, such restrictions are normally offset by a relatively generous leeway clause.

(2) Equity security investment personnel and procedures

A full-scale securities investment operation utilizes a number of skilled personnel including portfolio managers, security analysts, professional traders and economic researchers, as well as various support personnel and the supervisory services of some of the highest ranking officers in the company. Among the larger companies the most significant increase in personnel between 1964 and 1969 occurred in equity security portfolio managers, analysts and traders. This increase was more modest for the smaller companies.

Of the several basic ways in which institutional investors can obtain information and recommendations which influence decisions regarding which equity securities to buy or sell, in-house analysis of financial statements is rated most important by companies in all size groups. For smaller companies, information and recommendations purchased from broker-dealers via commissions ranks next in importance. For the largest 10 companies information purchased with commissions from brokerage houses and direct contact with issuers were ranked as about equally significant.

d. Portfolio composition of general accounts

Although most separate accounts created by life insurance companies have been intended primarily for investment in equity securities, life insurance general account investments have been constrained by tradition, their fixed dollar liabilities and the type of statutory restrictions summarized above, to a primary emphasis upon fixed income obligations. However, the movement of assets into separate equity accounts has been accompanied in recent years by various forms of equity participation obtained with general account investments in directly placed corporate debt securities and mortgage loans.

Total industry general account assets grew from $149 billion as of year end 1964 to nearly $194 billion at the end of 1969. Corporate debt securities and mortgage loans continued to account for about three-quarters of general account assets during this period, although the distribution of mortgage loans held shifted markedly away from single family home mortgage loans to loans on apartments and commercial properties. Policy loans increased proportionately more than any other asset category, from 4.8 percent of assets in 1964 to 7.1 percent in 1969. This policy loan experience contributed significantly to a very tight cash flow situation for many companies and in some cases retarded planned increases in common stock investments. Common stocks, which unlike other insurance company investments are reported at market value, increased from 3.6 percent of general account assets in 1964 to 3.9 percent in 1969.

Restricted common stock issues held in general accounts of respondent companies amounted to just 2.2 percent of common equities reported. Common stocks listed on the New York Exchange account

for 96.5 percent of the five largest insurers general account common stock holdings at the end of 1969. The remaining companies as a group have about three-quarters of their common stock holdings in stocks listed on the NYSE. NYSE listed stocks make up about three-quarters of the value of all common shares outstanding. Approximately half of the non-NYSE stocks excluding bank and insurance stocks, consist of stocks which are listed on the American Stock Exchange, solely on regional exchanges or are unlisted.

During recent years life companies have been successful in obtaining additional compensation on directly placed corporate debt obligations and on mortgage loans secured by apartments, or commercial business or other nonresidential properties. This additional compensation can take many forms including common stock, real property, instruments convertible into common stock, warrants, various options to purchase equity securities or real property, provisions for sharing in the income or capital gains realized by the borrower and interest in residual values.

It appears that insurers' taste for equity kickers on debt instruments has been stimulaed and that they will continue to negotiate hard for such provisions even as interest rates decline from the historic high levels reached in 1968–1970. Some respondents indicated that as interest rates ease, the desire for equity provisions may induce them into investing in lower quality debt instruments.

e. Trading in common equities

(1) Separate account turnover and activity rates

As life companies have increased their holdings of common equity securities in recent years, they have also increased their trading activity in these securities. Common equity turnover rates [400] for separate accounts increased substantially during the period 1965–1969 inclusive, with the most dramatic increase occurring in 1968. This timing lags behind the increased turnover for mutual funds by about 2 years, but is roughly in line with that of bank managed corporate pension funds and property and liability insurers.

In general, activity rates [401] also increased over the same period, but the overall percentage increase is smaller than that observed for turnover rates and this pattern is not ubiquitous as was true for turnover rates. Thus, for example, there is no particular trend in activity rates for nonregistered commingled accounts, or for the oldest accounts or for the largest accounts.

The Study finds that the increase in turnover rates during the 1965–1969 period occurred over a wide variety of accounts and is not due to changing mixes of account characteristics. Indeed, most account and insurer characteristics do not contribute much to an explanation of the variations in turnover rates among accounts.

(2) Separate account investment performance, volatility and turnover

The Study collected data on separate accounts which permitted computation of rates of return for 80 of the reporting accounts.

[400] Defined as the lesser of acquisitions and dispositions of common equity securities during a calendar year divided by the average market value of beginning year and end year holdings.

[401] Defined as the average value of acquisitions plus dispositions during the year divided by the same average holdings used in calculating turnover rates.

Each of these account's volatility also was calculated. An account's volatility is a measure of the sensitivity of the market value of the account's assets to movements in general market prices of the same types of assets. Since most separate accounts are primarily equity accounts the market standard employed was the Standard & Poor's 500 Stock Index. Use of the volatility concept made it possible to segregate that portion of an account's return resulting from portfolio management from that portion which simply reflects movements in the general level of stock prices. This was done by comparing the return on an account to the return realized by a standard, unmanaged account of the same volatility.

During the period covered (the latter part of the 1960's), relatively low volatility accounts performed somewhat worse than hypothetical unmanaged portfolios while higher volatility accounts performed somewhat better. This pattern is similar to that observed for accounts managed by other institutions.

Of primary interest, however, was not the excess return attributable to management *per se*, but the relation between this performance measure and account characteristics such as turnover, the total value of account common stock holdings and the asset size of the insurer which manages the account. Although a significant negative relation is found between performance and turnover for mutual funds and bank collective funds, no significant relation between these two variables appears to exist for separate accounts. Thus, although the Study does not find turnover to be negatively related to investment performance for separate accounts during the latter half of the 1960's neither is there any evidence that higher turnover is associated with better performance.

(*3*) *General account turnover and activity rates*

For the five year period 1965–69, there was also a year-to-year increase in turnover rates for general accounts as a group; the increase however, was much more modest than that recorded by separate accounts. The largest increase occurred in 1968, as it did with separate accounts. General account activity rates increased in about the same proportion as turnover rates over the period. Although general account activity rates for insurers reporting on both general and separate accounts increased from 10.6 to 19.5 percent between 1965 and 1969, these insurers' activity rates as a whole (for general and separate accounts combined) increased from 11.4 to 27.3 percent during the period. This difference is explained by the growth of, and higher activity rates generated by, separate accounts.

Turnover rates for general account equity securities are less than those for equity holdings in separate accounts for at least two reasons: (1) contractholders in separate accounts are primarily cost-conscious employers who seek relatively aggressive investment management in the hope of obtaining substantial investment returns, and (2) while most separate accounts are free from income and capital gains taxation, insurers do incur taxes upon gains made from security sales in the general account. Questionnaire responses indicate that capital gains tax consequences have some effect upon general account security sales.

f. Conflicts in the treatment of various accounts

(1) The problem

The proliferation of investment accounts managed by some life insurance companies' investment personnel raises questions as to how conflicts among differing interests are and should be handled in the management of multiple accounts. Several groups of interests may be involved and affected by investment decisions, including the interests of stockholders of the insurance company, the management of the insurance company and the various groups of shareholders, policyholders or contractholders which have participating interests in the various accounts. Stockholders are, of course, absent from the group of parties involved in decisions made by mutual insurers. The Study focused upon two specific types of allocation problems that arise in the management of multiple accounts; namely, (1) where more than one account is engaged in a program of purchasing or selling the same security, and (2) allotments of new equity issues among various accounts under management.

(2) Allocation policies and practices

When more than one account is buying or selling the same security over a period of time, allocations among accounts may be quite important if the trades are placed on the basis of information, or if the act of trading itself has price impacts, since early trades in purchase or sale programs are more likely to receive better prices. Just one-half of the Study's respondents stated that they had no policy as to allocation of purchase or sale transactions among various accounts. This lack of a policy was explained in some instances by the fact that only one account (the general account) was being managed, or that separate accounts were relatively new, or that the accounts were sufficiently small and/or only stocks with a large floatting supply were held or purchased so that any purchase or sale decision could always be completed in a single day.

Most of the largest companies reported that they had a policy of trying to allocate each day's trades in the most equitable way possible, generally in proportion to the size of each account's order or its position to be liquidated.

However, 11 respondents reported that some sort of conscious priority was established, with small accounts, registered accounts, separate accounts, or "performance-minded" portfolios receiving priority.

The Study also computed average prices received by three classes of insurer accounts whenever at least two of those classes of accounts within a reporting insurer purchased (sold) the same stock issue in the same month. This was done for about 800 stocks over 21 months, January 1968 to September 1969. An analysis of these data, which reflect the limited experience life insurers have had managing multiple accounts, provides no evidence that insurers consistently favor general account, single client separate account or commingled separate account portfolios in allocating acquisitions or dispositions of securities where the same security is bought (sold) for more than one of these classes of accounts in the same month.

Another means of giving preferential treatment to particular types of accounts is through the allocation of limited quantities of economically attractive securities, such as new common stock issues. Substantial numbers of new issues rose from their initial offering prices in after market trading during the 1960's. Consequently, acquisition of shares in the initial offering frequently proved to be quite profitable. Ten companies replied that some sort of preferential treatment existed as a manner of policy—most often favoring small separate accounts.

The Study's analysis of new issue activity collected detailed information on purchases of 84 new equity security issues during the 18 months beginning with January 1968. Of the 58.6 million of these issues purchased at offering by institutional investors, $3.7 million were purchased by 15 life insurance companies. Most of these companies were relatively small and apparently managed only one or two accounts. Nearly all of the purchase of these new issues which were allocated to nonregistered separate accounts, investment companies and accounts of affiliated life or property and liability insurers, were made by just six insurers.

For these six insurers, investment companies received the largest share of new issues relative to the size of their total common stock holdings; each type of separate account (registered, nonregistered, commingled and single client) also received disproportionately large shares, while general accounts and accounts managed for affiliated insurers received small allotments relative to the value of their common stock holdings.

(3) Concluding comments on preferential treatment problems

The statistical tests used to detect the existence of preferential treatment among accounts are meant to be suggestive only. The study considers the question of equitable treatment of accounts to be important and believes that effort needs to be applied in developing standards of fairness.

Finally, the discussion of conflict problems which arise when multiple accounts are managed is not intended to suggest that insurers should resist the trend toward account proliferation. Serious conflict questions can also exist in the management of large commingled accounts containing interests of a variety of customers with varying investment needs. Where there are no clear differences in investment objectives, commingled accounts may facilitate fair treatment. But where clear differences exist, segregation of customers with relatively homogeneous investment requirements can be a more effective means of serving customers' investment objectives and has the further advantage of bringing questions of priorities into the open.

The Property-Liability Insurance Industry

H. INTRODUCTION

Property-liability insurance in the United States, hereinafter P-L insurance, is variously referred to as fire and casualty, property and casualty (with or without the conjunction) and nonlife insurance. The P-L insurance industry provides financial protection against virtually every type of peril. *Property* insurance provides financial

protection against loss or damage to the insured's property caused by such perils as fire, windstorm, motor vehicles and vandalism. *Liability* insurance provides protection for the insured against loss arising out of his legal liability resulting from injuries to other persons or damage to their property. In addition, accident and health insurance, which provides coverage that pays benefits including reimbursement for loss of income in case of sickness, accidental injury or accidental death, is written by some property-liability companies. However, health insurance is most often categorized with the life insurance business.

P–L insurance together with life and health insurance make up the combined insurance industry. One of the largest financial industries in the United States, the combined insurance industry, managed assets of about $250 billion in 1969. Life insurance companies managed about $197 billion [402] while P–L insurance companies alone held an aggregate of approximately $52 billion.[403] Thus, P–L insurance may be thought of as the subordinate part, as measured by aggregate assets, of a brother-sister act with life insurance. Life insurance companies experience substantial asset accumulation for two major reasons that have no counterpart in P–L insurance operations. First, in addition to covering the cost of pure insurance, most life premiums include a significant element of savings-investment by the policy owner. There is no savings-investment element in P–L insurance premiums. Second, most life insurance policies involve relatively long-term contracts but level or average premiums are charged over the life of the policy even though the cost of covering the insurance risk rises steadily over the life of the contract. Although P–L premiums are normally collected in advance of the period or periods the insurance is in effect, contracts are short-term and typically cover risks over periods of three years or less and frequently over only a one-year period. In terms of timing and amount there is a more immediate relationship between dollars collected as premiums and dollars paid out for claims and expenses in P–L than in life insurance.

P–L asset accumulation is dependent in part on underwriting experience although there has been erratic and generally unfavorable experience (underwriting losses) in recent years. The general growth in underwriting volume also contributes to asset accumulation since premiums are collected in advance of the claims payments that may result. The most significant factors contributing to asset accumulation have been the long-term appreciation in value of the common stock portion of P–L portfolios and the retention of significant amounts of investment income. The latter reasons are less important in mutual P–L companies since they attempt to offset profits from operations and investments with dividends to their policyholders. Aside from capital contributions from stockholders and mutual company founders, these are the major explanations of the accumulation of assets in P–L insurance companies. While the total assets of the P–L insurance industry are small compared with life insurance industry assets, with respect to investment in the securities markets it is significant to note that almost all P–L investment assets are in marketable securities while very substantial life assets are in privately placed issues and mort-

---

[402] *1970 Life Insurance Fact Book*, Institute of Life Insurance, 69.
[403] *Best's Aggregates and Averages, Property-Liability 1970*, at 1. A. M. Best Company.

gages. Furthermore, the estimated $14.0 billion [404] of holdings of publicly traded equity securities by the P–L insurance industry at December 31, 1969, compared almost equally with the estimate of $13.7 billion of stockholders of the life insurance industry.[405] This places both P–L insurance and life insurance immediately after noninsured pension benefit plans, investment companies, bank trust funds and foundations in sizes of stockholdings.

There are several reasons for including P–L insurance as an integral part of the Institutional Investor Study. These reasons also describe the several points of inquiry toward which the P–L section of this chapter is directed. First, as mentioned above, P–L is the complement to the life insurance industry and in many cases P–L and life insurance operations are carried on by affiliated companies and their investment activities are managed centrally. Second, P–L insurance is the fourth or fifth largest institutional group in equity holdings. Third, starting from a very low volume of acquisitions and dispositions of common stock relative to the size of their common stock holdings, the reported common stock activity rate [406] of P–L companies has increased dramatically in the last three years. From a range of 6.9 percent to 8.4 percent per year from 1962 through 1967, the P–L reported common stock activity rate increased to 12.8 percent in 1968 and jumped to 26.1 percent in 1969.

In addition, some observers feel that the existing published data on P–L acquisitions and dispositions of common stock, which include transactions in affiliated company stock, are misleading and produce erroneously high activity rate figures. Careful examination of these data over the last five years would permit this hypothesis to be examined and corrections made, if necessary, to produce a more reliable indicator for inter-industry comparisons of stock market participation. Fourth, notably absent are consolidated common stock and other asset holdings data for the P–L industry. These data are valuable since this industry is replete with complex organizations and with pyramids of affiliated insurance companies known as insurance groups.[407] The P–L industry has an abundance of individual company financial data published annually on uniform convention statements for state insurance commissioners, but there are no valid industry-wide consolidated asset figures for insurance groups. Because of the chain-like affiliation of insurance companies in some groups and with as many as 20 P–L companies in some groups, the presence of uniform individual company financial statements is no substitute for a consolidated group statement. The basic central source of P–L insurance industry-wide data is the A.M. Best Company, which compiles much of its financial data from these annual convention statements. In the

[404] U.S. Securities and Exchange Commission, Office of Policy Research.

[405] Institute of Life Insurance.

[406] The common stock activity is currently definied as the average of purchases and sales divided by the average market value of stock holdings at the beginning and end of the period, stated at an annual rate. Common stock activity rates are published quarterly in the *Statistical Bulletin*, U.S. Securities and Exchange Commission, April, June, September and December issues.

[407] A P–L insurance "group," formerly referred to as a "fleet," is defined herein as including any affiliated company writing property-liability insurance that directly or indirectly controls, is controlled by, or is under common control with another property-liability insurance company, whether by reason of common management, ownership or otherwise.

absence of consolidated statements for many insurance groups, Best's publishes aggregative data which are necessarily replete with double counting of common stockholdings within P–L groups. The knowledgeable user of these industry-wide data must make crude adjustments by subtracting the value of all insurance stocks from the P–L insurance industry's portfolio. The unknowledgeable user is left to err unknowingly. Consequently, one signficant by-product of including P–L insurance in the Study is to produce benchmark consolidated asset holdings for a significant portion of the industry. Fifth, while the organization of P–L groups has been described as complex, they have the additional significance of being part of the complex, they have the additional significance of being part of the movement to integrated financial services and conglomeration. Since 1964 several large P–L insurance groups have been involved in mergers with non-insurance enterprises. Information on organizational changes and non-P–L activities of large P–L groups will provide valuable background and possibly indicate future developments in this area. In chapter XV of the Study three transfers of control involving a large P–L insurance groups are described in detail. Lastly, it is desirable to collect information about securities investment operations of P–L insurance groups so that they can be contrasted and compared with those of the other major financial institutions.

To collect the current information needed to satisfy the six objectives detailed above, a sample to be studied intensively was determined in a similar manner for the P–L insurance industry as for most other financial institutions examined in the Study. This sampling procedure considers that (1) the companies or affiliated entities that have the largest amount of assets in an industry tend to have the greatest economic impact as institutional investors and (2) a relatively small number of these large institutions will represent a significant part of the industry's impact. Following these two sample criteria it was decided that a census of the 25 largest P–L insurance groups would be used rather than a random sample. The number and identity of these P–L groups together with the sample selection procedure, research design and questionnaires used by the Study are described in appendix B to this chapter.

I. Structure of the Industry

1. Concentration, Entry Conditions and Regulation

The P–L insurance industry is relatively diffuse. Approximately 3,000 separately chartered companies or organizations underwrite P–L risks in the United States. All large P–L companies have at least one affiliated P–L insurance company. These affiliated companies are under common control and are referred to as insurance groups. Approximately 900 of these 3,000 P–L companies are organized as part of about 350 insurance groups.[408] As described in appendix B to this chapter large P–L groups are the most significant factors in the industry with the largest 50 P–L groups writing approximately 74 percent of industry premiums in 1968. That there is relatively great diffusion among P–L groups is evident since the largest group in

---

[408] *Best's Key Rating Guide, Property-Liability 1970*, at 39B–49B.

volume of net premiums written had only 5.9 percent of the U.S. market in 1969.[409] The parts of this section that follow deescribe the various forms of legal organization of P–L insurers, the different types of risks or lines of business that they insure and the influence state regulation has had on the organization and structure of the industry.

a. Forms of legal organization

There are four different legal forms of organization for private P–L insurers: stock corporations, mutual corporations, reciprocal insurance exchanges and Lloyds organizations. Two other types, government insurers and self-insurers, are of no relevance here since they do not involve the securities markets directly.

(1) *Stock companies.*—The stock company is the most significant form of legal organization as measured by the 68 percent of total industry net premiums written by stock companies in 1969.[410] There are approximately 820 stock companies writing P–L insurance in the U.S.[411] Each P–L stock company is incorporated under a state charter as are other corporations. The initial capitalization is provided by the purchase of its shares of common stock by the public or by the company founding it as an affiliate. The shareholders of the company elect the board of directors which appoints management to operate the company for profit for the owners.

(2) *Mutual companies.*—Second in importance to stock companies as measured by assets employed as well as net premiums written are P–L insurers organized as mutual corporations. The nearly 2,200 mutual companies wrote over 27 percent of the total industry net P–L premiums in 1969.[412] Each P–L Mutual company is incorporated under a state charter and its initial capitalization is provided by founding organizers-policyholders. Subsequent policyholders are part-owners of the mutual insurance company for the duration of their policies. The policyholder-owners elect a board of directors which in turn selects officers to operate the company for the exclusive benefit of the policyholder-owners.

To the extent that premiums collected and investment profits exceed the cost of operations including all losses this margin may be returned to the policyholder-owners as a "dividend to policyholders." This return is an adjustment to the premium paid for a policy. It is not like a dividend to a stockholder in a stock P–L company which is actually a return on the stockholder's equity investment. Some stock P–L companies also pay dividends on certain types of policies but typically this is a minor facet of their method of operations, while it is a major aspect of mutual company operations. This feature of returning to policyholder-owners the margin in excess of the cost of operations plus the absence of equity investor-owners to provide additional capital are perhaps the most significant differences between stock and P–L companies and their operations as insurers and as investors. Since there is limited policyholders surplus in a mutual company there is

---

[409] *Best's Aggregates and Averages: Property-Liability 1970,* at 1. Results of Study Form I–57.
[410] *Best's Aggregates and Averages: Property-Liability 1970.*
[411] See ch. VI, app. B, Table VI–B–2.
[412] *Best's Aggregates and Averages: Property-Liability 1970.*

restricted opportunity to invest the portfolio in common stock and thereby enjoy potential portfolio appreciations.

While there are nearly three times as many mutual P-L companies as there are stock P-L companies, many mutuals are relatively small and operate in local or restricted geographic areas. There are several noteworthy exceptions led by the State Farm Mutual group, the largest underwriter with approximately six percent of total U.S. P-L premiums. As described in appendix B to this chapter, of the 25 largest P-L groups which comprise the Study sample, five are headed by mutual P-L companies. A mutual company becomes affiliated as part of an insurance group by (a) incorporating another mutual P-L company (by providing the initial capital), (b) incorporating and capitalizing a new stock P-L company, or (c) purchasing an existing stock P-L company.

(3) *Reciprocal insurance exchanges and Lloyds organizations.*—The final segment of the P-L industry is comprised of two unincorporated forms of organization. The 45 reciprocal insurance exchanges and 15 Lloyds organizations writing P-L business in the U.S. provided only four percent of total U.S. P-L net premiums written in 1969.[413]

In a reciprocal exchange, those acquiring insurance subscribe to an agreement covering underwriting risk for other subscribers. As the name indicates, there is a mutual "exchange" of insurance. The subscriber's liability is several but not joint, and it is not limited by the subscriber's agreement.[414] While legally different, conceptually reciprocal insurance exchanges are similar to mutual companies in several respects. In many cases subscribers to insurance in a reciprocal exchange participate in profits and savings. Their surplus funds tend to be quite modest relative to liabilities for the same reasons described for mutuals. Finally, most reciprocal exchanges are relatively small and they have a small proportion of their assets invested in common stock. The Farmers Insurance Exchange Group is large enough to rank in the top 25 P-L groups as measured by net premiums written, but it has substantially fewer assets than any of the other 25 large P-L groups, and it has a very modest investment in publicly traded common stock.

Lloyds organizations are associations of individuals who voluntarily assume a specified part of the liability on each risk in which they participate in underwriting. These organizations are patterned after the famous underwriters at Lloyds, London, in which the private wealth of individual participating underwriters provides the ultimate reserves and protection for the insured. The 15 independent Lloyds organizations doing business in the U.S. are insignificant as institutional investors. Their combined managed assets of $56 million are only one-tenth of one percent of the industry total. The underwriters at Lloyds, London, maintain a trust fund known as Lloyd's American Trust Fund with a U.S. bank under provisions of the U.S. Trust Agreement dating from 1939. All premiums or claims due to or from underwriters at Lloyds, London, are paid into or out of this

---

[413] *Best's Aggregates and Averages: Property-Liability 1970*, at 1.
[414] *Best's Insurance Reports, Property-Liability 1970*, at 547B.

trust fund at the First National City Bank of New York. At December 31, 1969, this trust fund amounted to $784 million.[415]

(4) *Domestic, foreign and alien insurers.*—The way in which P–L insurance companies are legally organized under laws of the several states in the U.S. contributes to unusual use of the terms "domestic," "foreign" and "alien" insurers. All P–L insurance companies and organizations must be licensed to do business by the insurance regulatory authority in each state in which it wants to operate. A company or organization operating in the state in which it is incorporated or organized is referred to as a "domestic" insurer. In other states in which that P–L company or organization operates it is generally referred to as a "foreign" insurer. Finally, companies and associations organized outside of the United States are known as "alien" insurers. They operate in this country through a U.S. branch or office and must be licensed in each state in which they do business. There are several alien P–L insurers with significant operations in the U.S. including the Royal-Globe and the Employers-Commercial Union groups.

(5) *Insurance groups.*—For most purposes the P–L organization that is meaningful is the insurance group rather than the insurance company. In addition to having common control and management, insurance groups typically enter into insurance pooling agreements that allocate net premiums written by an entire group to each affiliated company on a pro-rata basis. To a large extent only the legal entity distinction exists between the group's companies.

There is a very high probability that a large P–L insurance company doing business on a nationwide or regional basis in the U.S. owns, is owned by, or is under common control, that is, affiliated with, another P–L company in what is called an insurance "group." [416] Solitary companies are nonexistent among very large P–L companies and companies with no P–L affiliates are rare even among companies of medium size. Stock groups are more prevalent and typically include more companies than are found in mutual groups because common stock ownership is a convenient and logical means of effecting control. Affiliation among mutual companies is more cumbersome.

Newly created insurers are typically in the form of incorporated mutual or stock companies. However, the organization of new P–L companies by existing P–L groups has been relatively infrequent in recent years. Most of the increase in the number of companies in large insurance groups in recent years has resulted from acquisitions.[417]

The significant portion of the industry is dominated by nearly 350 groups of affiliated companies. The 25 largest groups provided approximately 58 percent of total net premiums written in the U.S. in 1969. The 1964–1969 comparative volume of net premiums written for the 25 groups in the Study sample is shown in Table VI–133. This table also shows that these groups wrote 53.4 percent of industry premiums in 1964 and the volume increased to 58.2 percent of total industry volume in 1969.

---

[415] *Best's Insurance Reports, Property-Liability 1970*, at 543B.
[416] Insurance groups are discussed in sec. I.2 below.
[417] See sec. I.2.a (1).

TABLE VI-133

Property-Liability Insurance Groups
in Order of 1969 P-L Net Premiums Written

1969 Rank	Name of Group or Controlling Company	Net Premiums ($ millions) 1964 1/	1969 2/	Percent Increase in Net Premiums 1964 - 1969
1	State Farm 3/	803	1,717	+114%
2	Allstate	678	1,419	109
3	Continental Insurance 4/	554	1,131	104
4	Aetna Life & Casualty	567	1,083	91
5	Traveler's	662	1,059	60
6	Hartford Fire	651	1,000	54
7	Liberty Mutual 3/	458	889	94
8	INA	562	882	46
9	CNA 5/	600	783	31
10	Fireman's Fund American	524	733	40
11	U.S. Fidelity & Guaranty	383	630	64
12	Home	352	625	78
13	Nationwide 3/	376	514	37
14	Employers-Commercial Union 6/	256	492	102
15	Kemper 3/	286	490	71
16	Royal-Globe	324	472	46
17	Crum and Forster	183	467	155
18	Employers Ins. of Wausau 3/	195	394	102
19	American General 7/	232	391	69
20	Connecticut General 8/	251	371	48
21	St. Paul Companies	211	359	70
22	Reliance	208	313	54
23	Great American	200	307	48
24	Chubb 9/	111	284	156
25	SAFECO 10/	172	257	49
	TOTAL for 25 Groups	9,799	17,013	+74%
	25 Groups as Percent of Industry	53.4%	58.2%	
	TOTAL Industry	18,317	29,225	+60%

1/ Best's Fire and Casualty Aggregates and Averages, 26th edition, A.M. Best Company (1965), pp. 29
2/ Study Form I-57. Includes only premiums of U.S. P-L operations.
3/ Mutual company heads group.
4/ Formerly America Fore-Loyalty
5/ Formerly Continental Casualty
6/ Formerly Employers Group
7/ Formerly Maryland Casualty
8/ Formerly Aetna Insurance
9/ Excludes premiums of offices of 5 British companies managed by Chubb.
10/ Formerly General of America

b. Lines of P–L insurance

A line of insurance covers a described type of peril or perils. Historically a U.S. insurance company was an underwriter of only one or at most a very few closely related insurance risks until the mid-1940's, when state insurance regulations began permitting multiple-line underwriting by individual companies. Multiple-line underwriting was effectively accomplished through groups of affiliated nono-line companies. Now full multiple-line underwriting, which includes all perils except life insurance, is permitted in all states, and all large insurance groups and companies are multiple-line insurers. There remain many small local insurers that write only one or a few selected lines.

It should be noted that the movement to multiple-line insurance also includes the development of multiple-line contracts. For example, the "homeowner's policy" encompasses fire, theft and liability insurance in one contract. Finally, the development of insurance groups that include affiliated life insurance and title insurance companies has led to the concept known as "all lines" insurance. Affiliation of life and P–L insurance companies is prevalent among large groups.

The reporting of P–L insurance by specified lines is a requirement in the convention statement (blank) required by the National Association of Insurance Commissioners (NAIC). The 23 specific lines of business listed in the convention blank with the reference number for each line as shown in the blank are shown below:

Line of business

1. Fire
2. Extended coverage
3. Other allied lines
4. Homeowner's multiple peril
5. Commercial multiple peril
6. Earthquake
7. Growing crops
8. Ocean marine
9. Inland marine
14. Group accident and health
15. All other accident and health
16. Workmen's compensation
17. Liability other than auto (bodily injury)
18. Liability other than auto (property damage)
19. Auto liability (bodily injury)
20. Auto liability (property damage)
21. Auto physical damage
22. Aircraft physical damage
23. Fidelity
24. Surety
25. Glass
26. Burglary and theft
27. Boiler and machinery

For the purpose of the Study these 23 lines (plus "miscellaneous") are combined in eight major categories of related insurance lines. This classification of data for the Study P–L sample is reported and discussed in sec. J.2.b. A visual examination of the distribution of lines

of the sample does not show significant departure from industry-wide activity.

As discussed earlier the volume of net premiums written is a satisfactory proxy for the relative asset size and degree of concentration in the P–L industry.[418] While net premiums written indicate the volume of insurance retained by an insurer, gross premiums from direct business written reflect the direct public market activity of an insurance company or group.[419] Direct premium data available by lines, groups and states for 1969 show the concentration and dispersion in the P–L industry.[420]

On the basis of the volume of direct premiums written, the three automobile lines combined account for approximately 46.2 percent of all P–L premiums. This of course explains the considerable attention focused on regulation and ratemaking in automobile insurance by the industry, governments and the public. Workmen's compensation follows with 11.8 percent, while none of the other 19 individual lines accounts for 10 percent of the industry.[421] Including all miscellaneuos lines as one line, 10 different insurance groups write the most direct premiums on a nationwide basis in one or more of the 24 lines. When all P–L lines are combined the dispersion in the industry is indicated most clearly since the largest P–L group in terms of direct premiums written (State Farm) accounts for approximately six percent of the industry, the second largest group (Allstate) accounts for five percent and the next three groups write four percent each. The 10 largest groups combined had 38 percent of the industry direct premiums in 1969.

Premium volume in the several states is consistent with the general geographic distribution of wealth and population nationwide. Led by California with 11.7 percent, New York with 11.4 percent, Illinois with 6.6 percent and Texas with 5.5 percent, the 10 largest states in terms of direct premium volume account for about 60 percent of the national total. In the leading state (California) the underwriter with the largest share (State Farm) has only seven percent of the total. Similar dispersion is found in the other large volume states. The highest concentration by leading underwriter in a state is 17 percent of direct premiums in Hawaii (Hartford Group).

In summary, it is evident that the largest P-L groups do a major portion of nationwide insurance underwriting. However there is considerable dispersion of the business among these large groups and, to a lesser extent, among local and regional P-L insurers.

---

[418] Net premiums written are defined as gross premiums from direct business written, plus reinsurance assumed from other writers. less reinsurance ceded to other companies.

[419] Insurance is sold through two major systems of distirbution. One major system involves independent or exclusive agencies and accounts for 70 percent of industry premiums. The other system, involving direct selling by the insurer's own sales employees, had been increasing its share of the market in recent years. The direct selling method is not to be confused with the volume of direct premiums written cited in the text above which reflects total sales regardless of selling method.

[420] The data that follow in this subsection relate to 1969 and are taken from "Insurance Premium Distribution," *Best's Review: Property/Liability Insurance Edition* at 10–12 (June 1970).

[421] It should be noted that since underwriting experience and the size and timing of rate adjustments vary from line to line. premium volume and underwriting profit per line is not related in a consistent fashion. Hence. the large premium volume automobile lines generally have been large losers in recent years while. for example. the smaller workmen's compensation line has been profitable for many insurers. A similar relationship exists geographically wherein a small volume line in one state may be relatively profitable while a larger volume line in another state will generate disproportionate underwriting losses.

c. Regulation

Property-liability insurance companies are subject to regulation primarily by the states rather than by the federal government.[422] The areas in which federal regulation has some viability are taxation.[423] the securities laws [424] and to some extent the antitrust laws.[425]

State regulation on the other hand has flourished, reaching every aspect of the industry from rate setting and underwriting to investments of assets, corporate acquisitions and holding companies. Each state has its own laws and regulations which are administered for both life and nonlife insurance by a state insurance department headed by an insurance superintendent, director or most often a commissioner. The insurance department administers the law with vested legislative and quasi-judicial powers to make rules and regulations and hold hearings. Actions of the insurance department are subject to judicial review. The primary objective of state regulation is protection of policyholders although revenue production through taxation [426] is also a major consideration. Toward these objectives state regulation enters all phases of the insurance business including restricting investment, conducting periodic financial examinations, approving policies and rates and licensing companies, agents, brokers, etc.[427]

The major force in the industry that brings about a degree of uniformity in regulation in the several states is the National Association of Insurance Commissioners (NAIC). This organization is a significant factor in insurance regulation through its standing committees, studies of special problems, standardization of reports and preparation of model laws. In spite of this effort the laws of the states differ in many respects. This lack of uniformity is tempered in practice for the large insurers doing business in the major states by the fact that New York's insurance law requires foreign (non-New York domiciled) insurers substantially to comply with the requirements of New York for domestic insurers. Because few states are more restrictive than New York and because most large companies and groups do business there, the New York standards amount to a national standard for most purposes.[428]

In the subsections that follow, the relationships between regulation and (1) entry conditions, (2) organization including subsidiaries, (3) noninsurance holding companies and (4) portfolio investments

---

[422] Until the *South-Eastern Underwriters* case, 322 U.S. (1944), it had been assumed that the business of insurance was subject to only state regulation. The Court held that insurance business conducted across state lines is interstate commerce and subject to the antitrust laws. The subsequent passage of the McCarran Act in 1945 restored much of the status quo ante.

[423] Property-liability insurers are taxed under the provisions of subchapter L of the Internal Revenue Code. In general, federal taxation of property-liability companies is similar to that of other commercial corporate enterprises.

[424] Although contracts of insurance are exempt from coverage as securities under the acts, other securities issued by property-liability companies would generally be covered.

[425] The McCarran-Ferguson Act, 15 U.S.C. §§ 1011–15 (1965), ch. 209, 59 Stat. 33 (1945), provides that the business of insurance be subject to regulation and taxation by the several states and in general it makes the federal antitrust laws applicable to the business of insurance only to the extent that such business is not regulated by state law.

[426] The most significant method of insurance company taxation by states is in the form of a tax on premium volume.

[427] John D. Long, and Davis W. Greg, (editors), *Property and Liability Insurance Handbook* 982 (Richard D. Irwin, Inc., 1965).

[428] In some respects certain property-liability companies consider either their own domiciliary state or some other state such as Illinois or Maryland to be most restrictive in the investment area. (See Study responses, sec. J.2.a.) New York, however, serves as a meaningful general standard and further regulatory discussion here is based on it.

will be discussed. The final subsection summarizes current developments in the industry and the direction of future regulation.

(1) *Entry conditions.*—New York State Insurance Law specifies that no person, firm, association, corporation or company can do an insurance business in the state unless authorized to do so by the Superintendent of Insurance, who may issue a license to any insurer to do in New York State the specific kind or kinds of insurance business for which such insurer is qualified under the insurance law and under its charter. Under section 40 the Superintendent is empowered, in addition to issuing licenses to insurers, to order a licensed insurer to comply with all applicable sections of the insurance law, to assess certain penalties and to amend or revoke licenses. These licensing requirements apply to domestic, foreign and alien insurers. To qualify for continuation of the license an annual statement for each insurer in prescribed form reflecting the condition of the insurer on the preceding December 31 must be filed with the Superintendent by the first day of March each year. Licenses of domestic insurers have an indefinite term while foreign and alien insurers face annual renewal.

Stock or mutual insurance companies may be incorporated in New York as provided in section 48 of the Insurance Law. The company's charter must specify the kind or kinds of insurance business, as defined in section 46, that it intends to do. Before licensing any such corporation the Superintendent must determine that the minimum initial capital and surplus required by law has been paid in and is possessed by the corporation as cash or eligible investments. The specific amounts of capital and surplus required for various domestic, foreign and alien insurers are described below in sec. I.1.c(4).

A foreign or alien insurer seeking to be licensed must file with the superintendent copies of its charter, by-laws, statements of financial condition including paid-in-capital and surplus, statement of the kind or kinds of insurance business to be done and other such documents. After conducting an examination of the company's affairs the Superintendent may issue a license authorizing the insurer to conduct the insurance business specified in New York if it is shown that the company complies substantially with all requirements and limitations of the insurance law. No foreign or alien insurer shall be authorized to do business in New York State if it does in New York or elsewhere any kind of business other than an insurance business and such business as is properly incidental to the kind or kinds of insurance business which it is licensed to do in New York State. Renewal of the license is based on continued satisfaction of all of the above requirements.

It should be noted that an insurance company must be similarly licensed by the insurance department in each and every state in which it desires to do an insurance business. Each insurer must comply with the law and regulations of each such state including the filing of annual statements and other required reports. Section 61 of the New York Insurance Law effectively discourages discriminatory tax and regulatory burdens upon its domiciliaries operating in other states by providing automatic and equal reprisal against those other states' domiciliaries doing like business in New York State. All states have retaliatory laws covering all requirements and limitations of the insurance law.

(2) *Industry structure: subsidiaries of insurance companies.*—In general, P–L companies are permitted relatively great latitude in the

amount of investment in different types of affiliated (subsidiary) companies as well as in the amount and type of regular portfolio investment. The "portfolio investment" just referred to includes those investments acquired in the normal course of managing a portfolio of securities exclusively for investment income and capital gain while investment in affiliated companies is distinguished by a marked degree of control and presumably a permanent or semi-permanent position.

Regulation as it pertains to regular portfolio investment in P-L insurance companies is discussed in the next subsection. With regard to "regular portfolio investments" it will suffice here to note that section 87 and other sections of the New York Insurance Law [429] limit the total investment in any one institution, except classes of governmental obligations eligible for minimum capital investment, to a maximum of 10 percent of the investing insurer's admitted assets, unless the investment qualifies (a) under section 86 as an investment in another insurer or (b) under section 85-a as an investment in a subsidiary company doing a specified financial or insurance related business.[430]

Section 86 applies only to investment by one domestic P-L insurance company in other insurers after the former has met its minimum required capital and reserve investments according to sections 79 and 80. It specifies that the total direct investment together with indirect investment through intermediate subsidiaries must not exceed the greater of (a) 35 percent of surplus to policyholders of the acquiring insurer or (b) 50 percent of the acquirer's surplus over and above its liabilities and capital.[431] This is not particularly restrictive [432] as evidenced by the wide-spread development of groups of affiliated insurance companies, as discussed in Study section I.2 that follows. Furthermore, the existence in an insurance group of a non-insurance holding company at the top of the ownership chain allows essentially unrestricted affiliation between insurance companies.

In addition to investment in other insurers as above, under section 85-a, enacted in 1969, a domestic P-L company may invest in or acquire one or more solvent corporations engaged in any of the following businesses after it has satisfied its minimum capital and reserve investment requirements.

(a) insurance agent

(b) securities broker or dealer investing or trading for its parent or any affiliate

(c) management, sales or other service to any investment company subject to the Investment Company Act of 1940 as amended

(d) investment adviser

(e) insurance related functions including actuarial, loss prevention, safety engineering, data processing, etc.

(f) pension fund administrator

(g) ownership and management of assets which the parent could itself own and manage

---

[429] New York Insurance Law (McKinney) is used for illustrative purposes. See Study sec. I.1.c, introductory paragraphs.

[430] Should an investment subject to section 87 appreciate to the point where it amounted to more than 10 percent of admitted assets, that investment above 10 percent could no longer be included as admitted assets.

[431] N.Y. Ins. Law § 86 (McKinney 1966) allows that these investments may through subsequent appreciation increase to 50 percent and 60 percent in place of the amounts specified above in (a) and (b) respectively.

[432] There have been two instances recently that required some adjustment in the organization of two groups.

(h) administrative agent for government instrumentality performing an insurance function
(i) financing insurance premiums
(j) any other business activity reasonably ancillary to an insurance business
(k) a holding company owning businesses specified above in (a) through (j) and/or other insurers as limited by section 86

For the above investments to qualify under section 85-a the immediate parent insurance company must within one year acquire at least 95 percent of the subsidiary's outstanding voting stock[433] except that with respect to any one subsidiary in each chain of ownership from the domestic insurer parent, ownership of not less than a majority of the outstanding voting stock is permitted.

The law also requires that 90 days prior to acquiring a majority position in any corporation pursuant to section 85-a, the acquiring corporation must file a notice of intention with the Superintendent. The Superintendent may prohibit the proposed acquisition if it is found to be contrary to law or the best interests of the parent insurer's policyholders or the people of the State of New York.

(3) *Noninsurance holding companies: investments and regulations.*—Until 1967 or 1968 the concept of the noninsurance holding company[434] did not exist to any significant degree. Developments since that time involving noninsurance holding companies and the acquisition of insurance groups by them have had a marked impact on the industry and new regulations have resulted where the laws previously were silent. These developments and their background are described below.

As discussed in the next subsection of this chapter, the insurance law as it pertains to P-L company investments is focused on the safety and liquidity of the insurer and specifies that minimum required capital investment must be invested in certain assets that are quite liquid and supposedly possess minimal financial risk. Beyond these requirements the law provides only certain prohibitions and limitations on the concentration of investment. Portfolio managers of stock P-L companies have been able to invest significant amounts in common stock. They benefited from the long-term rise in stock market prices; the value of their portfolios increased since stocks are carried at market value and this is then reflected in expanded policyholders surplus.[435]

This expanded surplus (assets) provides a growing base for expanding insurance underwriting or increasing dividend payout to stock-

---

[433] Furthermore, section 481-a enacted in 1969 provides that any parent company directly or indirectly owning at least 95 percent of the voting stock of a domestic company may acquire all of the remaining outstanding shares by exchange of stock or cash. N.Y. Ins. Law § 481-a (McKinney 1969 Supp.).

[434] A holding company is one that directly or indirectly controls another company. A noninsurance holding company, as used in this chapter of the Study, is a company that is not licensed and authorized to do an insurance business. An insurance holding company is a licensed and authorized insurer that controls another company. As defined here insurance holding companies are very widely used in stock insurance groups.

[435] Conceptually, policyholders surplus is equivalent to common stock equity or net worth. The surplus that exceeds the minimum required surplus that is judged to be adequate to support the volume of underwriting being done by the company represents excess assets. Someone coined the expression "surplus-surplus" and this unfortunate terminology is widely used in the P-L industry and in the press. Although insurance regulation expresses requirements in terms of capital and surplus it is, of course the assets that are meaningful in meeting obligations. Instead of "surplus-surplus," the condition is brought into focus more appropriately with the expression "excess assets."

holders.[436] Since the latter alternative would involve liquidating portfolio assets and being subject to capital gains tax on the realized gains, it has not been used widely. At the same time the alternative of using the growing capacity by expanding the underwriting business has been followed to some extent by P–L companies through natural premium growth as opposed to aggressive expansion of underwriting. However, many observers of the industry have felt that P–L underwriting experience was bad and getting worse and that the long-run profit potential in P–L insurance underwriting was not good.[437]

These circumstances and interpretations led the market to place relatively low valuation and low price-earnings multiples on the publicly traded shares of P–L companies since the P–L industry was regarded as having relatively low growth, low return on investment and poor expectations for improvement.

Obviously the opportunity to expand into noninsurance areas such as financial services that would interface with their insurance business or allow them to make use of existing knowledge and experience in the investment-finance area would be attractive. This prospect was frustrated by investment restrictions on insurance company assets until the same holding company concept employed in the banking industry was applied in some insurance groups. The process was to reorganize the insurance group with an exchange of the outstanding shares of the parent insurance companies for the shares of a newly formed noninsurance holding company. The affiliated insurance companies could distribute excess assets to the holding company as a dividend for reinvestment by the new, unregulated company. Since the subsidiaries are generally wholly owned, consolidated reporting for federal income tax purposes makes the asset distributions tax free and, in addition, losses in one subsidiary can be written off against profits in another. These are significant tax benefits.[438]

With these and other incentives, large insurance groups such as CNA, INA, Continental and Great American formed noninsurance holding companies during the late 1960's. Concurrently with these changes within the insurance industry companies outside of the insurance business became aware of the numerous investment advantages of the noninsurance holding company. Several P–L insurance companies or groups were acquired by noninsurance companies during 1968.[439]

In several cases very sizable dividends subsequently were distributed to the parent holding company.[440] Perhaps the most famous situ-

---

[436] It should be noted that part of the enlarged capacity for underwritings may prove ephemeral depending upon downturns in market values of stock. Such has been the experience in the 1969 market slump.

[437] As mentioned elsewhere, the measurement of profits in the P–L insurance business is most difficult and it is the subject of considerable controversy. See Hearings before the Subcommittee on Antitrust and Monopoly of the Committee on the Judiciary, U.S. Senate, 90th Congress, Vol. 13 and 14 (1968).

[438] New York Insurance Law, § 76 allows a domestic insurance company to borrow under very limiting circumstances and conditions. A noninsurance holding company has no such restriction and a few groups, such as the St. Paul Companies and CNA Financial, have issued long-term debt securities.

[439] See sec. I.2.c.

[440] See, for example, "The Billion-Dollar Insurance Caper," *Forbes*, October 15, 1970, at 66–68. It should be noted, however, that this article overstates the situation significantly by including the full $465 million Continental Insurance (N.Y.) dividend to its holding company. Only $65 million of this was a conventional dividend paid in portfolio securities while $217 million was part of a corporate reorganization and $187 million was a cancellation of intragroup obligations between affiliates. At least $216 million should not be considered to be a dividend in the usual sense of the word.

ation was the $171 million dividend in portfolio securities which was paid by the Great American insurance group to its new noninsurance parent, National General Corporation.[441]

These developments, including the organization of noninsurance holding companies by insurers, the acquisition of insurance groups by noninsurance companies and the distribution of significant amounts of assets from insurance subsidiaries triggered studies of holding companies by the NAIC and New York State Insurance Department. Regulatory legislation in several states including New York soon followed. Additions to the Insurance Law in New York (1) provided stringent tests and limits on the amounts of dividends that could be distributed [442] and (2) required registration with the superintendent of noninsurance holding companies [443] (that is own 10 percent or more of the voting securities of domestic insurers). Section 69–e also requires that certain transactions between domestic insurers and noninsurance holding companies need advance notice to, and approval by, the Superintendent. Significantly, section 69–f requires that anyone other than an authorized insurer seeking to acquire control of any domestic insurer must receive approval in advance from the Superintendent.

Other states have acted similarly. For example, stringent terms were imposed before the 1970 acquisition of the Hartford Group by ITT was approved by the Insurance Commissioner in Connecticut. No other significant acquisitions by noninsurers have been noted since then.

(4) *Portfolio investments.*[444]—This section describes the major provisions of the New York insurance law as it pertains to investment by property-liability companies.

In order to understand the investment restriction section of New York Law, one must first be aware of the provisions establishing minimum capital and surplus requirements for authorized insurers. Like other states, New York imposes certain minimum financial requirements on insurance companies wishing to do business in the state.[445] They are not, of course, identical for all types of companies such as stock and mutual, nor for all lines of insurance, but fairly typical are the minimum paid-in capital and surplus [446] requirements for stock companies.[447] The paid-in capital and initial paid-in-surplus requirements vary by line and combination of lines of business. The initial paid-in-surplus must be equal to 50 percent of the required amount of paid-in-surplus for most lines other than fire and marine. These minimum initial capital requirements must be maintained thereafter.

---

[441] With this distribution of assets equal to over 50 percent of policyholders' surplus and with the decline in value of the remaining portfolio of Great American stemming from the stock market slide in 1969 and early 1970, they have since been cited for violation of § 86 of New York Insurance Law.

[442] N.Y. Ins. Law §§ 313 and 343 (McKinney Supp. 1969).

[443] *Id.*, § 69–c.

[444] The U.S. Internal Revenue Code taxes P–L companies as regular commercial enterprises. The most noteworthy aspect for investment is that tax-exempt interest income on municipal bonds becomes less attractive when underwriting experience is sufficiently bad, and profitable insurance business or noninsurance subsidiaries make investment in municipals more attractive.

[445] N.Y. Ins. Law §§ 311 and 341 (McKinney 1966).

[446] Paid-in-capital and surplus refer to the balance sheet accounts that represent the amount of equity that founders of an insurance company must supply and invest permanently in the company.

[447] N.Y. Ins. Law §§ 311 and 341 (McKinney 1966).

Table VI-134 below illustrates some of the minimum capital and surplus requirements.

TABLE VI-134

New York Capital and Surplus Requirements

Line of Insurance	Single Line		Additional Line 1/	
	Capital	Surplus	Capital	Surplus
Glass	$100,000	$ 50,000	$ 50,000	$ 25,000
Property Damage liability	100,000	50,000	50,000	25,000
Burglary and Theft	200,000	100,000	150,000	75,000
Workmen's Compensation	200,000	100,000	150,000	75,000
Fire	250,000	250,000	250,000	250,000
Personal Injury Liability	300,000	150,000	250,000	125,000
Fidelity and Surety	500,000	250,000	450,000	225,000
Combination: Fire and Marine plus all allied fire lines	500,000	500,000		
Combination: Complete multiple lines--fire or marine company 2/	500,000	3,475,000*		

1 / For a company that has provided the required minimum capital and surplus for any single line, the required capital for each additional line is reduced by $50,000 in most cases.

2 / N.Y. Ins. Law § 341(1)(f) (McKinney 1966).

* / After formation minimum required surplus to policyholders is $2,200,000.

Foreign (domiciled in another state) property-liability companies must maintain the same minimum capital and surplus required of domestic companies doing a like business. Alien (not domiciled in the U.S.) companies have the same minimum capital requirements plus a required minimum initial trusteed surplus equal to 150 percent of capital for all lines except fire and marine for which 200 percent is required. Perhaps the most significant aspect of these requirements is that there is only a modest concession in the initial capital and surplus required for complete multiple line companies. The initial requirement is essentially the sum of the single line requirements.

Deposits with the state are also required. Authorization to do business for stock casualty and/or surety insurers calls for a deposit with the Superintendent of Insurance of eligible securities worth $250,000, or the amount required as minimum capital for the kinds of business for which the company is licensed, whichever is less, but in no case shall the deposit be less than $200,000. These deposit requirements are imposed on foreign and domestic companies. Foreign insurers can satisfy this requirement by showing a like deposit in their state of incorporation.

New York's regulation of investments can be divided into three stages: (1) the investment of minimum capital requirements, that is, the minimum net worth prescribed by statute,[448] (2) the investment of reserve funds,[449] and (3) the investment of excess funds.[450]

A domestic company shall invest an amount equal to its minimum capital required by law or if a stock company, an amount equal to the required minimum surplus, whichever is greater, in only (1) obligations of the United States Government or its guaranteed agency obligations, (2) direct obligations of New York State or its political subdivisions, (3) direct obligations of other states and (4) certain mortgage loans on real estate located in New York State.[451] Sixty-percent of this total must be invested in the first two classes of securities above.

Having satisfied this minimum capital investment obligation, an insurer, other than a life company, must invest in only the securities listed in section 81 of the law until, when valued in accordance with the provisions of the law, the sum of section 81 investment plus cash and minimum capital investments equals or exceeds 50 percent of the aggregate of its unearned premium and loss reserves. Investments acquired to satisfy section 80 must be interest bearing or income paying. Major categories of section 81 investments are summarized below.[452]

1. Government obligations. Federal, state, city or county bonds if the interest and principal are payable from taxes or revenues.

---

[448] N.Y. Ins. Law § 79 (McKinney 1966).

[449] There are several types of reserve funds required by law, but the two of relevance here are:

Unearned Premium Reserve. That part of the paid premium applicable to the unexpired part of the policy period.

Loss Reserve. A fund in an amount estimated to provide for the payment of all losses or claims incurred prior to the date of statement which are unpaid as of such date and for which such insurer may be liable. This amount includes estimates to provide for the expense of adjustment or settlement of such claim.

N.Y. Ins. Law §§ 80 and 81 (McKinney Supp. 1969).

[450] *Id.*, § 85.

[451] *Id.*, § 81.

[452] N.Y. Ins. Law § 81 (McKinney Supp. 1969) lists 19 carefully defined categories of investments and describes in detail tests, qualifications and limits on size of investment at cost relative to size of the issue, issuer and investing insurer.

2. Corporation obligations. The corporation must be organized under U.S. laws, be solvent, and the obligation must have fixed interest and pass specified earnings tests. These obligations include bonds, debentures and notes.
3. Preferred or guaranteed stock. The corporation must meet certain dividend coverage and other tests.
4. Trustees' obligations or equipment trust certificates. Only if adequately secured.
5. Bankers' acceptances eligible for Federal Reserve member banks.
6. First mortgage bonds or notes. Narrow restrictions applied.
7. Real estate. Under narrow restrictions.
8. Foreign investments. Limited amounts of investments in Canada and other countries in which the insurer does business so long as the kind and quality is similar to those investments described in the preceding seven classes.
9. Stock and evidences of indebtedness of housing companies acquiring income-producing property. Narrowly restricted.
10. Stock of a Federal Home Loan Bank. Applies only to life insurers.
11. Obligations issued or guaranteed by the International Bank for Reconstruction and Development, Inter-American Development Bank or the Asian Development Bank. Limited amount.
12. The shares of a savings and loan or building association or the savings accounts of same if insured by FSLIC.
13. Common stocks or shares. Carefully restricted qualifications which in practice do not actually restrict common stock investment of property-liability insurers.
14. Any security or investment that qualifies under other subdivisions of § 81 regardless of its possession of equity provisions such as convertibility.
15. Production payments. Must be adequately secured and not have predominant speculative elements.
16. Stocks and obligations of mortgage companies. Tightly restricted. Requires approval of the Superintendent.
17. Investments which do not qualify or are not permitted under any other subdivision of this section. The "basket clause" is limited to 3.5 percent of assets and it is pertinent to life insurance companies only.
18. Personal property. Restricted and limited in size.
19. Adequately secured noncorporate obligations.

Once a domestic nonlife insurance company has satisfied the requirements for minimum capital investments and has accumulated and maintains reserve investments as specified in section 80 it may invest any portion of the remainder of its funds in any class of investments eligible under section 81 and any stock or shares, bonds or obligations, any similar instruments representing the same, or certain loans secured by life insurance cash surrender values, with the following exceptions as prohibited investments:
1. Obligations of insolvent corporations.
2. Mortgages or deeds of trust not qualifying under section 81.
3. Stock of the investing insurer.
4. Acquisitions that would give the insurer ownership of a majority of the outstanding stock of a corporation.

5. Any investment which is found by the Superintendent to be against public policy or designed to evade any prohibition of the statutes.

In addition, section 87 limits investments in the securities of any one institution, except for investment in section 79 governmental securities and investment in section 86 insurance companies, to no more than 10 percent of the investor's admitted assets.

Section 90 gives the Superintendent the power to refuse a license to any foreign insurer if he finds its investments do not comply in substance with the investment requirements and limitations imposed upon like domestic companies doing the same kind of insurance business.

It should be noted that in conversations with a member of the New York Insurance Department, it was stated that as a matter of course, a company's invesments in government obligations under Section 79 (investment of minimum capital) will almost always satisfy the requirements of section 80 (50 percent of the aggregate of unearned premium and loss reserve) and that as a practical matter, it is section 85 that controls their investments, rather than section 81.

(5) *Current and future developments relating to regulation.*—The preceding discussion emphasizes that with minor exceptions regulation of the P–L insurance business at present is at the state level. Some recent and current activities and developments at both the state and federal levels indicate that significant changes in the P–L insurance industry and its regulation are likely in the future. Individually and collectively these developments are the harbinger of changes that will affect P–L insurance company operations, profits, cash flows and investments. The extent to and specific manner in which these changes will affect the industry are unknown. Some of the major activities and developments are noted briefly below.

1. The Subcommittee on Antitrust and Monopoly of the Committee on the Judiciary of the U.S. Senate has been investigating automobile insurance for many months and the Chairman of that Subcommittee, Senator Philip A. Hart, introduced in 1970 three bills related to these hearings.[453] Hearings before the Subcommittee have covered many aspects of insurance operations including the overall profitability of P–L insurers.

2. Pursuant to a resolution of Congress, the Department of Transportation has been conducting an extensive study of all aspects of automobile insurance for more than two years. Its final report is expected early in 1971.

3. Several states have required recognition in ratemaking of some part of investment income. A recent landmark decision of the Texas Board of Insurance has determined that, after all expenses including taxes, and taking into account income from all sources, automobile insurance rates should provide a rate of return of about 11.5 percent.[454] This return is comparable to the ten-year Standard and Poor's Industrials average return. At hearings in New Jersey the same proposal is

[453] S4339, S4340 and S4341, 91st Cong., 2 Sess.

[454] The P–L insurance industry and the A.I.C.P.A. are currently discussing changes in the form of inclusion of realized and unrealized capital gains in financial statements for shareholders.

under consideration. The National Association of Insurance Commissioners also is studying actively the matter of investment income and overall profitability.

4. The Congress has passed legislation such as the Urban Property Protection and Reinsurance Act of 1968 by which the Federal Government directly or indirectly assumes an additional role in the insurance business in high risk areas. More recently, under the Housing and Urban Development Act of 1970 the Federal Government is expected to provide crime insurance in high crime rate areas where coverage is not available from private sources at reasonable rates.

5. A number of proposals have been developed which would provide benefits regardless of fault to persons injured in auto accidents. Massachusetts has enacted a limited no-fault insurance law which becomes effective January 1, 1971. This is the first significant modification to the use of the controversial tort liability system, a system which some claim is slow, expensive and discriminatory in compensating people injured in auto accidents. Serious consideration of significant insurance law reform can be expected in other states.

6. New York has enacted law restricting the ability of insurance companies to cancel automobile and some other insurance policies [455] except under certain specified conditions such as nonpayment of premiums. In all, 39 states have enacted legislation restricting the rights of insurers to cancel auto insurance policies.[456]

7. Laws have been passed recently at the state level that pertain to the acquisition of insurance companies and federal legislation in this area was passed by the U.S. Senate in 1970.[457] Several states have passed laws regulating the activities of insurance holding companies.

8. The Commerce Committee of the U.S. Senate has reported a bill [458] that, if enacted, would establish a Federal Insurance Guaranty Corporation to protect third party claimants and policyholders for losses incurred and for recovery of unearned premiums. This bill applies to all lines of insurance other than life, title, disability, mortgage guaranty and ocean marine.

In summary the above activities including investigations and legislation show great attention at the federal level being given automobile insurance and the insured public. Inevitably the question must be raised as to whether a business conducted nationally across state lines can respond to increasingly intense supervision from 50 state regulatory bodies without impairing its capacity to serve the insuring public. In many respects it is a question of the quantity rather than the quality of state regulation. The system of fragmentation of regulation across the several states, although awkward in many respects, is well entrenched.[459]

2. Property-Liability Insurance Groups and Complexes

Information on the development of groups of P-L companies and their subsequent extension into other activities through affiliates pro-

[455] N.Y. Ins. Law §§ 167-a and 167-b (McKinney Supp. 1969).

[456] See Note, "Automobile Insurance—Cancellations and Refusals to Renew—The Legislative Response," 9 *B.C. Ind. and Com. L. Rev.* 998 (1968).

[457] S3431, 91st Cong., 2d Sess. (1970).

[458] S2236, 91st Cong., 2d Sess. (1970).

[459] For more extensive discussion see John G. Day, "Economic Regulation of $nsurance in the United States," Department of Transportation Automobile Insurance and Compensation Study, U.S. Department of Transportation 51-77 (July, 1970).

vides a foundation for discussion of the investment organization and management of P–L groups. The degree of P–L group involvement in other financial activities is of general interest as a part of the trend toward financial integration and of particular interest to the extent that it influences the type, amount and flow of the complex's investment activities.

a. Insurance companies affiliated in groups

(*1*) *Property-liability companies*

A student of corporate organization and control looking for the first time at the P–L insurance industry in 1970 would observe an unusual if not unique organizational pattern. Although there are 3,000 P–L companies operating in the United States, the most significant of the P–L companies control or are under common control with other P–L companies.[460] With a few exceptions among mutual companies, this organizational pattern is much more prevalent with stock companies since the stock corporation provides direct and complete control through ownership. These P–L insurance groups [461] are composed of individual corporate entities but they generally have overlapping if not the same boards of directors, managements and staffs.

Although mergers and concentration among financial institutions have been of considerable concern to government and the public in recent years, the fact that the development of P–L insurance groups goes back to 1898 indicates that it is not just a phenomenon of the 1960's and 1970's. In 1898 the control of Mechanics and Traders of New Orleans was purchased by National Fire of Hartford (now part of the CNA Financial Group) and the following year Hartford Fire purchased Citizens of Missouri.[462] These two purchases are reputed to be the beginning of "fleet" or "group" operations in the United States. Significantly, the original motivation for the affiliation of P–L insurance companies by acquisition or by the organization of new subsidiaries no longer exists. One early motivation to have affiliations of P–L companies was the need to expand the insurance marketing or agency representation and yet circumvent industry rules that imposed agency limitations on single companies. However, a 1944 U.S. Supreme Court decision [463] held insurance to be commerce and where insurance operations were interstate these industry agency agreements were in violation of federal antitrust laws.

The second reason for the affiliation of separate P–L companies was that historically in the United States insurance regulations, with a few exceptions, effectively limited an insurance company to monoline insurance writing (for example, it could be a fire company but not a casualty company, and vice versa). In addition, New York State established extraterritorial effect through its prohibitions on multiple line writing by ruling that any insurance company doing business in New York, regardless of state of domicile, must abide substantially by New York regulation everywhere it did business. While some states

---

[460] See app. VI–B. In 1968 the largest 50 P–L groups wrote 74% and the 25 groups in the Study provided 59% of industry net premiums.
[461] "Insurance group" is defined in sec. H.
[462] Much of this discussion of early insurance group development is from *Best's Insurance Reports* (*Fire and Casualty*), viii (66th ed., 1965).
(1965) p. viii.
[463] U.S. v. South-Eastern Underwriters Association, 322 U.S. 533 (1944).

eased their multiple line restrictions beginning in 1944, New York did not change its law until 1949, and Ohio (1955) was the last state to permit multiple line insurance companies. [464] Even without the two original reasons P–L insurance groups continue to add other P–L companies for the purpose of entering new territories, taking on new insurance lines or expanding existing lines, writing specialized contracts or simply to take advantage of a state's laws that favor corporations domiciled there. All of these reasons can be stated in terms of increasing the prospective rate of return on investment for the insurance group although that aspect is not frequently enunciated. In the insurance industry, investment considerations and operations have traditionally been considered to be separate from, if not secondary to, the insurance underwriting side of the business.

The 25 P–L insurance groups covered in the Study have followed the industry practice of adding companies. As seen in Table VI–135 (1) from year-end 1964 through December 31, 1969 these 25 P–L groups increased from 125 to 155 P–L companies. This net increase of 30 companies is largely from acquisitions or the combination of P–L groups into a larger group. Relatively few new P–L companies were chartered by these 25 P–L groups during this five year period.

---

[464] John D. Long and Davis W. Gregg (editors), *Property and Liability Insurance Handbook*, 731–793 (1965).

TABLE VI-135

Number of Property-Liability Insurance Companies in 25 Large P-L Insurance Groups 1/

1969 Rank	Name of Group or Controlling Company	Number of P-L Companies 1964 2/	1969 1/
1	State Farm 3/	3	4
2	Allstate	3	3
3	Continental Insurance 4/	12	20
4	Aetna Life & Casualty	2	4
5	Traveler's	2	6
6	Hartford Fire	6	7
7	Liberty Mutual 3/	2	2
8	INA	4	6
9	CNA 5/	6	8
10	Fireman's Fund American	8	7
11	U.S. Fidelity & Guaranty	4	2
12	Home	2	3
13	Nationwide 3/	6	5
14	Employers-Commercial Union 6/	5	6
15	Kemper 3/	9	11
16	Royal-Globe	13	13
17	Crum and Forster	4	7
18	Employers Insurance of Wausau 3/	2	2
19	American General 7/	10	11
20	Connecticut General 8/	2	4
21	St. Paul Companies	2	2
22	Reliance	7	7
22	Great American	3	5
24	Chubb 9/	4	7
25	SAFECO 10/	3	3
	TOTALS	125	155

1/ Groups arranged in order of dollar amount of 1969 net property-liability premiums written. Source: Study Form I-57.
2/ Best's Insurance Guide with Key Ratings, 59th edition, A.M. Best Company (1965), pp. 1B-11B
3/ Mutual company controls group.
4/ Formerly America Fore-Loyalty
5/ Formerly Continental Casualty
6/ Formerly Employers Group
7/ Formerly Maryland Casualty
8/ Formerly Aetna Insurance
9/ Excludes offices of 5 British companies managed by Chubb.
10/ Formerly General of America

(*2*) *Life insurance affiliates*

P–L insurance groups have not remained exclusively in the property-liability insurance business. The movement to multiple line contracts, multiple line companies and multiple line groups has in most cases also included entering the life insurance business. Those groups writing health insurance and having life insurance affiliates are referred to as "all-lines" insurance groups. This affiliation with life insurance companies is particularly prevalent among the 25 large P–L groups in the Study. All but three of these groups have at least one active life insurance company as an affiliate. Four P–L groups with very large life insurance affiliates, Traveler's, Aetna Life and Casualty, CNA (Continental Assurance) and Connecticut General are at least as well known for their life business.

(*3*) *Other insurance related affiliates*

The largest 25 P–L insurance groups are also likely to have other types of insurance affiliates, including foreign P–L companies (12 groups), title insurance (5 groups), insurance agencies (13 groups) and ancillary financial service companies (15 groups).

All of the insurance affiliations referred to above are summarized on Table VI–136 along with other types of affiliates of financial enterprises with the 25 P–L insurance groups.

TABLE VI-136

Activities of Insurance Company Complexes: 1/
Affiliated Financial Enterprises of 25 P-L Groups
December 31, 1969

Category of Enterprise	Number of P-L Groups having enterprise	No. of Financial Enterprises in Complex		
		Total	Maximum	Mean (n=25)
1a. Prop.-Liab. Ins.--U.S.	25	155	20	6.2
1b. Prop.-Liab. Ins.--Other	12	23	5	0.9
2. Life Insurance	22	60	8	2.4
3. Accident & Health Ins.	1	1	1	*
4. Credit Life Insurance	0	0	0	0
5. Title Insurance	5	28	16	1.1
6. Insurance Agency	13	38	10	1.5
7. Mortgage Broker/Banking	4	7	4	*
8. Real Estate Manag./Adv.	10	29	7	1.2
9. Commercial Bank	2	2	1	*
10. Finance Company	15	46	9	1.8
11. Savings and Loan	3	4	2	*
12. Variable Annuity	2	2	1	*
13. Invest. Adv. Firm	12	20	3	0.8
14. Sec. Broker-Dealer	10	13	3	0.5
15. Small Bus. Invest. Co.	1	1	1	*
16. Venture Capital Firm	2	2	1	*
17. Investment Banking Firm	1	1	1	*
18. Leasing Firm	5	7	3	*
19. Other Fin. Service Firm	15	31	7	1.2
20. Holding Company	12	15	2	0.6
TOTAL		483		19.3

1/ An insurance company complex is defined as including all companies directly or indirectly controlling (or controlled by or under common control with) the property-liability insurance group. Nonfinancial enterprises, which are of significance in only a few complexes, are not included in the table above. Source: Form I-57A.

* Mean is less than 0.5.

b. Noninsurance holding companies and noninsurance enterprises

The regulatory aspects of the relatively recent development of the noninsurance holding company [465] or insurance groups in insurance company complexes [466] as a device for controlling insurance companies and other types of enterprises that are not legal investments of insurance companies are discussed in section I.1.c(3).[467]

While insurance holding companies are now subject to some regulation under insurance laws they are not subject to regulation of their investments as insurance companies. Regulations of P–L insurance companies' portfolio investments limits the amount a P–L company may invest in any one noninsurance or noninsurance related company to an extent that precludes, with minor exceptions, acquisition of control. Consequently, an avenue to corporate affiliation (control) of other noninsurance enterprises is to have a noninsurance holding company be the P–L insurance group parent company[468]

The noninsurance affiliations of large P–L insurance groups to date are almost exclusively with financial service enterprises. The most noteworthy exception is Allstate's affiliation as a subsidiary of its founder Sears, Roebuck and Company, the nation's largest retailer. Four other large P–L groups—Great American, Home, Reliance and Hartford Fire—also have some nonfinancial affiliations since they were acquired by conglomerate nonfinancial holding companies.[469] Control of Great American was attained by National General Corporation in October 1968; Home was acquired by City Investing Company in December 1968; Reliance was acquired by Leasco Data Processing Equipment Company in September 1968, and over 95 percent of Hartford Fire had been acquired by the International Telephone Company by June 19, 1970. Although these relatively recent affiliations involve some nonfinancial affiliates, only information about affiliated financial enterprises of P–L groups was requested in Form I–57. However, consolidated assets and consolidated net income of each P–L insurance group complex were collected to provide a measure of their overall size.[470]

The affiliated financial and nonfinancial enterprises in complexes within the 25 P–L groups in the Study had consolidated [471] assets of $62,724 [472] million at December 31, 1969. The assets of the 25 P–L insurance group complexes range from $690 million to $9,172 million and 17 had assets in excess of $1 billion. Of the total amount $30,767 million are in the consolidated assets of the 155 U.S. P–L companies that comprise the Study sample and include their subsidiaries. These

---

[465] A noninsurance holding company in the context of this chapter of the Study is a company not licensed or authorized to do an insurance business but it controls an insurance company.

[466] Insurance company complex is defined in the Study as including all companies or enterprises directly or indirectly controlling (or controlled by or under common control with) the P-L insurance group.

[467] For additional discussion of insurance holding companies see "Insurance Giants Move into Funds," *Business Week*, March 15, 1969, at 114–118 and "More Aggressive Policy," *Barrons*, January 12, 1970 at 5 and 9.

[468] See subsec. I.1.c(2).

[469] See ch. XV of the Study for case studies describing the Great American, Home Insurance and Reliance Insurance transfers of control.

[470] The acquisition of Hartford Fire by ITT, which had been contested originally in the courts, was carried out through a tender offer in 1970. The accompanying discussion and data do not include ITT or its affiliated companies.

[471] Technically, mutual group assets are combined rather than consolidated.

[472] The insurance company assets are included on a statutory basis consistent with state regulatory authorities which means that equities of P-L companies are at prescribed market values and other assets are essentially at cost.

complexes had consolidated net income of $1,221 million[473] for the fiscal year ending closest to December 31, 1969.

The financial affiliates of the large P–L groups are shown in Table VI–136. Exclusive of holding companies, approximately 66 percent of the financial enterprises reported there involve the insurance business, 27 percent involve specified noninsurance financial enterprises and seven percent are "Other Financial Service Firms." The most significant types of financial enterprise shown on Table VI–136 were finance companies (present in 15 groups), investment advisory firms (12 groups), securities broker-dealers (10 groups) and real estate management or advisory firms (9 groups). At least two other P–L groups have acquired securities broker-dealer firms during the first half of 1970 to continue this trend. Furthermore, although not shown directly in Table VI–136, 10 of the Study P–L group complexes were already active in the investment company business at the end of 1969. Their affiliated investment advisers managed $2,364 million of mutual fund assets at that date and not included in the previous asset total for complexes. In addition three other group complexes have entered the mutual fund business or have taken preliminary steps to do so during the first six months of 1970.

J. Behavior as Portfolio Managers

1. The Investment Organization of Property-Liability Groups

a. A centralized investment department function

Prior to designing the method by which information would be gathered about P–L insurance investments, screening interviews were held with investment officers from three large P–L groups. Information about the degree of centralization of P–L investment management function provided conflicting views from this small sample and telephone inquiries to other insurance executives failed to resolve the matter. Some felt that investment management was almost always consolidated and a few others thought that consolidation was the exception. This led to the design of a questionnaire with a complex identification numbering scheme.

It was decided that the basic questionnaire, Form I–57, would be completed once for each investment department within a P–L insurance group.[474] Although the number of investment departments per group was not known in advance, it was not expected to exceed three or four. This required the complex scheme of I.D. code numbers to accommodate the identification of multiple investment departments and to permit the assignment of each group company to the proper investment department.

The results for the 25 Study P–L insurance groups were unspectacular. Only four groups ultimately reported that they had more than

[473] Excluding the netincome of Sears, Roebuck but including the net income of the Allstate P–L group would drop the total net income reported here to $871 million. Some complexes reported net income that included statutory (unadjusted) P–L insurance group net income but at least 14 used an adjusted basis consistent with generally accepted accounting principles. The amount of difference that results cannot be estimated.

[474] Investment department means that division or group of persons within the P–L insurance group or an affiliated entity which makes day-to-day purchase, sale or hold decisions for the securities portfolio, even though some other person or group has ultimate responsibility over the investments of each company. For example, if a committee of investment officers makes only portfolio recommendations and these recommendations are seldom if ever overruled by a group with ultimate authority, the committee of investment officers and its staff *is* the investment department for the purposes of the Study. This department will not necessarily be the same as any department in the group that may be called the "Investment Department."

one investment department with two of these groups having two departments each, and two other groups having three investment departments. A total of nine P–L companies are managed by the six subordinate investment departments. Three of these departments represent a total of four companies acquired during 1969. The other three departments were relatively small and the companies are geographically remote from the parent organization. All six sub-groups were acquired since 1962. Their aggregate P–L assets were only $430 million, including two companies of approximately $150 million each. These amounts are insignificant when compared with the total consolidated assets for the 25 groups of approximately $31 billion. Because of the very small size of these departments relative to the remainder it was decided to abandon any attempt to study and contrast the responses and activities of separate investment departments in the same P–L group. Results throughout this chapter reflect the recombination of multiple investment departments in the four groups where they occurred.

The Study sample of 25 large P–L insurance groups, each consisting of from 2 to 20 P–L companies (mean 6.2 per group), is serviced for the most part by one investment department per group. Until they can be assimilated with the acquiring parent group, separate investment departments are retained in recently acquired, established P–L insurance companies and groups. An example of this phenomenon is the mid-1968 acquisition of the Glens Falls group located in Glens Falls, New York, by the Continental Insurance group with headquarters in New York City, Glens Falls originally had its own investment operation but by early 1970 Continental responded that Glens Falls and all of the other Continental P–L companies were served by the same investment department as defined for the Study. Consequently, for the major part of the P–L insurance industry the meaningful respondent unit for the questions of resource allocation and investment management is the P–L insurance group investment department.

b. The decision process and degree of autonomy of investment departments

A factor that bears importantly on the role of P–L insurance groups in the securities markets is the operational relationship between P–L investment departments and their higher authority and how these relationships may have changed in recent years. Each of the 25 P–L insurance groups was asked to describe the operational relationship between the boards of directors, any subordinate committee concerned with investments, and the investment department. Specifically they were asked to include the composition of relevant committees, the timing and form of the committee's authorization to the investment department to enter into securities transactions, and any existing discretionary limits that permitted investment department action without specific advance approval. Further, any significant changes in procedures since 1965 were to be reflected in their answers. A summary of the responses of the 25 P–L insurance groups for each group's main investment department follows.

Even though the several boards of directors for the companies in each group retain ultimate authority and responsibility, in every instance the insurance companies of the group have delegated responsibility for determining and implementing operational investment policy

to a subordinate committee of directors. Among the 25 P–L groups in the Study, this committee is most often called the "Finance Committee" (11 groups), but titles such as "Executive" (6), "Investment" (4), "Securities" (1), "Research" (1) or "Executive and Finance" (2) Committee are also used. In four cases the finance committee or its equivalent was responsible to another committee of the board of directors and reported to it instead of the entire board. In every case the board of directors ultimately approves all securities transactions of the group.

The finance committee typically consists of five to eight directors and most often includes those holding the positions of board chairman, the top one or two operating officers, the top financial officer and several outside directors. The smallest committee had three members; the largest had ten. In only one group was it evident that the committee responsible for investments was made up exclusively of insiders: four top operating officers plus the chairman and vice chairman of the board of directors. The finance committees of the large insurance groups included in the Study usually consist of top management plus outside directors.

Two P–L insurance groups, in addition to their finance committees, have investment advisory committees composed of experts in finance, economics and investments from outside of the insurance group. These committees meet monthly or semi-monthly to discuss current developments with the investment department and act in a consulting capacity on investment management.

Another significant variation in the usual roles of the finance committee and the investment department was indicated in one P–L group that employs an affiliated investment advisory firm to assist the committee and department. With this exception the 25 P–L groups provide their own internal investment management for their significant companies.[475]

The finance committee typically establishes investment policy and guidelines for the operations of the investment department. It meets with representatives of the investment department to receive and approve reports of interim department actions and to receive recommendations for future transactions. The frequency of these meetings varies from group to group: weekly in four groups, biweekly in five groups, monthly in fourteen groups and only quarterly in two groups. In several cases special meetings are held when there are unusual circumstances or when policy guidelines would be exceeded by a transaction proposed between regular meetings. Telephonic consultations are used on a regular basis by a few groups and by several other groups for exceptional situations.

In general, finance committees establish quite different investment policy guidelines for fixed income securities and common stocks. However, dollar amount or percentage-of-assets limits on the amount invested per issuer are used in many groups for most securities. For example, one respondent reported as follows:

> The discretionary limits of transactions by the Investment Department established by the Finance Committee are:
> 1. Municipal Bonds: $100,000 per issuer.
> 2. Corporate Bonds: $200,000 per issuer.
> 3. Short-Term U.S. Treasury Bills: no limit.
> 4. Other Short-Term obligations: $5,000,000 per issuer.

[475] Two subordinate P–L groups have small P–L companies with independent investment operations and each uses a bank trust department for investment counsel or management.

5. Publicly Traded stocks are permitted by (three) categories: . . . (permitting) investment (at cost) of not to exceed in aggregate 3% (or 2% or 1%) of the common stock portfolio.

The categories contain lists of names specifically approved by the Finance Committee. Other transactions require specific approval . . . .

The maximum dollar discretionary limit reported for a P–L group for an equity security is $10 million per issuer, although many groups did not indicate that any specific dollar limits existed.

Subject to these discretionary constraints per issuer, the investment department is usually at liberty to buy and sell most fixed income securities without securing specific committee authorization. The sale of common stock, with one exception, is also permitted without specific authorization. In contrast, purchases of common stock normally are permitted only with advance authorization by the finance committee unless the issuer is on their approved list. Of the 25 P–L groups, 18 require advance authorization or use an approved list for common stock purchases. In many instances the approved list includes those issues currently held in the portfolio, thereby allowing the investment department flexibility at any time to add to existing positions in those issues not exceeding the maximum investment permitted. From time to time the investment department makes recommendations for additions to the approved list of issues of companies not owned currently. The list is also reviewed by the finance committee periodically.

While additions to an approved list or the authorization of a transaction requires a majority vote by the finance committee in most groups, in one group unanimous approval is required. These procedures for approval and authorizations appear formidable, conservative and formal but there are modifying provisions in many P–L groups' investment policy. Telephonic consultation was mentioned earlier and at least 10 groups indicated that, when necessary, advance approval of a transaction by as few as two committee members is sufficient.

Not all P–L groups have investment policies and procedures similar to the representative ones described above. As an illustration of very restrictive group investment policies, note the following response:

Approval of the Executive Committee is generally obtained prior to the execution of a securities transaction . . . . While the Executive Committee approves most transactions, prior approval of the Board of Director is needed for any major commitment.

In contrast, the following two P–L groups (A and B) reported investment policies that are much more flexible than the investment policies followed by most groups:

A. The Company's Board of Directors appoint seven of its members to serve as a finance committee with responsibility for investment policy. This policy is implemented by the Investment Department which reports on its activities to the Finance Committee monthly. The purchase or sale of a security is made by the Department without advance approval and there are no dollar limits placed on transactions.

B. The Finance Committee has delegated to the Common Stock Department through the Treasurer, the authority to purchase and sell common stocks, subject to reporting weekly on all transactions completed during the preceding week. The Treasurer, the Chairman and any of the other members of the Finance Committee may act on the basis of the weekly report to restrict any further activity in any security. Common stock purchases made during any month without prior approval of the Committee may not exceed 10% of the market value of the portfolios at the end of the month preceding the purchase.

The foregoing procedures were instituted in early 1968. Prior to that time stocks for purchase were selected from a list that had the prior approval of the Finance Committee.

Furthermore, the final paragraph in group B's response above illustrates the type and direction of change that has been made since 1965 in some P–L groups' investment policies so as to achieve more flexibility and to liberalize investment department procedures. Six of the 25 respondent groups specifically indicated that they had changed their investment procedures significantly since 1965. Several others mentioned that the investment department's discretionary limits had been expanded since 1965. These significant changes in investment department flexibility are a harbinger of a gradual shift in investment procedure by the P–L industry. This change is perhaps best illustrated by the following response by one P–L group:

> These procedures have changed significantly since 1965. . . . It was formerly the practice to secure individual security authorization, rather than operate within broad general limitations. Although the Investment Department was empowered to proceed without prior Executive Committee approval of specific actions, this was regarded as an emergency power; therefore telephonic approval was expected to be sought whenever possible prior to taking such actions.
>
> Greatly increased investment activity, changed personnel of both the Executive Committee and the Investment Department and the adoption of a different philosophy as to the role to be played by the Executive Committee in investment matters led to the change in procedure.

In summary, this section has described the degree of autonomy of the P–L investment department and the relationship of the department to its finance committee. In three-quarters of the groups studied, the finance committee retains considerable control over the department, particularly with regard to the purchase of common stock. There is evidence however, that gradually the role of the finance committee is being restricted to making policy guidelines and that investment departments are being granted increased authority and flexibility in making equity investments.

c. Internal staff of P–L investment departments

Changes in the numbers of persons in various investment department employment categories between 1964 and 1969 give some indication of the relative significance of these positions today versus five years ago. This information and information about the academic and professional training of security analysts were requested of the 25 P–L insurance groups.

Table VI–137, Investment Department Personnel in Various Capacities, summarizes the combined investment department staffs for all 25 P–L groups in "full-time" equivalents in 1964 and 1969. The percentage change is also shown in each category. Although small in terms of the number of full-time equivalents, the most significant relative change is the great increase in the number of professional traders. This is particularly true of equities traders, whose numbers increased fourfold in this five year period. In contrast, total investment department personnel increased 48 percent during this period. Also of interest is the great increase in account supervisors, portfolio managers and investment research staffs for equities compared to the relatively small increase in those categories for bonds. These changes show that in staffing the investment departments of P–L groups, increased emphasis is being given to investment in equities. Further, this presumably means emphasis on common stock investment since preferred stock investment is relatively modest and it is often more closely associated with bonds and other fixed income investment.

TABLE VI-137

Investment Department Personnel
in Various Capacities 1/

Employment Category	Full-time Equivalents 12/31/64 Subtot.	12/31/64 Totals	12/31/69 Subtot.	12/31/69 Totals	Percentage Change Subtot.	Percentage Change Totals
Account Supervisors and Portfolio Managers -- Bonds	35.5		41.9		+18.0%	
-- Equities	29.0		42.8		+47.6%	
		64.5		84.7		+31.3%
Economic Research Staff		4.3		8.1		+88.4%
Investment Research Staff -- Bonds	38.4		44.5		+15.9%	
-- Equities	73.2		130.2		+77.9%	
		111.6		174.7		+56.5%
Professional Traders -- Bonds	8.3		10.6		+27.7%	
-- Equities	3.9		17.4		+346.2%	
		12.2		28.0		+129.5%
Clerical, Secretarial		165.4		246.1		+48.8%
Executives (not included above)		29.1		36.3		+24.7%
Other		42.3		56.0		+32.4%
TOTAL 2/		429.5		633.6		+47.5%

1/ Source: Form I-57.

2/ Sums may not add to total because of rounding.

The definition of each employment category in Table VI–137 was subject to interpretation by each respondent and this led to some inconsistencies. The 25 P–L groups reported 174.7 full-time equivalents for Investment Research Staff at the end of 1969. When asked directly, "How many investment research analysts (securities analysts) does the Investment Department have?" the response was 206. The latter figure presumably includes some officers and others that were classified separately in Table VI–137 by some respondents. Using 206 as the relevant number of security analysts, the P–L groups reported that almost one-half (102) had advanced degrees such as the M.B.A. or L.L.B. degree.

The 25 P–L groups were also asked to report what number of their investment department officers, investment research analysts and others have passed the three Chartered Financial Analysts ("C.F.A.") examinations. These results are displayed in Table VI–138. Relating the numbers reported to the total investment department personnel exclusive of secretarial and clerical employees shows that slightly less than one out of five has completed one or more of the Chartered Financial Analysts examinations. While this reflects the recent origin of the C.F.A. examinations it also suggests that relatively little emphasis has been placed on this formal measure of professional investment training as of the end of 1969.

d. Search for and evaluation of investments

The 25 P–L group investment departments were asked to rank several specified external sources of securities research and information by indicating the importance of each source in making purchase or sale decisions. These results are summarized in Table VI–139 It should be noted that respondents were not instructed to differentiate between common stock and other securities in their responses. Different codes might be more or less appropriate depending on the type of security being considered. The following "Importance Codes" were used to respond:

TABLE VI-138

Investment Department Personnel
and Highest Level Completed
of C.F.A. Examinations 1/

Levels Of Chartered Financial Analyst Examinations	Number of Investment Department Officers Analysts and Others Passing Level 2/
First Level	22 (5.7%)
Second Level	16 (4.1%)
Third Level	38 (9.8%)
Total, All Levels	76 (19.6%)

1/ Source: Form I-57.

2/ Total investment department personnel (see Table VI.d.1.c-1) time equivalents at December 31, 1969, excluding clerical and secretarial, are 389.5. This number is used as the base.

TABLE VI-139

Importance of Selected External Sources
of Investment Information 1/

External Information Sources	Importance Code 2/ (most) ⟵⟶ (least)					Total Res-ponse 3/
	1	2	3	4	5	
Information and recommendations from broker-dealers purchased via commission dollars	8 (32%)	14 (56%)	3 (12%)	0	0	25 (100%)
Information and recommendations purchased from investment advisers on a continuing or contractual basis	1 (4%)	3 (12%)	7 (28%)	1 (12%)	11 (44%)	25 (100%)
Information and recommendations received from other research organizations not included above (with or without compensation)	0	8 (32%)	9 (36%)	6 (24%)	2 (8%)	25 (100%)
Direct contact with security issuers	6 (24%.	7 (28%)	7 (28%)	5 (20.0%)	0	25 (100%)
Financial statements of issuers	22 (88%)	0	2 (8%)	1 (4%)	0	25 (100%)
Others	1 (4%)	3 (12%)	0	0	6 (24%)	10 (40.0%

1/ Source: Form I-57.

2/ See sec. J.1.d. for meaning of importance codes.

3/ Each cell shows the number of P-L investment departments giving a particular rank or code to a source of information.

Code and Description

1	Very important, always used
2	Important, used often but not always
3	Somewhat important, used sometimes but not frequently
4	Not important, used only infrequently or rarely
5	Unimportant, never used

"Financial statements of issuers" is ranked as the top source of information by 88 percent of respondents with 22 of 25 investment departments ranking financial statements with Code 1. The only other category that scored consistently high was "Information from broker-dealers purchased via commission dollars." Of the 25 responses, 22 ranked this source with Code 1 or 2, and 56 percent ranked it as second in importance. Those respondents assigning Code 1 or 2 for "Others" use sources such as Federal Reserve Board statistics and other government publications, financial news media, trade and professional journals and talks by management to financial analysts groups. Thirteen (52 percent) of the departments almost always use direct contact with security issuers. In a related but independent question about the percentage of research analysts' time spent in personal or telephonic contact with issuers of securities 21 of 25 investment departments, responded with "20% or less." The remaining four indicated from 20 percent to 40 percent of their analysts' time was spent in this manner.

When questioned about their approach to securities evaluation, the "Fundamental Approach" ranked first (92 percent of the investment departments) and "Economic Outlook" ranked second. "Technical Approach" showed a distant third place, although seven groups used it often. The two respondents assigning Code 1 to "Other" considered (a) market psychology and political factors and (b) industry position and management to be of prime importance in the evaluation of securities. This information is summarized in Table VI–140.

As a general practice security analysts were assigned to one or more specific industries in 16 of the 25 investment departments. Of the remaining nine investment departments several indicated that only certain industries such as utilities were assigned to specific analysts. Three other respondents indicated that the assignment of industries did not pertain for bonds. Only a few investment departments failed to use industry assignments for their security analysts, allowing the analysts to choose areas and issues that interest them.

TABLE VI-140

Importance of Various Approaches to Securities Evaluation 1/

Approach to Securities Evaluation	Importance Code 2/ (most) ← 1	2	3	4	→ (least) 5	Total Response 3/
Fundamental	23 (92%)	2 (8%)	0	0	0	25 (100%)
Technical	0	7 (28%)	7 (28%)	11 (44%)	0	25 (100%)
Economic Outlook	5 (20%)	12 (48%)	6 (24%)	2 (8%)	0	25 (100%)
Other	2 (8%)	0	0	0	7 (28%)	9 (36%)

1/ Source: Form I-57.

2/ See sec. J.1. for meaning of inportance codes.

3/ Each cell shows the number of P-L investment departments giving a particular rank or code to an evaluation method.

e. Allocation and trading procedures [476]

The 25 P–L investment departments were asked about the method used to allocate purchase or sale transactions among the several accounts and companies they served. The responses did not reveal any pattern of preferential trading or allocation procedures. In general, factors such as cash position and relative size determine allocations and frequently average prices are credited or charged to each company if multiple transactions are involved.

The questions inquired about transactions that extended over a period of time and transactions that involved economically attractive securities such as new issues. Similar questions were addressed to other institutions by the Study. In most P–L groups investment policy and regulation [477] tend to minimize the instances wherein there are investments in unseasoned issues or investments in individual issues of such size that transactions might need to be spread over several days.

Many groups (16) reflect prorata allocations based on the relative size of each company and using, for example, weighted average prices for each day's transactions. Most responses also emphasized the logical and dominant influence of differing cash positions among group companies in allocating transactions. A few groups mentioned quantity commission rates, but some groups attempted to minimize commissions while others explicitly ignored them. Finally, one group indicated a degree of preferential allocation in that transactions were completed first for accounts managed for owners other than the group, including separate accounts, and then group accounts were serviced on a weighted basis at average cost.

In section J.1.b the decision process and degree of autonomy of investment departments were discussed. Frequently finance committee authorization was required prior to any action by the investment department to purchase common stock not on an approved list. The P–L groups were also asked directly whether they used lists of securities approved (recommended) for sale, hold or purchase. The responses summarized in Table VI–147 indicate that 14 of the 25 P–L groups (56 percent) use lists of securities approved for purchases. Only seven groups use lists of securities recommended for sale and five groups use lists of securities recommended for hold.

2. Investment Policy and Practice

Insurance underwriting and investment management within a P–L insurance company or group may be considered as two distinct if not separate operations. Except at the level of top management, creation and marketing of insurance products and services is accomplished and the funds that have been generated are invested and managed without immediate and direct concern about the connection between insurance underwriting and investment. If anything, the basic role of the investment management is obscured by the fact that only a very small minority of the insurance group's employees are involved directly in investment operations. This includes the board of directors, top management and the investment department professional staff,

---

[476] Institutional trading is discussed in ch. XIII.
[477] See sec. I.1.c(4), J.1.b and J.2.e.

which numbers well under two dozen people in most P–L groups studied. This is not to imply that the vital role of income and capital gains in offsetting the almost chronic unsatisfactory industry underwriting experience of recent years has been unnoticed. However people involved on the insurance side of the business are not immediately concerned with the investment portfolio or its management, and vice versa. Further, as all large P–L groups become more diversified in the insurance lines and policies written, the investment-insurance risk relationships that were part of the lore of the industry also have been obscured.

The 25 P–L groups were questioned in order to ascertain what impact such factors as underwriting activity and experience, taxes and liquidity may have had on investment management in the 1965–1969 period. To provide the relevant background and context, questions were also asked about the impact of investment regulations and capital requirements on investment management. Data were also collected from the P–L groups as to their (a) lines of insurance business, (b) underwriting experience including dividends to policyholders, (c) net investment income, (d) realized and unrealized gains and (e) each groups' interpretation of the state investment restrictions to which each of their companies are subject. The discussion that follows summarizes the responses of the 25 P–L insurance groups to these questions and includes summary data that depicts their operating environment as well as investment policy and experience during the five-year period ending December 31, 1969.

a. Investment regulation, company policy and common stock investment

As described earlier in subsection I.1.c(4), statutory and regulatory law affects the investments of all P–L insurance companies and groups. These laws and regulations most frequently affect portfolio holdings by requiring a minimum amount of investment in qualifying types of securities—primarily fixed income—with the amount being related to (a) minimum required capital and surplus and (b) the company's liabilities known as statutory unearned premium and loss reserves.[478] The maximum amount of common stock investment is specified indirectly for non-life insurance companies by finding the remainder after deducting the amount of investment required in assets other than common stock.

To ascertain how policy and management with respect to common stock investment are influenced by regulation, respondent investment departments were asked to specify the maximum dollar amount that each company could have invested in common stock at December 31, 1969 under the most restrictive regulatory statute of any state to the laws of which the company was then subject. They were also to indicate the percentage actually held of such maximum amount and to

[478] Insurance accounting terminology is persistent in continuing the use of terms that are no longer widely accepted in general accounting. The word "surplus" has been retained in lieu of the generally used description "capital paid-in" or "retained earnings," as appropriate. "Surplus" here does not necessarily imply that there are any funds available for use, let alone extra funds. Also, the word "reserve" as used here depicts a regular liability of the company, not an amount of funds held to meet a contingency. "Statutory" as used with an accounting expression in the insurance industry means as that item is calculated according to statute or regulatory authority. History must be the only significant vote for the retention of these misleading antiquated accounting terms.

describe how they arrived at these figures. In a separate question they were asked to elaborate on the amount of common stock held by each company using 90 percent of maximum as an arbitrary benchmark.

These questions proved to be quite bothersome and difficult for many of the respondents to interpret and answer. There are two apparent reasons for this difficulty. First, the responses ultimately given indicate that frequently P–L investment departments are guided by internal policies that are both separate from and typically more restrictive than the stated regulatory requirements. Second, and since the above reason made the above Study questions academic in many cases, the respondents arrived at conflicting interpretations of what would be the hypothetically appropriate answer. Basically two responses were expressed here, either that the domiciliary [479] state is the only state of consequence or that there is one identifiable most restrictive state and this may not be the domiciliary state. The latter interpretation is based on the universally used concept of "substantial compliance" with the laws and regulations of any state, other than the domiciliary state, in which the company is licensed to do business. To illustrate the two opposing interpretations note the following two responses:

"It is our understanding that as a domestic property and casualty company in . . . we are not subject to the investment laws of the (other) states in which we do business. We furnish those states a certificate of compliance with the investment laws of . . . (domiciliary state)."

(and)

"A domestic (New York) non-life insurer must maintain assets corresponding to one-half of the company's reserves including minimum capital, in certain specified classes of reserve investments, before the company is permitted to invest in other types of investments including common stocks. A foreign non-life insurer must substantially comply with the investment restrictions and requirements applicable to a domestic insurer."

As another illustration of the interpretation problem, of the two large P–L groups based in Pennsylvania that are in the Study sample, one indicated the domiciliary state and the other indicated New York State as being most restrictive.

Some groups based their response on careful state-by-state legal research and others responded on the basis of what appeared to be obvious. The results summarized in Table VI–141 below indicate a strong belief that New York is the state regulator that would determine the maximum amount of common stock investment permitted if internal policy did not intercede. Although all of the 10 P–L groups selecting states other than New York State are domiciled elsewhere, approximately an equal number of groups foreign to New York give their consensus to New York as the most limiting state.

[479] Domiciliary state is the state that charters the insurance company. That U.S. company operating in any other state is a "foreign" insurance company, subject to substantial compliance. A company not chartered in one of the United States is an "alien" insurance company.

TABLE VI-141

States Whose Regulatory Statutes Are Most Restrictive In Terms Of Amount Of Common Stock Held By P-L Insurers

State	Number of Groups Giving Consensus to State	Number of Group Companies Per State
New York	15	96
Illinois	4	15
Wisconsin	1	5
Washington	1	5
Ohio	1	4
Pennsylvania	1	4
Maryland	1	2
Minnesota	1	2
Other States	0	22
Totals	25	155

Source: Form I-57.

Whether the insurance group and its investment department feel that the regulations of the domiciliary state or some other state are most restrictive is irrelevant for most purposes since internal policy is, in reality, the effective determining factor. What the P–L groups think ultimately would be the limiting state regulation on common stock is significant only in the sense that it shows that if internal policies are relaxed for any reason in the future, P–L insurers potentially could increase their common stock holdings significantly for most companies. One group's argument for adopting a policy favoring greater common stock investment based on the deleterious impact of inflation on long-term insurance reserves is described in section J.2.b. Of the 155 companies covered in the survey only 13 companies had sufficient investment in common stock at December 31, 1969 to exceed 90 percent of the maximum allowed under their interpretation of the most restrictive state regulation.

In response to inquiring why common stock investment was less than 90 percent of the maximum allowed, internal investment policy was cited frequently. It is felt by the P–L groups that full utilization of the maximum legal common stock ownership would be imprudent because of the risk of severe shrinkage of policyholders surplus which would result from declining portfolio values in a significant stock market downturn. The resulting reduction in asset values (and surplus) could jeopardize the position of policyholders or at least curtail premium writing since each group tries not to exceed a ratio of premium volume to policyholders surplus that it has established as a target.

It should be noted that the method of reporting asset values that is required for all P–L companies makes the recorded value of the common stock portfolio change with market gyrations. In contrast, fixed income securities (which make up more than one-half of the total P–L company portfolio) must be recorded at amortized values that are immune from changes in market values. Consequently, fluctuations in interest rates and bond prices are not reflected in reported portfolio values. Under market conditions existing in 1969, for example, substantial additional depreciation in the market value of P–L insurance portfolios is not reflected in published financial statements because of these different valuation requirements. This notion is summarized by one group as follows:

> Management has always regarded the amount of capital and surplus as the primary consideration in determining the maximum investment in common stocks, reflecting in part the need to value common stocks at market and the effect that a price decline would have on surplus. The existence of a gap between the actual investment and the statutory maximum is not considered to be a sound reason for increasing the investment (in common stock).

b. Impact of volume and lines of property-liability insurance written on liquidity and portfolio composition

Part of the lore of the P–L insurance industry is that historically investment relationships have existed between (a) the volume of net premiums written in various lines of insurance and (b) liquidity requirements, portfolio composition and management. Examination of these hypotheses is of interest as it may indicate how P–L insurance groups are influenced to invest in various types of assets including common stocks.

53-940 O—71—pt. 2——45

As described earlier in section I.1.b., there are 23 different lines of P–L insurance. Respondent P–L groups were asked to report the 1969 net premiums written [480] for each company in the following eight categories of insurance lines: A. Fire and Allied, 01, 02, 03; B. Multiple Peril, 04, 05; C. Workmen's Compensation, 16; D. Liability others than Auto, 17, 18; E. Automobile, 19, 20, 21; F. Fidelity and Surety, 23, 24; G. Others Lines, 06, 07, 08, 09, 14, 15, 22, 25, 26, 27, etc.[481]

Table VI–142, Aggregate Net Premiums Written in 1969 by Categories of Insurance Lines, shows the premium distribution in dollars for five mutual P–L groups, 20 stock P–L groups and the 25 mutual and stock groups combined. Each category as a percentage of total net premiums written in 1969 is also shown.

Among hypotheses about lines of insurance business, their attendant cash flow characteristics and appropriate investments, one hypothesis suggests that losses that arise from lines such as fire insurance (line 01) are associated with immediately recognized events which have identifiable fixed costs. There is also quick payout associated with these losses. On the other extreme, casualty insurance business and workmen's compensation (line 16) in particular has associated with it uncertainty in timing, duration and total size of payment. The latter line (workmen's compensation) implies the need for long-term appreciation in asset values to meet long duration coverage costs which are affected by inflation.

---

[480] Net premiums written are defined as gross premiums from direct business written during the year, plus reinsurance assumed from other writers, less reinsurance ceded to other companies. This figure represents the ultimate or net insurance underwriting position assumed in each line or class of lines by the company during the year. In many respects it is similar to gross revenue in general accounting although the premiums written are not necessarily earned during the same period they are written.

[481] The numbers 01 through 27 refer to 23 specific lines of insurance, plus four spaces for miscellaneous lines, as specified in the standard convention blank (form) of the National Association of Insurance Commissioners, for annual reporting by all P-L companies.

TABLE VI-142

AGGREGATE NET PREMIUMS WRITTEN IN 1969
BY CATEGORIES OF INSURANCE LINES
FOR 25 P-L GROUPS

Categories of Lines	Net Premiums Written 1/ 2/ $(000) and % of Total		
	5 Mutual Groups	20 Stock Groups	25 Groups
A. Fire and Allied	$92,198 2.30%	$1,503,479 11.55%	$1,595,676 9.38%
B. Multiple Peril	$345,937 8.63%	$1,873,566 14.40%	$2,219,503 13.05%
C. Workmen's Compensation	$578,730 14.45%	$1,532,713 11.78%	$2,111,443 12.41%
D. Liability other than Auto	$161,384 4,03%	$956,603 7.35%	$1,117,988 6.57%
E. Automobile	$2,492,177 62.23%	$4,875,069 37.47%	$7,367,246 43.30%
F. Fidelity and Surety	$14,375 0.35%	$357,836 2.75%	$372,212 2.19%
G. Other Lines	$319,746 7.98%	$1,909,222 14.67%	$2,228,968 13.10%
TOTAL	$4,004,547 100.00%	$13,008,489 100.00%	$17,013,036 100.00%

1/ Vertical and horizontal totals may not add due to rounding.

2/ Source: Study Form I-57.

However, as seen in Table VI-142 there is wide diversification across categories of lines of insurance. While auto lines predominate with 62 percent and 37 percent of all mutual and stock group aggregate net premiums respectively, the remaining six categories of lines range between 0.4 percent and 14.5 percent of aggregate net premiums. The development of multiple line underwriting and policies with packages of coverage have added an element of risk spreading to the P-L group which would tend to dilute the impact of any particular lines of business on cash flow.

With regard to the volume and growth of aggregate industry net premiums, the average annual rate of growth has been 9.8 percent per year for the five year period ending December 31, 1969. The increase in 1969 was 12.3 percent.[482] The 25 P-L groups in the Study sample increased their net premiums written in 1969 by an average of 10.8 percent compared with their 1968 volume. In 1969 these 25 groups combined grew at a slightly lower rate than the industry as a whole.

Given their own experience about volume of premiums and lines of business each of the 25 groups was asked, in the context of consideration of its relative reserves (liabilities), and surplus (capital in excess of liabilities), to describe what investment consideration, if any, is given to absolute and relative liquidity needs in determining portfolio composition. Cash plus traditional high quality, short-term liquid investments were to be contrasted to common stock investment. In addition, they were asked to describe the impact their particular group's distribution of premiums by classes of lines had on the types of securities held in their portfolio. Finally, any significant changes in these relationships during the last five years were to be noted.

On the question of premium lines and portfolio composition the PZL groups gave quite uniform and consistent responses that indicated, for example, "investment by types of securities is not influenced by distribution of net premiums written by line." Further, the ability of a P-L group to spread its underwriting risks uniformly over its several companies is illustrated by the following response. "Reinsurance of premiums within the . . . group allows investment management on a group basis." Only occasional exceptions were noted where a particular group had a concentration of premium writings in fidelity, multiple peril, or similar lines that call for immediate settlement.

Responses concerning the relationship of premium volume to liquidity and portfolio composition were more complex and difficult to interpret clearly. For one thing, some respondents inappropriately interpreted the question as being restricted only to the effect on long-term investments such as common stocks. They dismissed the investment in cash and short-term liquid securities as a treasury-type consideration separate from (long-term) portfolio investment management. It was the intention of the Study to inquire about the investment policy at the broader level so as to include both types of investment functions. Another problem with the responses was that, given the complexity of the question, other respondents addressed themselves to inveestment generally, without explicitly relating the volume of premiums written to the liquidity issue.

---

[482] *Best's Aggregates and Averages: Property-Liability 1970*, at 1 (1970).

Given the unfocused nature of some responses, it is concluded that liquidity considerations in general do not have a significant effect on portfolio composition among these 25 large P-L groups. Premium volume is regarded as only one factor in the liquidity equation. Five of the groups attest specifically that liquidity has little if any impact on portfolio composition by types of securities. One of these respondents reports that "[I]ts cash receipts from premiums, investment income and maturing investments together with cash and short-term investments are adequate to pay all current claims, expenses, taxes and unusual casualty losses."

In addition, one-half of the respondents did consider liquidity as a factor in choosing investment but simply kept a percentage or constant dollar amount of their portfolio in typical liquid securities. For example, one respondent answered as follows:

"Liquidity reserve of $15 million . . . is maintained at all times invested in U.S. Treasury obligations of which $10 million must be due within one year. From time to time additional specific reserves are maintained in highly liquid securities. At least 75 percent of all liabilities are covered by cash, reserves, bonds and other quick assets."

Where investment consideration was referred to more explicitly the policy is to maintain a pool of liquid assets and to schedule the maturities of bonds to produce a regular cash flow. Several groups mentioned that should the need ever arise, in addition to their marketable bond portfolio, their common stock investments were of high quality and marketability. The implication is that any part of the total portfolio could be sold at any time if the situation demanded it, but that this has never occurred. This implies that if the need ever arose the P-L insurers believe they would sell long-term bonds and, or stocks in spite of depressed market values such as existed in 1969 and 1970.

Eight groups felt that as net premiums rose so must liquidity requirements, but two others argued convincingly that the increased premium inflow had the opposite effect. A stock group presented the volume-liquidity relationship as follows:

"An important determinant of cash flow for a property and liability insurance company is the trend of its premium volume. Our companies have shown a sizeable growth of premium volume for several years, producing a substantial annual cash flow and essentially eliminating the necessity to hold a large short-term investment position. Regardless of the trend of premium volume, there is a seasonal cash drain in the early part of each year, due in large measure to State Premium Tax payments. Our short-term investment position at year-end would ordinarily be maintained at a level adequate to meet this seasonal factor."

A mutual group responded as follows:

"The Investment Department has studied the liquidity needs of its companies several times and has yet to find a satisfactory model or analytical method for determining liquidity needs. Nevertheless, investment consideration is given to our liquidity needs, applying our best judgment to the factors we think are relevant. Firstly, we consider the cash flow generated by the insurance operations. Over the years the insurance operations have provided large and fairly reliable amounts of funds. On a cash basis, unexpected catastrophes and other adverse insurance claims are usually offset with funds from premium payments. Even if insurance operations operate at a loss for several years, premium growth usually results in an overall positive cash flow. Secondly, we consider the schedule of bond maturities, which is a large and very reliable source of funds. Thirdly, we consider investment income. Since most of the investment income

consists of interest payments, it also is a very reliable source of funds. Fourthly, we consider projections and budgets of the companies in our group. Finally, we determine how much liquidity is needed in the portfolios. Our tentative conclusion has been that actual liquidity of our companies has been well above needed liquidity, and that a change in the growth rate of premium volume would have a very significant impact on liquidity needs."

At least four groups made specific reference to their recent reconsideration of their reserve and surplus position, as well as premium volume, in determining portfolio composition. One group described their reduction from a very high liquidity position over the last five years reflecting an investment policy shift toward growth equities and some categories of fixed income securities. Two other groups that previously limited common equity investment to 100 percent of capital and surplus have explicitly revised their internal policy to permit this common stock ratio to increase to 115 percent in one case and 150 percent in the other. One of these groups cited the need to produce more growth in surplus to offset the fact that, "[I]n the casualty insurance business some reserves, such as for workmen's compensation cases, are long-term reserves without any fixed dollar amount, as in the life insurance business. The initial amount set aside, after a period of time, becomes inadequate because of inflationary influences in the economy." The fourth of these P-L groups indicated the common stock investment may now equal 100 percent of capital and surplus. The ratio formerly was 85 percent to 90 percent.

In summary, there is almost unanimity among the 25 P-L groups that diversification across lines plus reinsurance has virtually eliminated special consideration of insurance lines in portfolio management.[483] At the same time there is some difference of opinion about the impact of premium volume, reserves and surplus on portfolio composition. Obviously even those who disclaim any consideration of premium volume still maintain some pool of liquid, short-term securities to meet contingencies. Most significantly, however, there is evidence of further stress among P-L groups on the vital role played by common stocks in building surplus and maintaining a satisfactory reserve to surplus ratio.

c. Underwriting experience and income taxes

Traditionally the separation of the insurance underwriting function from the investment function, as described above, has excluded essentially all investment return from direct consideration in ratemaking. Although recently this approach has come under study or been altered by several state legislatures,[484] a ruling adopted by the NAIC[485] in 1921 has long provided the basis for the evaluation of profits and ratemaking in the P-L industry. The 1921 Profit Formula[486] is stated as follows:

1. Underwriting profit (or loss) is arrived at by deducting from earned premiums, all incurred losses and incurred expenses.

2. No items of profit or loss connected with the so-called banking end of the business should be taken into consideration. . . .

---

[483] An attempt to measure these relationships statistically is described in Robert Daines, "An Analysis of the Impact of the Underwriting Function on the Investment in Common Stock for Multiple Line Insurance Company," *Journal of Risk and Insurance*, September, 1968, at 357–370. Mr. Daines found a positive but varied relationship.

[484] For example, Florida, North Carolina, Virginia, Texas and New Jersey. among others. See sec. I.1.b(5).

[485] National Association of Insurance Commissioners.

[486] *1922 Proceedings of the NAIC*, 19–29.

Since that time the controversy among P-L insurance companies and groups, industry regulators and government agencies at the state and federal level, academicians and the rest of the public concerning the exclusion of the "banking end" of the business from underwriting ratemaking has fluctuated in intensity. The NAIC has been reviewing the issue,[487] a congressional subcommittee [488] has P-L insurance practices and profits under its scrutiny, the U.S. Department of Transportation is conducting a continuing study of automobile insurance, several states such as Virginia and North Carolina have passed legislation requiring consideration of investment income in ratemaking, and testimony on the subject is being heard by state insurance commissions in New Jersey and Texas.[489]

For the specific purposes of the study and its focus on the role of institutions such as P-L insurance groups in the securities markets this controversy and its resolution is of only tangential consequence. The Study is interested in what impact if any underwriting activity has on the investments of P-L groups and whether change in the regulatory consideration of investment income might affect investment policy and behavior. These Study needs require that the fundamental differences between the results of statutory insurance accounting and reporting and the more widely used accrual accounting be identified herein before these investment questions can be answered. Consequently, the relevant background explanation that follows defers consideration of the intense unresolved debate over the measurement of P-L profitability in favor of the portfolio management questions.

Under the statutory accounting method prescribed for all P-L companies, sales commissions and other expenses related to the acquisition of an insurance contract are charged off as incurred rather than being capitalized as prepaid expenses on the balance sheet. This conservative approach considers these charges as current costs thereby avoiding their inclusion on the balance sheet as a prepaid expense—an asset that has no liquidation value. The alleged regulatory purpose here is to emphasize the solvency of the P-L company and the policyholders' position in liquidation.[490]

In contrast to this traditional regulatory posture is the argument that the focus in financial reporting for P-L companies should be on a

---

[487] *Measurement of Profitability and Treatment of Investment Income in Property and Liability Insurance,* NAIC. June 1970. This well written study gives through consideration to the problems inherent in (1) the accounting system, (2) measuring profitability, and (3) treatment of investment income in ratemaking.

[488] Subcommittee on Antitrust and Monopoly of U.S. Senate Committee on the Judiciary. See sec. I.1.b(5) above for further information on this and the other regulatory developments mentioned here.

[489] As reported in sec. I.1.b(5) income from all sources will now be considered in ratemaking in Texas.

[490] While allegedly focusing on solvency, but with the apparent inconsistencies and inaccuracies that follow, statutory insurance accounting requires that assets such as furniture, fixtures, automobiles and all premiums due over 90 days be excluded entirely from the balance sheet. Even in liquidation the value of these "nonadmitted" assets would be greater than zero. At the same time, investments in securities other than common or preferred stock are carried essentially at cost totally ignoring the actual liquidation value which would be approximated by market value. With somewhat over one-half of the total assets of P–L companies made up of these fixed income securities carried at cost (amortized value) the purported solvency objective is not satisfied by statutory balance sheet reporting. As a result of the significant decline in the market value of these fixed income securities during the last several years, recent statements actually ignore the liquidation of solvency objective in favor of stable reporting value for non-equity investment.

"going concern" basis.[491] This approach would adopt the use of some form of accrual accounting (rather than the modified cash accounting described above). Hence more emphasis would be placed on the statement of operating results than on the static financial position portrayed by the balance sheet, although that financial statement also would be more in accord with widely used "generally accepted accounting principles." A more objective matching of premium acquisition and other costs with premium revenue as it is earned over the life of the insurance contract would affect both statements. It should be noted that aside from the technical issue that current statutory P-L insurance reporting violates accounting principles that are generally accepted in many commercial and financial industries,[492] the existing statutory practice would not have a significant impact if premium volume was stable over time. However, P–L industry premium volume has been growing at an average annual rate of 7.7 percent over the last 20 years [493] and at the rate of 9.8 percent per year for the five years ending December 31, 1969.[494] This produces chronic overstatement of insurance reserves (liabilities) relative to surplus on the balance sheet and chronic understatement of periodic operating profits. Both discrepancies are caused by the immediate write-off of premium acquisition costs described above. This also results in reported reserves that overstate the real liabilities of the company as a going concern. These reserves are estimated to include from 10 to 50 percent equity depending on the profitability of the insurance lines and company involved.[495]

As a result of these discrepancies plus those related to other statutory accounting requirements P–L insurance companies and financial statistical services such as A. M. Best and Company for years have prepared supplementary statements of adjusted earnings and adjusted equity or surplus.[496] The practice of preparing annual reports for their shareholders and the public with supplementary adjusted data is nearly universal among large stock P–L groups even though there is no uniform industry-wide method for making the adjustments. In addition, strict statutory reporting is not acceptable for the purposes of meeting the reporting requirements of either the SEC [497] or the New York Stock Exchange.

It would appear that the prospects are favorable that statutory reporting requirements will be modified eventually to accommodate both

---

[491] A strong argument may be made that solvency is provided by the cash flow from operations in a going concern and consequently satisfaction of solvency via liquidation of assets is an unrealistic and unsatisfactory regulatory approach, economically and socially.

[492] Some P–L industry sources insist that generally accepted accounting principles used elsewhere in commerce are not applicable in the unique situation of underwriting property—liability risks.

[493] *Measurement of Profitability and Treatment of Investment Income in Property and Liability Insurance*, NAIC, 1970, at 33.

[494] A. M. Best Co.

[495] *The Insurance Industry*, Hearings before the Subcommittee on Antitrust and Monopoly of the Committee on the Judiciary pursuant to S. Res. 233, Part 13 Automobile Liability Insurance, 1968, at 7799–7817. The estimates of equity in unearned premium reserves are from A. M. Best and Company.

[496] *Measurement of Profitability and Treatment of Investment Income in Property and Liability Insurance*, NAIC, June 1970, at 17. The formula developed by A. M. Best and Company has received quite wide acceptance.

[497] See SEC Regulation S–X, 17 C.F.R. 210 *et seq.*

the traditional solvency-in-liquidation and going concern approaches. One proposal is that the initial step be the inclusion of a supplemental schedule showing the adjusted results in the standard convention blank (form) which is used for reporting to state insurance commissions. The slowness in adopting these changes is a cost associated with the fragmentation of regulation among the several states as well as the division of opinion on these issues.

Since the only data on underwriting results that are readily and uniformly available from all P–L companies are statutory figures, data were collected in that form. Federal income taxes for P–L companies also are based on statutory results. The 25 P–L groups were asked to report statutory underwriting gain (or loss) for each year from 1965 through 1969 for each company in the group. In addition, statutory net investment income earned, dividends to policyholders, realized capital gain (loss) and unrealized capital gain (loss) for each company were reported for the same five-year period.

The statutory results of P–L insurance underwriting are more properly reflected by reducing statutory net underwriting gain (loss) by the amount of dividends paid to policyholders. Otherwise the premiums are overstated by what is essentially a refund to the insured. Table VI–143 summarizes these data for the 25 P–L groups in the Study subdivided into five mutual groups and 20 stock groups. In general the table shows a five year period of adjusted statutory losses with temporary improvement in 1966 followed by increasingly large losses. The total loss for the five-year period is nearly $1.6 billion.

Although not reflected in these data, it is possible that rate increases being granted in many states will provide some reduction in statutory underwriting losses in 1970. Lagging periodic rate adjustments are characteristic of the P–L insurance industry.

Although investment income generally has been excluded from direct and complete consideration in ratemaking, net investment income earned is a regular and significant source of income to P–L companies. Net realized capital gain (loss), which also has been excluded from direct consideration in ratemaking, is a somewhat more erratic source of income since it is directly affected by market fluctuations and tax considerations. Table VI–144 summarizes these two income sources and Table VI–145 combines these results with those derived in Table VI–143 to show the overall stautory results of underwriting and investing.

TABLE VI-143

STATUTORY NET UNDERWRITING GAIN (LOSS) AND
DIVIDENDS TO POLICYHOLDERS, 1965-1969
($ Thousands) 1/ 2/

	Net Underwriting Gain (Loss) (A)	Dividends to Policyholders (B)	Gain (Loss) less Dividends (A) Less (B)=(C)
5 Mutual Groups			
1965	75,725	101,759	(26,034)
1966	134,873	119,735	15,138
1967	91,496	129,409	(37,913)
1968	29,437	145,832	(116,395)
1969	(81,402)	150,538	(231,940)
Mutual Total	250,129	647,272	(397,143)
20 Stock Groups			
1965	(259,840)	27,592	(287,431)
1966	(14,122)	29,486	(43,607)
1967	(72,418)	42,867	(115,284)
1968	(242,209)	63,355	(305,564)
1969	(348,208)	73,593	(421,801)
Stock Total	(936,796)	236,893	(1,173,689)
25 PL Groups			
1965	(184,115)	129,350	(313,465)
1966	120,751	149,220	(28,469)
1967	19,078	172,276	(153,197)
1968	(212,771)	209,187	(421,959)
1969	(429,610)	224,132	(653,742)
TOTAL	(686,667)	884,165	(1,570,832)

1/ Columns and rows may not agree because of rounding.

2/ Source: Form I-57

TABLE VI-144

NET INVESTMENT INCOME EARNED AND
NET REALIZED CAPITAL GAIN (LOSS), 1965-1969
($Thousand) 1/ 2/

	Net Investment Income 3/ (A)	Net Realized Capital Gain (Loss) (B)	Investment Income plus Capital Gain (Loss) (A) plus (B) = (C)
5 Mutual Groups			
1965	113,470	5,428	118,897
1966	131,741	11,490	143,230
1967	151,691	1,564	153,255
1968	125,723	12,010	137,733
1969	211,478	11,370	222,847
Mutual Total	734,101	41,861	775,962
20 Stock Groups			
1965	516,363	121,190	637,553
1966	555,572	264,428	820,000
1967	618,442	76,530	694,973
1968	710,063	305,084	1,015,147
1969	794,380	622,054	1,416,434
Stock Total	3,194,821	1,389,286	4,584,107
25 P-L Groups			
1965	629,832	126,618	756,450
1966	687,312	275,918	963,230
1967	770,133	78,094	848,227
1968	835,786	317,094	1,152,879
1969	1,005,858	633,423	1,639,281
Group	3,928,922	1,431,147	5,360,068

1/ Columns and rows may not add because of rounding

2/ Source: Form I-57

3/ Intragroup dividends have been eliminated.

TABLE VI-145

STATUTORY UNDERWRITING RESULTS AFTER
DIVIDENDS TO POLICYHOLDERS AND
NET INVESTMENT INCOME AND REALIZED GAIN
1965-1969. ($Thousands) 1/

	Net Underwriting Gain (Loss) less Dvds to Policyholders (A) 2/	Investment Income plus Realized Capital Gain (Loss) (B) 3/	Underwriting and Investment Results (A)+(B)=(C)
5 Mutual Groups			
1965	(26,034)	118,897	92,864
1966	15,138	143,230	158,369
1967	(37,913)	153,255	115,341
1968	(116,395)	137,733	21,338
1969	(231,940)	222,847	(9,093)
Mutual Total	(397,143)	775,962	378,818
20 Stock Groups			
1965	(287,431)	637,553	350,121
1966	(43,607)	820,000	776,393
1967	(115,284)	694,973	579,688
1968	(305,564)	1,015,147	709,583
1969	(421,801)	1,416,434	994,633
Stock Total	(1,173,689)	4,584,107	3,410,418
25 P-L Groups			
1965	(313,465)	756,450	442,985
1966	(28,469)	963,230	934,761
1967	(153,197)	848,227	695,030
1968	(421,959)	1,152,879	730,921
1969	(653,742)	1,639,281	985,539
TOTAL	(1,570,832)	5,360,068	3,789,236

1/ Columns and rows may not add because of rounding.

2/ Source: Table VI.J.2.c-1

3/ Source: Table VI.J.2.c-2

As reflected in Table VI-145 the simple combination of all investment income and realized gain with the statutory underwriting loss after policyholder dividends leaves a positive residual of $3.8 billion for the five-year perod. This does not imply that direct offset of underwriting results with total investment returns is an appropriate adjustment. It simply provides a combined measure of aggregate statutory underwriting and investment results before income taxes for these P-L groups for 1965 through 1969.

The final element of investment results that is of interest is the net unrealized capital gain (loss) for the same period. Although the data in this instance include an unknown and significant amount of double counting that results from the pyramid of ownership of stock insurance companies in some P-L insurance groups, these figures do reflect the high degree of volatility of policyholder surplus. These wide swings result entirely from the equity portion of the portfolio since only investments in common and preferred stock are reported at market value. This volatility is reflected by the range of year-to-year change from a plus (gain) of $0.97 billion to a minus (loss) of $2.16 billion. The five-year period produced a net unrealized capital loss of $1.27 billion. These results are summarized in Table VI-146.

Given their recent statutory underwriting experience the 25 P-L groups were asked, in the context of current federal income tax provisions,[498] to describe the impact of underwriting profits and losses on portfolio composition and on investment management for income, and realized and unrealized gains.

---

[498] In general federal taxation of P-L companies is similar to that of other commercial enterprises.

TABLE VI-146

NET UNREALIZED CAPITAL GAIN (LOSS)
($Thousand) 1/ 2/

	Net Unrealized Capital Gain (Loss)
5 Mutual Groups	
1965	11,865
1966	(113,876)
1967	24,491
1968	72,920
1969	(113,049)
Mutual Total	(137,648)
20 Stock Groups	
1965	308,467
1966	(1,137,923)
1967	943,152
1968	783,033
1969	(2,028,283)
Stock Total	(1,131,554)
25 P-L Groups	
1965	320,332
1966	(1,251,798)
1967	967,643
1968	855,953
1969	(2,161,331)
Total	(1,269,202)

1/ Source: Form I-57

2/ These data include an unknown but significant amount of double counting resulting from the pyramid of stock company ownership within some P-L insurance groups.

The purpose of these questions is to ascertain the continuing impact of underwriting experience and tax law on their selection of different types of investment and on investment activity.

With regard to portfolio composition it is essentially the uniform practice of 17 of the P–L groups to move out of tax-exempt bonds and into taxable bonds as underwriting gains turn to losses. The reverse movement takes place when underwriting gains are being realized since the tax-exempt income is most desirable. These changes are brought about through the regular roll-over of the portfolio through maturing securities and sinking fund retirement in all P–L groups. Some groups enter into a selling (or buying) program to accelerate the desired changes. The fundamental reason for the shift into or out of tax-exempt (municipal) bonds is the relative yield advantage that one affords over the other, depending on whether the interest would or would not be subject to federal income taxes. One group indicated that during periods of underwriting gain they seek to add growth stocks as well as municipals because of the tax advantage of any capital gains realized on the former. In contrast, seven groups felt that neither underwriting experience nor taxes had a significant effect on portfolio composition. One group indicated that they did no bond trading and consequently could not react to underwriting results.

It is also clear that for P–L groups such as Allstate, Fireman's Fund, Great American, Hartford Fire, Home, and Reliance, all of which are a part of large noninsurance operations that may file consolidated federal income tax returns, the noninsurance sources of income may be sufficiently profitable to offset unfavorable insurance underwriting experience. Consequently their consolidated operating profit or loss from all operations would determine the need to increase or diminish their tax-exempt bond investment. The presence of a profitable life insurance operation is not a factor here since life insurance companies are taxed under separate provisions of the Internal Revenue Code.

Aside from the exceptions noted above, it would appear that P–L insurance groups in general respond to some degree to prolonged statutory underwriting losses by reducing or halting further purchases of tax-exempt bonds. In light of the statutory underwriting losses experienced recently, given the IRS provision exempting interest from municipal bonds from federal income taxes, and given the related higher pretax yield available on taxable bond issues, P–L insurance groups are acting in an economic, rational manner only if they exercise the option to divert investment funds into higher net yield (taxable) bonds.

Whether prospective changes in regulatory consideration of investment income will affect investment policy or behavior is subject to conjecture at this time. The direct inclusion, for example, of the investment income associated with the investment of funds equivalent to P–L liabilities would offset some underwriting expenses. Concurrently, insurance rates and premium income would change but in directions and in amounts that defy forecasting. Presumably these resultant changes would reduce statutory underwriting losses since extended large underwriting losses threaten the viability of the P–L industry. To the extent that underwriting results are altered, the relative use of taxable and tax-exempt securities would change as described above.

With regard to the second part of the question, 16 of 24 groups reported that underwriting losses increased flexibility in managing the equity portfolio by permitting them to take capital gains which are offset by underwriting losses and avoid or minimize current taxes. As a representative response, one group reported:

"The prospect of paying capital gains taxes frequently results in deferment of the sales of stock. The approaching expiration of tax-loss carry-forward has initiated a sales program to realize capital gains on the sales of investments."

Only five groups stated that underwriting gains and losses and capital gains had little or no effect on taking gains or losses. No groups indicated that underwriting gains were covered by realized capital losses.

In summary, the P-L groups are responsive to the provisions of the Internal Revenue Code (a) providing for tax exempt interest income from certain securities and (b) offsetting operating losses with realized capital gains, to minimize taxes.

d. Measuring investment performance

The problems associated with measuring underwriting profit and overall profitability for P-L insurance groups was described in the preceding section. Measuring the rate of return on the investment portfolio of P-L groups, that is, investment performance, also presents some difficult but not insurmountable problems.[499] Whether a P-L investment department measures investment performance, what methods are used and how frequently it is measured provide some indication of how closely the department is attuned to the performance factor in investment management. This is turn indicates to some extent how "performance oriented" P-L insurance groups are and, accordingly, whether their investment management is responsive to measures of the performance factors that are under their control.

The problems associated with measuring P-L investment department performance in a manner that is most meaningful and technically most acceptable are (a) the isolation of funds under control of the investment department from all other funds and (b) market valuations. Using the Bank Administration Institute's widely accepted time-weighted rate of return method as a technically appropriate measure, one needs to know "the (market) value of the fund at the beginning and end of the time period under study, the date and amount of each cash flow into and out of the fund, and the (market) value of the fund at the date of each such cash flow." [500] For these purposes the funds being managed and controlled include all portfolio assets, and cash is considered as a liquid, no-return "security." Since the cash flow of investment operations in a P-L company in many respects is contingent upon insurance operations and experience, it is difficult to isolate those funds that are under control of the invest-

---

[499] Note that there are at least two concepts of performance, one of which encompasses the other. The broader concept measures the rate of growth in the (market) value of a portfolio. The "yield to maturity," also known as "internal rate of return," discounted "rate of return," or "average compounded rate of return" gives a valid and useful measure of the growth or performance of the portfolio. However, some factors, notably the timing and amount of cash flows into or out of the portfolio, are not under control of the investment manager (department) and a narrower concept provides a measure of the performance of the manager (department) by taking the timing of cash flows into consideration. This measure is relevant here since it focuses on the investment department's decision area.

[500] *Measuring the Investment Performance of Pension Funds*, 3–5 (Bank Administration Institute, Park Ridge, Illinois, 1968).

ment department. For example, dividends received or the proceeds from the sale of securities are available for general use. In essence they are removed from the portfolio or funds controlled by the investment department instead of routinely being available for reinvestment.[501] This conceptual problem must be resolved before the cash flows appropriate for measuring performance can be identified. With regard to the second problem the fact that only common and preferred stocks are required to be carried at market value for statutory reporting means that more than one-half of the portfolio is routinely reported at a stable value that is irresponsive to changes in market value. Some P-L groups make rough market approximations for their debt portfolio from time to time for internal purposes. A few groups have installed a service that routinely determines periodic market valuations for the entire portfolio.

In light of these limitations, particularly the general absence of market values for the debt portion of the portfolio, the 25 P-L groups in the Study were asked to describe their attempts to measure or evaluate investment performance or rate of return on only their equity portfolios. They were to indicate how the returns are measured. While this separation of the total portfolio is an artificial segregation that permits only limited observation and conclusions, emphasis on the equity element is consistent with the focus of the Study.

Aside from two P-L groups that reported that they made "no formal attempt" to measure performance, all other P-L groups stated that they measured performance of their equity portfolios. Almost all of these 23 groups compared their results with one or more stock market indexes or averages. The following comparisons were mentioned: Standard and Poor's 425 or 500, Dow-Jones Industrials or Utilities, the New York Stock Exchange Index, a growth mutual fund, A.M. Best Reports, other insurance companies and the general economy. No groups mentioned comparing P-L companies within their own group, which is consistent with the notion that they do not differentiate between their companies in terms of investment management.

Fourteen P-L groups indicated that they used a single measure of investment performance. Among these 14 groups the measures range from elementary to sophisticated as reflected by the following list.

Brief Description of Methods:	*Number of Groups*
(a) Uses outside service (method unspecified)	1
(b) Simple percentage change in portfolio value	2
(c) (b) above, adjusted for net purchases and sales	1
(d) (b) above, adjusted for (realized) gains	3
(e) (b) above, adjusted for gains and dividends	2
(f) (b) above, adjusted for gains, dividends and cash flow	2
(g) (f) above, on a unit basis	1
(h) (b) above, compared with results of simultaneous equal purchases of units of Standard and Poor's 500 Index	1
(i) Uses outside service which does same as (h) above, adjusting, for dividends and cash flow	1

Of the four groups using multiple measures of performance, two calculated percentage gains with and without any adjustment for dividends. A third group used a unit value approach and a simple percentage gain or loss over time adjusted for cash flow. The final group

[501] The portfolio as defined here, including cash, is not accounted for in the same manner as a separate account.

53-940 O—71—pt. 2——46

used four measures which are included below since they are representative of some of the more sophisticated approaches used by the 25 P-L groups.

1. On an annual basis, computations are made to indicate portfolio results comparable to investing in one share of a mutual fund and reinvesting all realized gains and dividends received. These performance charts use year end 1960 as a base, and run from 1958 to the present year.

2. An annual compound rate of return since inception of the equity investment is computed monthly on a discounted cash flow basis, for each portfolio. The weighted average annual compound rate of gain on common stocks is also calculated considering dividends received, capital gains realized and unrealized gains and losses. The results are presented in a monthly investment report.

3. A dollar-weighted time-held annual rate of return is computed for each company held. These computations include both dividend, income and capital gains realized and unrealized. Rates of return on securities sold and securities held and comparable results of the S&P 425 Industrials are calculated.

4. Performance charts are prepared for each industry comparing the price performance of the portfolio industry, the S&P 425, and the S&P Industry Price Index. The industry charts are prepared on a quarterly basis beginning with the Base Year 12/31/60 equal to 100. A monthly chart comparing the portfolio in total and the S&P 425 Index is also prepared.

The groups indicated "the time span covered" in measuring investment performance primarily by specifying the maximum frequency of measurement as shown by the following list:

Maximum Frequency:	*Number of Groups*
(a) Annually	6
(b) Quarterly	6
(c) Monthly	8
(d) Weekly	1
(e) Not specified	4

Most of those measuring returns quarterly or more frequently also indicated that they used the measures in some form of time series to reveal trends. The time span covered by the series was usually more than one year and several groups smoothed these series with three and five year moving averages.

In summary most large P–L insurance groups measure investment performance but many responses to the performance measurement question failed to indicate clearly how they calculated their "rate of return." Even those groups that indicated that they adjusted appropriately for the timing and amount of cash flow were incomplete in their answers. Many groups use rudimentary methods that provide only crude indicators of portfolio appreciation, and measurements are made relatively infrequently. Only a very few groups produce a measure that apparently could be used to indicate the performance of the investment department itself. Accordingly there is little evidence here that these large P–L groups are performance orientated at this time.

There is some indication that P–L groups are moving toward more appropriate performance measurement. One group specifically reported that they were now using the Bank Administration Institute's

time-weighted method of measuring performance. Two other groups said they currently were changing their internal valuation and reporting system to allow them to produce a time-weighted measure on a frequent basis.

e. Participation in the venture capital market

The final area of P–L insurance group investment policy and practice inquired about concerns degree of involvement in the venture capital market. For the purposes of the Study the venture capital market was defined as "private placements to small companies." The purpose of this inquiry was to ascertain the degree to which P–L groups were active in providing capital to small and typically relatively new companies. The participation of institutional investors in providing venture capital to small companies has important implications regarding the supply of capital for corporate growth and, ultimately, the future supply of investment securities. It is also of interest since it gives a more complete description of P–L group portfolio management with regard to risk assumption and rate of return.

Participation in venture capital involves investment in private as opposed to public issues or placements, and by definition, investment in small companies. Both of these characteristics imply in general greater risk with regard to the investor's liquidity and ability to easily resell the security. Potentially there may be greater business risk as well. Given the traditional emphasis on maximizing liquidity and minimizing market and investment risk in P–L portfolios for the insurance policyholders, it is not surprising that private placements to even large well established companies are relatively insignificant in terms of the total P–L group portfolio. The emphasis historically has been on readily marketable, low business risk investments. Furthermore private placements in general require an investment department with sufficient staff and expertise to provide the additional analysis required. In return for assuming these higher risks and greater costs a commensurately higher average rate of return is expected.

As shown in Table VI–147 below, the 25 large P–L groups in the Study had only $655 million or 2.13 percent of their consolidated assets in restricted securities at December 31, 1969. Restricted securities as defined for the Study are securities that could not have been offered to the public for sale, as of that reporting date, without first being registered under the Securities Act of 1933, and include, for example, privately placed, long-term debt instruments as well as "letter stock" meeting this definition.

TABLE VI. 147.—CONSOLIDATED HOLDINGS OF RESTRICTED SECURITIES BY 25 P-L GROUPS, DEC. 31, 1969

Type of restricted security	Amount (thousands)	Percent of total assets
Nongovernment, long term debt, U.S. issuer:		
Issued with equity provision	$80,725	0.26
Issued without equity provision	429,539	1.40
Debt subtotal	510,264	1.66
Common stock	144,351	0.47
Total restricted securities	654,616	2.13
Total consolidated assets	30,766,881	100.00

Source: Form I–21.

Venture capital investments as defined by the Study are therefore some small fraction of the $655 million of private placements reported in Table VI-147.

Each P-L group investment department was asked to describe the manner in which it had participated in the venture capital market in the last five years and what its expectations were in this area for the future.

Of the 25 large P-L groups in the Study 10 indicated either no or essentially no partcipation in private placements to small companies during the 1964-1969 period. Further, only two of these groups suggested that they might consider involving themselves in the venture capital market in the future. Typical of the comments from nonparticipants are the following two responses:

"All private placements have been made to other than small companies. The increased risk inherent in investing in venture capital far outweighs any increase in return and thus future investment in this field is unlikely."

"We have in the past and are continuing to study the venture capital investment area but have thus far concluded that we do not have the staff capability to engage in this investment area and that the cost to develop such capability is not commensurate with possible returns."

In general the degree of participation in the venture capital market by the other 15 P-L groups is relatively modest. Only four or five might be considered to be engaged in active programs in this area and even these programs involve only one or two percent of their total assets. For the other 10 or 11 groups, typical limited involvement is portrayed by the following response:

"During the last five years in only two instances have we participated in the venture capital market by the acquisition of a private placement of a small company. . . . The extent of our future involvement in venture capital investments will be dependent on the opportunities which may be presented to us, we do not presently contemplate actively seeking out such investments."

In several instances the respondents mentioned the type of security issued in the private placement; common stock or debt with an equity kicker were the issues most frequently used.

The responses also indicated that P-L groups with significant life insurance operations had investment staffs experienced in private placements and among these groups there was a tendency to be participants, or more active participants, in the venture capital market. Among the five P-L groups most active in making private placements to small companies, two have private placement sections or divisions and two others are important life insurers.

Perhaps the most significant aspect of these 15 responses is that five of the P-L groups indicated that their initial participation in venture capital investment had occurred in the last three years. Also, one other group is starting a venture capital investment program in 1970 with an investment limit for the pilot project of one percent of assets or $5 million. Although only one group mentioned tax considerations, it is consistent with the behavior described in section J.2.c above that the move out of tax-exempts for groups incurring operating losses might also tend to encourage private placement and venture capital investments.

In summary, at this time very few large P-L insurance groups are engaged in providing more than a nominal amount of venture capital.

However, there is evidence of involvement to some degree by many more P–L groups in the last two or three years. This is particularly true among groups that already have a large investment department staff and the necessary expertise.

3. Asset Holdings, Liabilities and Surplus of Property-Liability Groups

This section presents the major part of the information collected by the Study on the asset holdings, liabilities and surplus, investment characteristics and portfolio activity of the 25 P–L insurance groups that received Form I–57 and the attendant questionnaire Forms I–20, I–21, I–24 and I–26. These data have enabled the Study to prepare and present tables showing consolidated asset holdings, liabilities and surplus for these insurance groups, the asset composition by categories of assets, common stock holdings by exchange listing of issues held and turnover and activity rates for common equities. In presenting these measures the totals in dollars and in relative (percent) amounts for the 25 P–L insurance groups are shown, as are the subtotals for mutual (5) and stock (20) groups.

a. Consolidation of property-liability group assets, liabilities and surplus

Study questionnaire Form I–21 was designed to collect uniform information on asset holdings from a variety of accounts and institutions. Form I–21 was also designed so that with Form I–21A Liabilities and Surplus, the asset information for each individual P–L company could be consolidated for its group.[502] Consolidated assets for each P–L group in the Study were aggregated to produce consolidated asset information for a major part of the P–L industry. For these groups the consolidated asset holdings eliminated the double counting present in published industry asset totals.[503] The double counting arises because of the pyramid of ownership of stock corporation P–L companies within some groups. It arises specifically in the type of structure where P–L Company A owns P–L Company B, because B is carried as an asset on A's balance sheet. Simple aggregation of the assets of A and B, which is what A. M. Best Company does to produce an industry total, overstates the assets by an amount equal to the equity of A in B, plus any balances outstanding between these two companies at the reporting date.[504]

Each of the 25 P–L insurance groups in the Study was asked to complete Form I–21 for each of its affiliated P–L companies as of December 31, 1969. Only that one reporting year was requested here because of the substantial burden that requiring comparative figures for another year would impose. Each P–L company reported as a

[502] See Supplementary Volume II for copies of Forms I–21 and I–21A.
[503] A. B. Best Company, Inc., is the most widely known and used collective source of insurance company, insurance group and insurance industry data. Because required regulatory reporting is on a company-by-company basis and because some but not all insurance groups publish consolidated statements in one form or another, there is no industry-wide source of uniform consolidated assets (ie., with double counting eliminated).
[504] A. M. Best Company does produce condensed consolidated asset information for some large stock groups that have significant asset double counting.

separate category of assets its investment in any affiliated P-L companies and also any amount owed to it by any affiliated companies.[505] On Form I-21A these same companies reported both the amount owed to all affiliates and the amount of each company's policyholders surplus (net worth). More detailed information concerning each company's amounts owed to affiliates and from affiliates is required to achieve a complete consolidation that would satisfy most accountants. A very close approximation of a complete consolidation was achieved by reducing the asset "investment in affiliated P-L companies" by an amount determined by multiplying the percent of ownership in the affiliate (subsidiary) by the policyholders surplus of the affiliated P-L company.[506] Policyholders surplus was also reduced by the same amount so that both the adjusted asset and the adjusted liability and equity sides of the balance sheets could then be summed to provide consolidated assets for the P-L insurance group. Although the asset and liability categories that included the amounts owed among all affiliated companies were left unadjusted, they did not materially affect the consolidated results. For example, the unadjusted asset line "due from affiliated companies" in the consolidation of all 25 P-L groups amounted to less than $90 million out of $30.767 billion.[507]

It should be noted also that the P-L groups were instructed to report asset values using the same values reported in the NAIC annual convention blank. This means that only common and preferred stock investments are included in the consolidation at stated market value and all other assets including debt are included at "amortized value" which approximates cost rather than market. Although market values were desired by the Study for all assets of all institutions, it was recognized that insurance company statement values were readily available for all P-L respondents and market values for other-than-equities could not be provided within a reasonable time at a reasonable cost to the respondent.

The results of this consolidation for the 25 P-L groups are shown in Table VI-148. The consolidated assets amount to $30.767 billion while the aggregate unconsolidated assets for the 145 companies included in the 25 P-L groups was $33.462 billion. This adjustment in consolidating reduced the comparable aggregate assets by $2.695 billion, or 8.1 percent.

The aggregate asset figures available for the entire P-L industry

[505] To reduce the considerable reporting burden even further for P-L respondents, those P-L groups with eight or more U.S. P-L companies could elect not to report this information for any P-L companies with less than $10 million in admitted assets. Four groups exercised this option and omitted 10 P-L companies with aggregate assets of $34.0 million, about one-tenth of one percent of the aggregate assets of the 145 companies included in the consolidation.

[506] In the few instances where this adjusted amount exceeded the carrying value of the investment on the parent's balance sheet, the adjustment was reduced so as not to leave a negative residual.

[507] This consolidation only applies to P-L affiliations. To the extent that, for example, a P-L owns a life insurance company, this investment is carried on an unconsolidated basis. This explains most of the relatively significant item "affiliated company shares" (Table VI-148) amounting to $2.00 billion out of $30.77 billion in consolidated P-L assets for the Study sample. Of this $2.00 billion in affiliated company investment, $1.62 billion represents affiliated life companies. Four P-L groups with large life operations comprise $1.36 billion of that $1.62 billion total.

at December 31, 1969, as compiled by A. M. Best Company, are as follows:

	Billion
Stock Companies	$37.992 (72.6%)
Mutual Companies	12.746 (24.3%)
Reciprocal Exchanges	1.574 (3.0%)
Lloyds Organizations	0.056 (0.1%)
Total Aggregate P-L Industry Assets	$52.369 (100.0%)

Accordingly, using the comparable aggregate asset data, the Study sample of 25 large P–L groups covered 63.9 percent of the industry assets reported at the end of 1969. The Study consolidated figure presents an accurate bench-mark for future reference, based on approximately two-thirds of P-L industry assets.

The consolidation involving the non-asset side of the balance sheet for the five mutual and 20 stock groups and for the 25 groups combined as shown in Table VI–149. The adjustment in consolidating within each group was made using the total policyholders surplus for each P–L company. Consequently, the results do not provide meaningful numbers for accounts such as capital or paid-in-surplus which make up policyholders surplus. Therefore, Table VI–149 shows only the major liability accounts and total policyholders surplus, both in thousands of dollars and in relative amounts.

b. Asset holdings

Detailed asset holdings data at December 31, 1969 are presented in Tables VI–150 through VI–156 for three combinations of P–L groups: mutuals (5), stock (20) and total (25). Table VI–150 summarizes total assets in six major asset categories, and the details of the asset types in each of these major categories are presented in the six tables that follow. These seven tables are: (1) Summary, (2) Cash and Near Cash, (3) U.S. Government, State, Local and Foreign Government Issues, (4) Nongovernment Long-Term Debt Issues, (5) Common Stock, Warrants, Rights and Options, (6) Mortgage Loans and Real Estate Owned, (7) Preferred Stocks and All Other Assets. Each of these seven tables shows the absolute and relative contribution of each asset type to the major category of which it is a part. Table VI–148 should be referred to for the relative contribution of 16 subcategories to total assets.

For the 25 groups combined, categories of assets that are notable for their relatively large size are state and local governments (28.35 percent) and common stock (33.66 percent). Mutual groups and stock groups differ markedly in both of these categories, but particularly in common stock investment. Mutuals have only 11.57 percent in common stock compared to 38.61 percent for stock groups. Much of this differential is related to the significantly smaller proportion of funds provided by policyholders surplus in mutuals, as is reflected by Table VI–149. This table shows mutuals to have policyholders surplus amounting to 20.00 percent of total liabilities and surplus (or, equivalently, total assets) while the comparable surplus figure for stock groups is 33.00 percent. In contrast the investment of mutuals in state and local government securities amounts to 39.21 percent of total assets, and stock groups have 25.91 percent invested in state and local government securities. Both types of P–L groups are important suppliers of funds for investment in state and local governments, and stock groups are particularly important common stock investors.

TABLE VI-148

ASSET HOLDINGS OF P-L GROUPS
December 31, 1969
($ Thousand and % of Totals) 1/ 2/

	5 Mutual Groups	20 Stock Groups	25 PL Groups
1. Cash and Near Cash	$ 75,204 1.33%	$ 505,736 2.01%	$ 580.940 1.89%
2. U. S. Governments	862,167 15.29%	1,455,281 5.79%	2,317,448 7.53%
3. U. S. State & Local Govt.'s	2,211,270 39.21%	6,510,602 25.91%	8,721,872 28.35%
4. Foreign Government Securities	86,686 1.54%	311,810 1.24%	398,496 1.30%
5. Nongovernment, Short-term Debt	112,540 2.00%	532,962 2.12%	645,502 2.10%
6. Nongovernment, Long-term Debt	892,771 15.83%	1,719,915 6.84%	2,612,686 8.49%
U. S. Issuers; issued with equity provision	38,265 0.68%	281,319 1.12%	319,584 1.04%
U. S. Issuers; issued without equity provision	852,954 15.13%	1,350,396 5.37%	2,203,350 7.16%
Foreign Issuers	1,552 0.03%	88,198 0.35%	89,750 0.29%
7. Preferred Stock	184,347 3.27%	616,193 2.45%	800,540 2.60%
8. Common Stock -- Total	652,702 11.57%	9,702,413 38.61%	10,355,115 33.66%
Affiliated Company Shares	124,059 2.20%	1,885,070 7.50%	2,009,129 6.53%
9. Loans Secured by Real Estate Mortgage	27,146 0.48%	14,058 0.06%	41,204 0.13%
10. Real Estate Owned	115,828 2.05%	384,070 1.53%	499,896 1.62%
11. Warrants, Rights, Options	266 0.00%	11,270 0.04%	11,536 0.04%
12. Other Assets	418,347 7.42%	3,363,288 13.38%	3,781,645 12.29%
13. Total Assets	5,639,275 100.00%	25,127,605 100.00%	30,766,880 100.00%

1/ Source: Forms I-57 and I-21
2/ Columns may not add because of rounding.

TABLE VI-149

LIABILITIES AND SURPLUS
December 31, 1969
($ Thousand and Percent of Totals) 1/ 2/

	5 Mutual Groups	20 Stock Groups	25 P-L Groups
1. Losses and Unearned Premiums--Total	$ 4,112,985 72.94%	$15,421,805 61.37%	$19,534,790 63.49%
1.1 Losses and Adjustment Expenses	2,829,087 50.17%	8,584,251 34.16%	11,413,338 37.10%
1.2 Unearned Premiums	1,283,898 22.77%	6,837,554 27.21%	8,121,451 26.40%
2. Borrowed Money	0 0.00%	50,612 0.20%	50,612 0.17%
3. Owed to Affiliates	19,691 0.35%	60,691 0.24%	80,449 0.26%
4. Other Liabilities and Reserves	378,577 6.71%	1,303,723 5.19%	1,682,300 5.47%
5. Total Liabilities	4,511,319 80.00%	16,836,831 67.00%	21,348,150 69.39%
6. Policyholders Surplus	1,127,956 20.00%	8,290,774 33.00%	9,418,730 30.61%
7. Total Liabilities and Surplus	5,639,275 100.00%	25,127,605 100.00%	30,766,880 100.00%

1/ Source: Forms I-57, I-21 and I-21A.

2/ Columns may not add because of rounding.

TABLE VI-150

ASSET HOLDINGS - 1969 [1/]
PROPERTY & LIABILITY INSURANCE GROUPS
SUMMARY OF MAJOR CATEGORIES OF ASSETS AND TOTAL ASSETS
(IN THOUSANDS OF DOLLARS)

		(1)*	(2)*	(3)*	(4)*	(5)*	(6)*	(7)
ACCOUNT TYPE	N	CASH & NEARCASH	GOVTS &SHORT-TERM NONGOVTS	NONGOVT LONG-TERM	COMMON & WARRANTS	MORTGAGE & REAL ESTATE	OTHER ASSETS	TOTAL ASSETS
		75,204	3,272,664	892,771	652,968	142,974	602,694	5,639,275
MUTUAL GROUPS	5	1.33%	58.03%	15.83%	11.57%	2.53%	10.68%	100.00%
		505,736	8,810,654	1,719,915	9,713,683	398,126	3,979,490	25,127,605
STOCK GROUPS	20	2.01%	35.06%	6.84%	38.65%	1.58%	15.83%	100.00%
		580,940	12,083,319	2,612,686	10,366,652	541,099	4,582,185	30,766,881
TOTAL	25	1.88%	39.27%	8.49%	33.69%	1.75%	14.89%	100.00%

1/ Source: Form I-21. See Forms I-21 and I-57 in Supplementary Volume II for definitions.
* See related Tables b-2 through b-7 that follow for details comprising each of these summary column subtotals.

TABLE VI-151

ASSET HOLDINGS - 1969 1/
PROPERTY & LIABILITY INSURANCE GROUPS
CASH AND NEAR CASH ITEMS
(IN THOUSANDS OF DOLLARS)

ACCOUNT TYPE	N	(1) 2/ CURRENCY DEMAND DP M-BKS	(2) CURRENCY DEMAND DP ELSEWHERE	(3) 3/ TOTAL CURRENCY DEM DEPS	(4) 4/ C.D.'S	(5) OTHER TIME & SAV DP IN BANKS	(6) OTHER TIME & SAVINGS DEPOSITS	(7) TOTAL CASH & NEARCASH
MUTUAL GROUPS	5	717 0.95%	49,103 65.29%	64,192 85.35%	6,478 8.61%	4,484 5.96%	50 0.06%	75,204 100.00%
STOCK GROUPS	20	3,109 0.61%	396,319 78.36%	447,104 88.40%	32,477 6.42%	25,201 4.98%	953 0.18%	505,736 100.00%
TOTAL	25	3,826 0.65%	445,422 76.67%	511,297 88.01%	38,954 6.70%	29,685 5.10%	1,004 0.17%	580,940 100.00%

1/ Source: Form I-21. See Forms I-21 and I-57 in Supplementary Volume II for definitions.
2/ Currency and demand deposits in banks managing a P-L investment account.
3/ Column (3) is the subtotal of columns (1) plus (2). It does not add since some respondents reported only the subtotal.
4/ Certificates of deposit.

TABLE VI-152

ASSET HOLDINGS - 1969 1/
PROPERTY & LIABILITY INSURANCE GROUPS
US GOVERNMENT, STATE, LOCAL AND FOREIGN GOVERNMENT ISSUES 2/
(IN THOUSANDS OF DOLLARS)

ACCOUNT TYPE	N	(1) US GOVT SHORT-TERM	(2) US GOVT LONG-TERM	(3) 3/ US GOVT TOTAL	(4) US STATE & LOCAL GOVT	(5) FOREIGN GOVT	(6) NONGOVT SHORT-TERM	(7) NONGOVT SHORT-TERM FOREIGN	(8) 4/ NONGOVT SHORT-TERM TOTAL
MUTUAL GROUPS	5	125,690 3.84%	736,477 22.50%	862,167 26.34%	2,211,270 67.56%	86,686 2.64%	111,757 3.41%	783 0.02%	112,540 3.43%
STOCK GROUPS	20	122,139 1.38%	1,333,141 15.13%	1,455,281 16.51%	6,510,602 73.89%	311,810 3.53%	513,253 5.82%	19,708 0.22%	532,962 6.04%
TOTAL	25	247,830 2.05%	2,069,618 17.12%	2,317,448 19.17%	8,721,873 72,18%	398,496 3.29%	625,010 5.17%	20,492 0.16%	645,502 5.34%

1/ Source: Form I-21. See Forms I-21 and I-57 in Supplementary Volume II for definitions.
2/ See Table b-1 (this section), column (2), for the grand total for this table.
3/ Column (3) is the subtotal of columns (1) plus (2).
4/ Column (8) is the subtotal of columns (6) plus (7).

TABLE VI-153

ASSET HOLDINGS - 1969[1/]
PROPERTY & LIABILITY INSURANCE GROUPS
NONGOVERNMENT LONG-TERM DEBT ISSUES
(IN THOUSANDS OF DOLLARS)

ACCOUNT TYPE	N	(1) RESTRICTED US ISSUERS W/EQUITY	(2) OTHER US ISSUERS W/EQUITY	(3)[2/] TOTAL US ISSUERS W/EQUITY	(4) RESTRICTED US ISSUERS WO/EQUITY	(5) OTHER US ISSUERS WO/EQUITY	(6)[3/] TOTAL US ISSUERS WO/EQUITY	(7) FOREIGN ISSUERS	(8) TOTAL NONGOVT LT DEBT
MUTUAL GROUPS	5	25,064 2.80%	13,201 1.47%	38,265 4.28%	141,982 15.90%	617,002 69.11%	852,954 95.54%	1,552 0.17%	892,771 100.00%
STOCK GROUPS	20	55,661 3.23%	225,175 13.09%	281,319 16.35%	287,557 16.71%	1,062,838 61.79%	1,350,396 78.51%	88,198 5.12%	1,719,915 100.00%
TOTAL	25	80,725 3.08%	238,376 9.12%	319,584 12.23%	429,539 16.44%	1,679,840 64.29%	2,203,350 84.33%	89,750 3.43%	2,612,686 100.00%

1/ Source: Form I-21. See Forms I-21 and I-57 in Supplementary Volume II for definitions.
2/ Column (3) is the subtotal of columns (1) plus (2), US Issuers with equity provision.
3/ Column (6) is the subtotal of columns (4) plus (5), US Issuers without equity provision. Column (6) does not add since some mutual respondents reported only the subtotal (6).

TABLE VI-154

ASSET HOLDINGS - 1969[1]
PROPERTY & LIABILITY INSURANCE GROUPS
COMMON STOCK, WARRANTS, RIGHTS & OPTIONS
(IN THOUSANDS OF DOLLARS)

ACCOUNT TYPE	N	(1) ADR'S & FOREIGN ISSUERS	(2) RESTRICTED U.S. ISSUERS	(3) INVESTMNT COMPANY SHARES	(4) AFFILIATED COMPANY SHARES	(5) OTHER U.S. ISSUERS	(6)[2] TOTAL COMMON STOCK	(7) WARRANTS RIGHTS & OPTIONS	(8) TOTAL COMMON & WARRANTS
MUTUAL GROUPS	5	7,094 1.08%	6,412 0.98%	511 0.07%	124,059 18.99%	514,626 78.81%	652,702 99.95%	266 0.04%	652,968 100.00%
STOCK GROUPS	20	114,951 1.18%	137,939 1.42%	8,378 0.08%	1,885,070 19.04%	7,556,075 77.78%	9,702,413 99.88%	11,270 0.11%	9,713,683 100.00%
TOTAL	25	122,045 1.17%	144,351 1.39%	8,889 0.08%	2,009,129 19.38%	8,070,701 77.85%	10,355,115 99.88%	11,536 0.11%	10,366,652 100.00%

1/ Source: Form I-21. See Forms I-21 and I-57 in Supplementary Volume II for definitions.
2/ Column (6) is the subtotal of columns (1), (2), (3), (4) and (5).

TABLE VI-155

ASSET HOLDINGS - 1969 1/
PROPERTY & LIABILITY INSURANCE GROUPS
MORTGAGE LOANS AND REAL ESTATE OWNED
(IN THOUSANDS OF DOLLARS)

ACCOUNT TYPE	N	(1) MORTGAGE 1- TO 4-FAMILY	(2) OTHER MORTGAGE WO/EQUITY	(3) 2/ MORTGAGE WO/EQUITY TOTAL	(4) MORTGAGE WITH EQUITY	(5) 3/ TOTAL MORTGAGE	(6) REAL ESTATE OWNED	(7) TOTAL MORTGAGE & REAL ESTATE
MUTUAL GROUPS	5	25,350 17.73%	1,035 0.72%	26,384 18.45%	715 0.49%	27,146 18.98%	115,828 81.01%	142,974 100.00%
STOCK GROUPS	20	3,910 0.98%	8,189 2.05%	12,099 3.03%	0 0.00%	14,058 3.53%	384,068 96.46%	398,126 100.00%
TOTAL	25	29,260 5.40%	9,224 1.70%	38,484 7.11%	715 7.61%	41,204 7.61%	499,896 92.38%	541,099 100.00%

1/ Source: Form I-21. See Forms I-21 and I-57 in Supplementary Volume II for definitions.
2/ Column (3) is the subtotal of columns (1) plus (2).
3/ Column (5) is the subtotal of columns (3) plus (4). It does not add since some respondents reported only the subtotal Mortgage Loans (5).

TABLE VI-156

ASSET HOLDINGS - 1969 1/
PROPERTY & LIABILITY INSURANCE GROUPS
PREFERRED STOCK AND ALL OTHER ASSETS 2/
(IN THOUSANDS OF DOLLARS)

ACCOUNT TYPE	N	(1) CONVERT PREFERRED US ISSUERS	(2) NONCONV. PREFERRED US ISSUERS	(3) 3/ TOTAL PREFERRED STOCK	(4) POLICY LOANS	(5) DUE FROM AFFILIATED COMPANY	(6) ACCOUNTS RECEIVABLE FR BROKERS	(7) ALL OTHER	(8) 4/ OTHER ASSETS TOTAL
MUTUAL GROUPS	5	20,479 3.39%	163,263 27.08%	184,347 30.58%	0 0.00%	20,260 3.36%	45,118 7.48%	352,969 58.56%	418,347 69.41%
STOCK GROUPS	20	201,314 5.05%	339,825 8.53%	616,193 15.48%	1,774 0.04%	69,031 1.73%	881,986 22.16%	2,410,506 60.57%	3,363,298 84.51%
TOTAL	25	221,793 4.84%	503,088 10.97%	800,540 17.47%	1,774 0.03%	89,291 1.94%	927,104 20.23%	2,763,476 60.30%	3,781,645 82.52%

1/ Source: Form I-21. See Forms I-21 and I-57 in Supplementary Volume II for definitions.
2/ See Table b-1 (this section), Column (6), for the grand total for this table.
3/ Column (3) is the subtotal of Column (1) plus (2).
4/ Column (8) is the subtotal of Columns (4), (5), (6) and (7).

It should be noted that the total common stock investment of the 25 P–L groups of $10.4 billion includes $2.0 billion in unconsolidated affiliated company common stock. Of this amount $1.6 billion is the investment of these P–L groups in affiliated life insurance companies and four groups with very large life operations comprise $1.4 billion of the $1.6 billion.

Three other areas of significant investment for the 25 groups are Other Assets (12.29 percent), U.S. Governments (7.53 percent) and Nongovernment Long-term Debt, which is essentially corporate debt (8.49 percent). Of the latter amount only 1.04 of the 8.49 percent is in issues with conversion or other equity provisions. The large amount of Other Assets consists primarily of uncollected premiums and amounts owed by agents.

In contrast to the significantly large investment categories described above is the relatively small investment in loans secured by mortgages (0.13 percent). As was described in sec. J.2.e, P–L groups tend to emphasize liquidity in their investments and consequently private placements of all types are not a significant portion of their portfolio.

c. Common stock investment by exchange listing

The investments of the 25 P–L groups in nonaffiliated company common stock at the end of 1964 and 1969 are classified by stock exchange listing and related characteristics in Tables VI–157, –158 and –159. There are no significant differences between mutual and stock groups reflected in the tables. Consistent with P–L insurers' stress on marketability in all categories of investments, the Study found that 86.7 percent of their common stock was listed on the NYSE at the end of 1969. The increase in this proportion from 84.5 percent in 1964 reflects the listing on the NYSE of several large commercial banks or their holding companies. The holdings of particular issues of common stock by P–L groups is discussed in chapter IX of the Study.

53–940 O—71—pt. 2——47

TABLE VI-157

COMMON STOCK HOLDINGS
BY EXCHANGE LISTINGS
25 P-L GROUPS
($ Thousands and % of Total) 1/ 2/

Common Stock	1964	1969
Listed on New York Stock Exchange	$ 5,836,910 84.5%	$ 7,320,794 86.7%
Listed on American Stock Exchange	45,622 0.7%	96,191 1.1%
Of Banks and Insurance Companies Not Listed on New York or American Stock Exchanges	732,360 10.6%	647,664 7.7%
Of Other Companies Not Listed on New York or American Stock Exchanges	294,607 4.3%	380,552 4.5%
Total	6,909,499 100.0%	8,445,201 100.0%

1/ Source: Form I-57 and I-24.
2/ Totals may not add because of rounding.

TABLE VI-158

COMMON STOCK HOLDINGS
BY EXCHANGE LISTINGS
5 MUTUAL P-L GROUPS
($ Thousands and % of Total) 1/ 2/

Common Stock	1964	1969
Listed on New York Stock Exchange	$ 260,932 86.2%	$ 446,451 83.3%
Listed on American Stock Exchange	4,008 1.3%	10,428 2.0%
Of Banks and Insurance Companies Not Listed on New York or American Stock Exchanges	25,770 8.5%	38,324 7.2%
Of Other Companies Not Listed on New York or American Stock Exchanges	12,156 4.0%	40,923 7.6%
Total	302,867 100.0%	536,126 100.0%

1/ Source: Form I-57 and I-24.
2/ Totals may not add because of rounding.

TABLE VI-159

COMMON STOCK HOLDINGS
BY EXCHANGE LISTINGS
20 STOCK P-L GROUPS
($ Thousands and % of Total) 1/ 2/

Common Stock	1964	1969
Listed on New York Stock Exchange	$ 5,575,978 84.4%	$ 6,874,343 86.9%
Listed on American Stock Exchange	41,614 0.6%	85,762 1.1%
Of Banks and Insurance Companies Not Listed on New York or American Stock Exchanges	706,590 10.7%	609,340 7.7%
Of Other Companies Not Listed on New York or American Stock Exchanges	282,451 4.3%	339,629 4.3%
Total	6,606,632 100.0%	7,909,074 100.0%

1/ Source: Form I-57 and I-24.
2/ Totals may not add because of rounding.

4. Common Stock Turnover and Activity Rates

Turnover and activity rates relate the dollar amount of common stock acquired and/or disposed of to the average amount held during the period. Activity rate ("ACT") is defined as the average of acquisitions and dispositions during the period (on an annual basis), divided by the average of holdings at market value at the beginning and at the end of the period, times 100. Turnover rate ("TOV") is defined similarly except that the numerator is simply the lesser of acquisitions and dispositions for the period. Since shares may be acquired or disposed of through conversions, exchanges and the like, data were collected separately for "cash only" and "noncash" transactions. These data were collected on Study Form I–26, Volume of Trading in Account: Common Equities, in the same fashion throughout the Study and the computations are consistent for all institutions and types of accounts. In the case of P–L groups the common stock holdings for December 31, 1964 used in the 1965 computations were provided from Form I–24, Common Stock by Exchange Listing. These data in Form I–26 provided turnover and activity rates for each year, 1965 through 1969, on a cash only basis and also with noncash transactions included. The TOV and ACT are summarized in Table VI–160 for mutual (5), stock (20) and 25 P–L groups combined.

Because of the structure of ownership of affiliated P–L companies in P–L groups and because contributions to capital and reorganizations within groups involve transactions unrelated to common stock activity in the public market, intragroup holdings and intragroup transactions of this type were excluded from Form I–26. The cash and noncash acquisition and disposition data were carefully checked with respondents to eliminate all internal transactions in each P–L group in the Study.

TABLE VI-160

P-L INSURANCE GROUP CONSOLIDATED
COMMON EQUITIES TURNOVER AND
ACTIVITY RATES, 1965-1969 1/ 2/
(Percent)

	1965		1966		1967		1968		1969	
	TOV	ACT	TOV	ACT	TOV	ACT	TOV	ACT	TOV	ACT
CASH AND NON CASH Acquisitions and Dispositions										
5 Mutual Groups	7.05	11.13	12.98	19.41	16.92	23.95	22.87	29.11	37.62	46.29
20 Stock Groups	4.26	6.25	4.59	6.37	5.30	7.85	7.46	9.92	16.11	20.44
25 P-L Groups	4.39	6.48	4.99	6.99	5.88	8.65	8.33	11.00	17.43	22.02
CASH ONLY Acquisitions and Dispositions										
5 Mutual Groups	6.97	10.97	9.93	16.31	16.24	23.30	18.27	24.63	34.94	43.70
20 Stock Groups	3.69	5.71	3.88	5.52	4.36	6.87	6.51	8.75	13.03	16.31
25 P-L Groups	3.84	5.95	4.17	6.04	4.95	7.69	7.17	9.65	14.37	17.99

1/ Source: Forms I-57, I-24 and I-26.
2/ TOV, Turnover Rate; ACT, Activity Rate.

The results in Table VI-160 showed marked increases in all measures over the period studied but the rates in the early years are noteworthy because of their low values relative to other institutions. The 1969 ACT (22.0 percent) and the 1969 TOV (17.48 percent) are more than double the 1968 rates for the 25 P-L groups and reflect the most dramatic increase in the period studied. However, it should be noted that in comparison these 1969 rates are still only one-half of the rates reported for open-end investment companies.

The Securities and Exchange Commission regularly computes and publishes ACT data for several types of institutions including P-L companies. These Commission data combine cash and noncash transactions, and are consistently one or more percentage points above the results from the combined cash and noncash data carefully produced from the Study. This comparison of P-L ACTs is summarized below:

	1965	1966	1967	1968	1969
(a) Commission	8.2	8.3	9.9	15.7	26.1
(b) Study	6.5	7.0	8.7	11.0	22.0
(a)-(b) Difference	+1.7	+1.3	+1.2	+4.7	+4.1

The differences are most significant in 1968 and 1969.

The difference between mutual group and stock group ACT and TOV reflected in Table VI-160 is significant. It shows that the five mutual groups in the Study were much more active in moving common stocks into and out of their portfolios throughout this five-year period. At the same time the overall impact of their higher TOV and ACT on the combined mutual and stock group rates is rather modest. This results from the much smaller relative investment in common stocks by mutual groups as compared to stock groups as well as presence of only five mutual groups among the 25 P-L groups in the Study. The weighted average ACT is not raised significantly.

K. SUMMARY AND CONCLUSIONS

PROPERTY-LIABILITY INSURANCE

1. Property-Liability Insurance in the Study

P-L insurance may be thought of as a second and much smaller part, as measured by aggregate assets, of a brother-sister team with life insurance. However, with respect to investment in the securities markets it is significant to note that almost all P-L investment assets are in marketable securities, while very substantial life assets are in privately placed issues and mortgages.

The P-L insurance industry was included in this Study for the following reasons:

1. To complement the study of life insurance investment;
2. P-L companies rank as the fourth or fifth largest institutional holder of common stock with approximately $14 billion in publicly traded shares on December 31, 1969;

3. To explore the reported recent increase in P–L common stock activity rate; [508]

4. To provide consolidated asset holdings data for a significant part of the P–L industry;

5. To examine the organization and composition of P–L insurance groups [509] and their degree of financial integration; and

6. To examine the securities investment operation of P–L groups.

The Study collected information from the 25 largest groups (20 stock groups and five groups headed by mutual companies). Together these groups wrote approximately 58 percent of the total industry net premiums in 1969.

2. Structure of the Industry and Regulation

a. Structure

The P–L insurance industry is relatively diffuse. Approximately 3,000 separately chartered companies or organizations underwrite P–L risks in the United States. Essentially all relatively large P–L companies are affiliated with at least one other P–L insurance company. These affiliated companies are under common control and are referred to as insurance groups. There are approximately 350 insurance groups, made up of 900 of the 3,000 P–L companies. Large P–L groups are the most significant factors in the industry, with the 50 largest groups writing approximately 74 percent of industry premiums in 1969. That there is relatively great diffusion among P–L groups is evident, since the largest group in volume of net premiums written had only 5.9 percent of the U.S. market in 1969.

The stock company is the most significant form of legal organization for private P–L insurers, as measured by the 68 percent of total industry net premiums written by stock companies in 1969. There are approximately 820 stock companies writing P–L insurance in the United States.

Second in importance to stock companies as measured by assets employed as well as net premiums written are P–L insurers organized as mutual corporations. The nearly 2,200 mutual companies wrote over 27 percent of the total industry net P–L premiums in 1969.[510] The mutual company feature of returning to policyholder-owners, in the form of a dividend, the margin in excess of the cost of operations. and the absence of equity investor-owners to provide additional capital, are perhaps the two most significant differences between stock and mutual companies and their operations as insurers and as investors. These differences limit the amount of policyholders surplus. Since State P–L investment regulations (and company policy) indirectly base the allowable amount of common stock investment on the amount of policyholders surplus, these differences effectively limit the

---

[508] The common stock activity rate is currently defined as the average of purchases and sales divided by the average market value of stock holdings at the beginning and end of the period, stated at an annual rate. Common stock activity rates are published quarterly in the Statistical Bulletin, U.S. Securities and Exchange Commission, Arpil, June, September, and December issues.

[509] A P–L insurance "group," formerly referred to as a "fleet," is defined herein as including any company writing property-liability insurance that directly or indirectly controls, is controlled by, or is under common control with another property-liability insurance company, whether by reason of common management, ownership, or otherwise.

[510] *Bests Aggregates and Averages: Property-Liability 1970* (A. M. Best Co.).

amount of common stock investment and the attendant opportunity for portfolio appreciation for mutual companies.

Insurance groups, in addition to having common control and management, typically enter into an insurance pooling agreement that allocates net premiums written by the entire group to each affiliated company on a pro rata basis. To a large extent only the legal entity distinction exists among a group's several companies. Stock groups are more prevalent, and typically include more companies than are found in mutual groups, because common stock ownership is a convenient and logical means of effecting control. Affiliation among mutual companies is more cumbersome.

Although accurate consolidated asset figures for P–L groups and for the total P–L industry are nonexistent, the volume of net premiums written is a satisfactory proxy for relative asset size and reflects the degree of concentration in the P–L industry.[511] While net premiums written indicate the volume of insurance retained by an insurer, gross premiums from direct business written reflect the direct public market activity of an insurance company or group. Direct premium data available by lines, groups and States for 1969 show the concentration and dispersion in the P–L industry.

On the basis of the volume of direct premiums written, automobile lines account for approximately 46.2 percent of all P–L premiums. This of course explains the considerable attention paid by the industry, governments and the public to regulation and ratemaking in automobile insurance. Workmen's compensation follows with 11.8 percent, but none of the other 19 individual lines accounts for as much as 10 percent of the industry. When all P–L lines are combined the dispersion in the industry is indicated most clearly since the largest P–L group in terms of direct premiums written (State Farm) accounts for approximately 6 percent of the industry, the second largest (All-state) accounts for 5 percent and the next three groups 4 percent each. The 10 largest groups combined had 38 percent of the industry direct premiums in 1969.

b. Regulation

Property liability insurance companies are subject to regulation primarily by the States rather than by the Federal Government. The primary objective of State regulation is protection of policyholders, although revenue production through taxation is also a major consideration. Toward these objectives State regulation enters all phases of the insurance business including restricting investment, conducting periodic financial examinations, approving policies and rates and licensing companies, agents and brokers.

A major force for uniformity of regulation among the several States is the National Association of Insurance Commissioner (NAIC). This organization is a significant factor in insurance regulation through its standing committees, studies of special problems, standardization of reports and preparation of model laws. In spite of this effort the laws of the State differ in many respects, though this lack of uniformity is tempered in practice for the large insurers doing business in the major States by the New York insurance law requirement that

[511] Net premiums written are defined as gross premiums from direct business written, plus reinsurance assumed from other writers, less reinsurance ceded to other companies.

foreign (non-New York domiciled) insurers substantially comply with the New York requirements for domestic insurers. Because few States are more restrictive than New York and because most large companies and groups do business there, the New York standard amount to national ones for most purposes.

Entry into the P–L business is controlled by New York insurance law[512] primarily (1) by requiring a minimum amount of capital and surplus for each specified line of insurance a company intends to write, (2) by specifying liquid, fixed income investments in which the minimum capital funds may be legally invested, and (3) by requiring that the company be licensed by the State insurance department to conduct a specified insurance business. Similar requirements including reporting as well as licensing are imposed by each State in which the company does business.

In general P–L companies are permitted relatively great latitude in the amount of investment in different types of affiliated (subsidiary) companies as well as in the amount and type of regular portfolio investment. With regard to portfolio investment in nonaffiliated companies, regulation is effected primarily through the minimum capital investment requirements described above and an additional required investment in specified categories of qualified assets until the combined total exceeds 50 percent of unearned premium and loss reserves. Aside from the concentration limitation mentioned below, the remainder of a P–L company's investments are essentially unrestricted. New York insurance law limits the total investment in any one institution, except classes of governmental obligations eligible for minimum capital investment, to a maximum of 10 percent of the investing insurer's admitted assets, unless the investment qualifies (*a*) as an investment in another insurer or (*b*) as an investment in a subsidiary company doing a specified financial or insurance related business. As to investment in another insurer, New York specifies that the total direct investment together with indirect investment through intermediate subsidiaries must not exceed the greater of (*a*) 35 percent of surplus to policyholders of the acquiring insurer, or (*b*) 50 percent of the acquirer's surplus over and above its liabilities and capital. This is not particularly restrictive, as evidenced by the widespread development of groups of affiliated insurance companies. Furthermore, the existence in an insurance group of a noninsurance holding company at the top of the ownership chain allows essentially unrestricted affiliation between insurance companies.

In addition to investment in other insurers as above, New York allows a domestic P–L company to invest in or acquire one or more solvent corporations engaged in any of the following businesses after it has satisfied its minimum capital and reserve investment requirement:

(*a*) Insurance agent;

(*b*) Securities broker or dealer investing or trading for its parent or any affiliate;

(*c*) Management, sales or other service to any investment company subject to the Investment Company Act of 1940, as amended;

(*d*) Investment adviser;

[512] New York insurance law is used for illustrative purposes.

(*e*) Insurance related functions including actuarial, loss prevention, safety engineering, data processing, et cetera;

(*f*) Pension fund administrator;

(*g*) Ownership and management of assets which the parent could itself own and manage;

(*h*) Administrative agent for government instrumentality performing an insurance function;

(*i*) Financing insurance premiums;

(*j*) Any other business activity reasonably ancillary to an insurance business;

(*k*) A holding company owning businesses specified above in (*a*) through (*j*) and/or other insurers;

The organization of noninsurance holding companies by insurers, the acquisition of insurance groups by noninsurance companies and the distribution to them of significant amounts of assets from insurance subsidiaries triggered studies of holding companies by the NAIC and the New York Insurance Department. Regulatory legislation in several States including New York soon followed. Additions to the insurance law in New York (1) provide stringent tests and limits on the amount of dividends that can be distributed and (2) require registration with the superintendent of noninsurance holding companies that control (that is, own 10 percent or more of the voting securities of) domestic insurers. Certain transactions between domestic insurers and noninsurance holding companies now require advance notice to, and approval by, the Superintendent of insurance. Significantly, approval in advance is required for anyone other than an authorized insurer seeking to acquire control of any domestic insurer. The fragmentation of regulation among the several States is awkward in many respects, but it is also well entrenched. Despite this fact, Federal involvement in the property-liability insurance business by way of studies and legislation is evident. For example, problems involving automobile insurance and high risk areas are widespread and are receiving national attention.

c. Property-liability groups and complexes

The 25 P–L insurance groups covered in the Study have followed the industry practice of adding companies. Groups add new P–L companies for the purpose of entering new territories, taking on new insurance lines, writing specialized contracts, or simply taking advantage of state laws favoring domestic corporations. From yearend 1964 through yearend 1969 these 25 P–L groups increased from 125 to 155 P–L companies. This net increase of 30 companies resulted largely from acquisitions of companies or from combinations with other P–L groups. Relatively few new companies were chartered by these 25 groups during this five year period.

P–L insurance groups have not remained exclusively in the property-liability insurance business. The movement to multiple line contracts, multiple line companies and multiple line groups has in most cases also included entering the line life insurance field. Those groups writing health insurance and having life insurance affiliates are referred to as "all-lines" insurance groups. This affiliation with life insurance companies is particularly prevalent among the 25 large P–L groups studied. All but three of these groups have at least one

active life insurance company as an affiliate. Four P–L groups with very large life insurance affiliates—Travelers, Aetna Life and Casualty, CNA (Continental Assurance) and Connecticut General—are at least as well known for their life business as for their P–L business.

While insurance holding companies are now subject to some regulation under insurance laws, they are not subject to regulation of their investments in the manner that insurance companies are regulated. Consequently, one avenue to corporate affiliation (control) of other noninsurance enterprises is to have a noninsurance holdign company be the parent company.

The noninsurace affiliations of large P–L insurance groups to date are almost exclusively with financial service enterprises. The most noteworthy exception is Allstate's affiliation as a subsidiary of its founder, Sears, Roebuck and Co., the Nation's largest retailer. Several other groups have been acquired by conglomerate corporations having important noninsurance business.

The complexes composed of the 25 P–L groups and their affiliated financial and nonfinancial enterprises had consolidated assets of $62.764 billion at December 31, 1969. The assets of the 25 P–L insurance groups themselves range from $690 million to $9.172 billion and 17 had assets in excess of $1 billion. Of the total amount $30.767 billion are in the consolidated assets of the 155 P–L companies and their subsidiaries that comprise the study sample.

The financial affiliates of the large P–L groups include finance companies (present in 15 groups), investment advisory firms (12 groups), securities broker-dealers (10 groups) and real estate management or advisory firms (nine groups). At least two other P–L groups have acquired securities broker-dealer firms during the first half of 1970 to continue this trend. Ten of the P–L group complexes were already active in the investment company business at the end of 1969. Their affiliated investment advisers managed $2.364 billion of mutual fund assets at that date and were not included in the previous asset total for complexes. In addition three other complexes have entered the mutual fund business or had taken preliminary steps to do so during the first six months of 1970.

3. Behavior as Portfolio Managers

a. Organization and procedure in investment departments

In the insurance industry investment cosiderations and operations traditionally have been considered to be essentially separate from, if not secondary to, the insurance underwriting side of the business. The 25 large P–L insurance groups are serviced for the most part by one investment department [513] per group. With one exception the 25 P–L groups provide their own internal investment management for their

[513] Investment department means that division or group of persons within the P–L insurance group or an affiliated entity which makes day-to-day purchase, sale, or hold decisions for the securities portfolio, even though some other person or group has ultimate responsibility over the investments of each company. For example, if a committee of investment officers makes only portfolio recommendations and these recommendations are seldom, if ever, overruled by a group with ultimate authority, the committee of investment officers and its staff is the investment department for the purposes of the study. This department will not necessarily be the same as any department in a group that may be called the "Investment Department."

significant companies. Factors that bear importantly on the role of P–L insurance groups in the securities markets are the operational relationships between these investment departments and their higher authority and any changes in these relationships in recent years.

Even though the several boards of directors in each group studied retain ultimate authority and responsibility, in every instance the insurance companies of the group have delegated responsibility for determining and implementing operational investment policy to a subordinate committee of directors, usually called the finance, executive or investment committee. The finance committee typically consists of five to eight directors and most often includes the board chairman, the top one or two operating officers, the top financial officer and several outside directors.

The finance committee typically establishes investment policy and guidelines for the operations of the investment department. In general the investment policy guidelines established by a finance committee are quite different for fixed income securities and common stock. However, dollar amount or percentagge of assets limits on the amount invested per issuer are used in many groups for most securities. The maximum discretionary limit reported for an equity security is $10 million per issuer, although many groups did not indicate that any specific dollar limits existed.

Subject to these discretionary constraints per issuer, the investment department is usually at liberty to buy and sell most fixed income securities without security specific committee authorization. The sale of common stock, with one exception, is also permitted without specific authorization. In contrast, purchases of common stock are normally permitted only with advance authorization unless the issue is on the approved list. In many instances the approved list includes those issues currently held in the portfolio, thereby allowing the investment department flexibility to add to existing positions of issues that do not exceed the maximum amount permitted.

Additions to an approved list or the authorization of a transaction requires in most groups, a majority vote by the finance committee. Though procedures for approval and authorization appear formidable, conservative and formal, there are modifying provisions in many P–L group's investment policy. At least 10 groups indicated that approval of a transaction by as few as two committee members is sufficient when necessary. Recent changes in investment department procedures reported by some groups indicate a gradual shift toward increased investment flexibility in the P–L industry.

Changes in the number of persons in various investment department employment categories between 1964 and 1969 give some indication of the relative significance of these positions today versus five years ago. The most significant relative change is the great increase in emphasis on professional traders. This is particularly true of equities traders, whose numbers increased fourfold in this five year period, compared to an increase of 48 percent in total investment department personnel. Also of interest is the relatively great increase in account supervisors, portfolio managers and investment research staff for equities compared to the increases in those categories for bonds. This increased emphasis on investment in equities presumably means common stock

investment since preferred stock investment is relatively small and is often associated with fixed income investment.

The 25 P-L group investment departments were asked to rank several external sources of securities research and information, indicating their importance in making purchase or sale decisions. "Financial statements of issuers" is ranked as the top source of information by 88 percent of the respondents. The only other category that scored consistently high was "Information from broker-dealers purchased with commission dollars."

b. Investment policy and practice

Part of the lore of the P-L insurance industry is that historically investment relationships have existed between (a) the volume of net premiums written in various lines of insurance and (b) liquidity requirements, portfolio composition and management. Given its own experience about volume of premiums and lines of business each of the 25 groups was asked, in the context of consideration of its relative reserves (liabilities) and surplus (capital in excess of liabilities), to describe what investment consideration, if any, is given to absolute and relative liquidity needs in determining portfolio composition. Cash plus traditional high quality, short-term liquid investments were to be contrasted to common stock investments. In addition, they were asked to describe the impact their particular groups' distribution of premiums by classes of lines had on the types of securities held in their portfolio.

Nearly all of the 25 P-L groups agree that diversification across insurance lines plus reinsurance has virtually eliminated consideration of insurance lines in portfolio management. At the same time there is some difference of opinion about the impact of premium volume, reserves, and surplus on portfolio composition. Obviously even those groups that disclaim any consideration of premium volume still maintain some pool of liquid, short-term securities to meet contingencies. Most significantly, however, there is evidence of some reevaluation among P-L groups of the role played by common stocks in building surplus and maintaining a satisfactory reserve to surplus ratio.

The 25 P-L groups were asked, in the context of current Federal income tax provisions, to describe the impact of underwriting profits and losses on portfolio composition and on investment management for income, realized and unrealized gains. The purpose of these questions was to ascertain the continuing impact of underwriting experience and tax law on the selection of different types of investment and on investment activity. The responses indicate that P-L insurance groups in general respond to some degree to prolonged statutory underwriting losses by reducing or halting further purchases of tax-exempt bonds. In light of the statutory underwriting losses experience recently, given the IRS provision exempting interest from municipal bonds from Federal income taxes, and given the related higher pretax yield available on taxable bond issues, P-L insurance groups are acting in a rational economic manner only if they exercise the option to divert investment funds into higher net yield (taxable) bonds. In contrast, P-L companies that are affiliated with profitable noninsurance operations may continue to favor tax-exempt investments.

Until recently, the traditional separation of the insurance underwriting functions from the investment function has excluded essentially all

investment return from direct consideration in ratemaking. Whether prospective changes in regulatory consideration of investment income in ratemaking will affect investment policy or behavior is subject to conjecture at this time. The inclusion of, for example, the investment income associated with the investment of funds equivalent to P–L liabilities would offset some underwriting losses and expenses. Concurrently insurance rates and premium income would change but in directions and in amounts that defy forecasting. Presumably these resultant changes would reduce statutory underwriting losses since P–L companies cannot survive prolonged losses. To the extent that overall profits change, the relative use of taxable and tax-exempt securities would also change. To the extent that statutory accounting does not adequately reflect actual underwriting experience the likely impact of including investment income in ratemaking is disguised further.

Most groups also reported that underwriting losses increased flexibility in managing the equity portfolio by permitting them to take capital gains which are offset by underwriting losses, thereby avoiding or minimizing current taxes.

Although most large P–L insurance groups measure investment performance, many of them use rudimentary methods that provide only crude indicators of portfolio appreciation and measurements are made relatively infrequently. Only a very few groups produce a measure that apparently could be used to indicate the performance of the investment department itself. Based on this information there is little evidence that these large P–L groups are performance oriented at this time. There is, however, some indication that they are moving toward more appropriate performance measurement. One group specifically reported that they were now using the Bank Administration Institute's time-weighted method of measuring performance. Two other groups said they currently were changing their internal valuation and reporting system to allow them to produce a time-weighted measure on a frequent basis.

The degree of involvement of P–L groups in the venture capital market is restricted by the traditional focus on liquidity in P–L investments. This emphasis on marketability has led P–L groups to invest almost exclusively in publicly traded issues. Private placements to large, well-established companies are insignificant. Only in a few P–L groups, particularly those with large life insurance assets to invest, do the investment departments have the experience and expertise necessary for involvement in private placements of any type. A few groups indicated a developing interest in venture capital investments, but in general there does not appear to be a significant movement in this direction among P–L groups.

Data collected by the Study permitted the first uniform consolidation of P–L insurance group assets for a significant part of the industry. The 25 P–L groups in the study had consolidated assets of $30.77 billion at December 31, 1969. By comparison it was determined that the Commission has made satisfactory approximations in estimating P–L industry assets for its reports and for activity rate computations.

The consolidation of assets also produced accurate common stock holdings data that distinguished between investment in affiliated companies and other portfolio common stock. After eliminating investment in all affiliated companies, the total common stock investment

of the 25 P–L groups was $8.445 billion at the end of 1969. Of this dollar amount, 86.7 percent of the common stock was listed on the NYSE, indicating the preference of P–L groups for stocks of that type.

Categories of assets in which the 25 P–L groups had significant investment were common stock (33.66 percent), State and local governments (28.35 percent), nongovernment long-term debt (8.49 percent), and U.S. Governments (7.53 percent). Common stock investment was significantly more important in stock groups than in mutual groups, with 38.61 percent and 11.57 percent of assets, respectively.

Other data collected allowed the Study to compute the first accurate common stock activity and turnover rates for P–L groups by eliminating intragroup transactions. The annual activity rates for 1965 through 1969 from study data increased from 6.5 to 22 percent. This confirmed the significant increase in activity revealed in the Commission's published data, but the published figures consistently overstated the activity rate by one to four percentage points. In spite of the marked increase over this period, the correct P–L activity rates still are less than one-half of the rates reported for investment companies.

Overall, the Study concludes that P–L insurance groups have not exhibited unusual investment developments nor have they had a significant impact on the securities markets during the period studied. Although the investment activities of P–L companies are regulated by the several States in which they operate, internal insurance company and group policies tend to control regular portfolio investments. Investment regulation does limit investment in noninsurance activities by P–L companies but the unregulated holding company has been used effectively to permit unrestricted investment in these areas. Several large P–L groups were acquired by noninsurance holding companies during 1968–69, but market conditions and new State regulations affecting the acquisition of P–L companies apparently have stemmed this development.

The diversification of P–L groups together with the peculiarities of statutory financial reporting requirements for P–L companies have contributed to a credibility gap in the P–L financial reports which are required by every State in which an insurance company operates. Among the accounting shortcomings in this reporting is the failure to determine underwriting results in a meaningful manner, the absence of market valuations for all securities investments, and the absence of consolidated financial statements for P–L groups. Improvements in some of these areas of reporting are forthcoming.

APPENDIX VI-A

Sampling Procedures for Life Insurance Company Questionnaires—Forms I–50, I–51, and I–52

A. SAMPLE SELECTION: FORM I–50, THE LIFE INSURANCE AND VARIABLE ANNUITY COMPANY SEPARATE ACCOUNT QUESTIONNAIRE

Form I–50, the life insurance and variable annuity company separate account questionnaire was sent to 54 companies.[514] Included with form I–50 were Forms I–3A, I–20, I–21, I–22, I–24, I–25, and I–26. This package was to be completed for each separate account managed by officers or employees of the respondent company or any affiliated entity except that some accounts were relieved from re-

[514] The questionnaires themselves and the respondent lists are published in the Study's Supplementary Volume II.

sponding to much of the package. An "affiliate" was defined as "an entity that directly or indirectly controls, is controlled by, or is under common control with your company."

Separate accounts relieved from completion of the entire questionnaire package included (1) accounts with no assets (other than start-up funds) as of December 31, 1969, (2) accounts established exclusively for Canadian or other foreign customers, and (3) accounts existing solely as liquidation accounts.

Accounts with no assets were only required to complete questions one through eight of Form I–50. Accounts for foreign customers and liquidation accounts were only required to complete Form I–50 and questions one through nine of Form I–21.

Also, any respondent with more than 15 separate accounts was permitted to complete the entire I–50 package for only the largest 15 such accounts in terms of the market value of assets as of December 31, 1969. For any remaining accounts only questions one through nine of Form I–50 and all of Form I–21 needed to be completed.

Form I–50 was not to be completed for mutual funds which were not considered separate accounts.

The 55 companies to whom the Form I–50 package was mailed were selected on the following basis. Twenty-six companies (including four Canadian companies) represent the core group of large companies which received all Part 3 questionnaires sent to life insurance companies. The 22 U.S. companies were selected as the largest U.S. companies in terms of common stock holdings as of December 31, 1968. The four Canadian companies qualified by virtue of being the four Canadian companies whose holdings of U.S. common stock issues as of December 31, 1968 exceeded the cutoff applied to the selection of the 22 U.S. companies. Three of the 22 large U.S. insurers reported that they had no separate account assets as of year-end 1969.

In addition to the 26 core companies the Form I-50 package was mailed to all other life insurance and variable annuity companies which reported total separate account assets in excess of one million dollars as of December 31, 1968. The separate account asset data which served as the basis of selection was supplied by the Life Insurance Association of America.

B. SAMPLE SELECTION: FORM I–51, THE LIFE INSURANCE AND ANNUITY COMPANIES EMPLOYEE-RETIREMENT-BENEFIT PLANS QUESTIONNAIRE

The basic sampling strategy was to obtain responses from all large U.S. life companies and other U.S. companies who were active in the annuity business or had significant annuity business *and* were respondents to Form I-50. Canadian companies were excluded from this sample in order to reduce the burden requested of them. U.S. companies became respondents if, (1) the company itself was large, or (2) the company had pension reserves in excess of $50 million at the end of 1968, or (3) the company had pension reserves in excess of $25 million at the end of 1968, *and* was an I–50 respondent.[515]

The large companies selected consisted of the 22 largest U.S. companies in terms of common stock holdings as of December 31, 1968. These companies represent the core group of large U.S. companies that received Part 3 questionnaires sent to life companies.

In addition, as noted, Form I-51 was sent to all companies showing pension reserves of $50 million or more as of December 31, 1968. Finally, any respondent to Form I-50 not already selected was added to the sample if it had end-1968 pension reserves in excess of $25 million.

A total of 50 companies were mailed the Form I-51 package. Eight companies were excused because they proved to be currently inactive in the group annuity business.[516] Four of these were among the 22 large companies; three had been selected on the basis of having over $50 million in pension reserves and one had over $25 million in pension reserves and was an I-50 respondent. Thus, 42 companies remained in the sample utilized.

C. SAMPLE SELECTION: FORM I–52—THE LIFE INSURANCE COMPANY INTRINSICS QUESTIONNAIRE

Included in the Form I–52 package was Form I–52. Parts A, B, C, D and E, and Forms I-20, I-21, I-24 and I-26. The sampling strategy for Form I-52 consisted of

[515] The information on pension reserves by company was supplied by the Life Insurance Association of America.

[516] The pension reserve data on which selection was based included individual annuity as well as group annuity business.

two parts: (1) selection of all large life insurance companies, and (2) a judgment selection of other companies thought to be in some degree active in equity based products.

The large companies selected consisted of the 22 largest U.S. companies and the four largest Canadian companies in terms of U.S. common stock holdings. These 26 companies represent the core group which received Part 3 questionnaires directed to life companies.

The judgment sample was selected to provide companies ranging over a wide spectrum which offered one or more equity-based products including:

(1) Individual variable annuities.

(2) Mutual funds—

(a) created by the life company or an affiliate;

(b) whose management companies were acquired by the life company or an affiliate;

(c) formed jointly with other life companies; or

(d) managed by unaffiliated enterprises but offered by the life company's agents.

(3) Variable life insurance.

Companies were selected from information in published sources including particularly, the Life Insurance Stock Letter, supplement, October 1968. (Financial Research Associates) and "Equity Products Survey," *Pension and Welfare News*, July 1969.

Since some insurance complexes have both large life and large property and liability companies, there was a problem of sampling overlap with Form I–57. Four companies among the large 22 life companies represented overlap situations. They were Travelers, Aetna, Continental Assurance and Connecticut General. These companies received both Form I–52 and I–57 and were given special instructions on how to deal with overlaps and discrepancies between the instructions in the two forms.

Four other companies who would otherwise have been in the I–52 sample were eliminated because the complexes of which they were a part received I–57. They were American General Life of North America, Nationwide Mutual and Fireman's Fund.

The final judgment sample utilized consisted of 33 U.S. companies and seven Canadian companies. Thus, overall 55 U.S. companies and 11 Canadian companies received the I–52 package. The Canadian companies were requested to complete at least Part B of Form I–52.

APPENDIX VI–B

PROPERTY-LIABILITY INSURANCE SAMPLE SECTION, RESEARCH DESIGN AND QUESTIONNAIRES

The sample selection procedure for the 25 large P–L insurance groups included in the Study is described below. The name of each insurance group included in the Study is given and the relationship of the sample to the P–L industry is discussed. Finally, the design of the research is indicated by describing the various questionnaires used by the Study to collect information from the P–L groups.

In the absence of consolidated asset data for insurance groups in the P–L industry it was determined that net P–L insurance premiums written by each group would provide an appropriate proxy for consolidated assets to identify the 25 largest groups. These net premium data are readily available, they avoid the double counting problem and they provide a measure of absolute and relative size of P–L insurance groups. The most recent annual net premium information then available (1968 data) is reported in *Best's Insurance Reports: Property-Liability* 1969[517] and in *Best's Aggregates and Averages: Property-Liability* 1969.[518]

From these sources the largest P–L insurance groups based on 1968 net premiums written were identified and it was determined that the 25 largest groups would include approximately 59 percent of the total industry net premiums in 1968. Table VI–B–1 lists these 25 P–L groups, their 1968 premiums and the Study Group I.D. Code number that they were assigned for their basic questionnaire package, Form I–57.

---

[517] A. M. Best Company, Morristown, New Jersey (1969).
[518] *Id.*

TABLE VI-161

P-L INSURANCE GROUPS IN STUDY SAMPLE

1968 Net Premiums	Study Group I.D. Code No. 1/	Name of Group or Controlling Company	1968 Net Premiums (millions) 2/
1.	77170000	State Farm 3/	$1,441
2.	77010000	Allstate	1,227
3.	77220000	Travelers	1,170
4.	77020000	Continental Insurance 4/	1,079
5.	77230000	Aetna Life and Casualty	1,012
6.	77030000	Hartford Fire	894
7.	77180000	Liberty Mutual 3/	771
8.	77040000	INA	712
9.	77050000	Fireman's Fund American	655
10.	77240000	CNA 5/	644
11.	77060000	Home	582
12.	77070000	U.S. Fidelity and Guaranty	546
13.	77190000	Nationwide 3/	482
14.	77080000	Employers-Commercial Union 6/	466
15.	77090000	Royal-Globe	455
16.	77200000	Kemper 3/	417
17.	77100000	Crum and Forster Insurance	391
18.	77210000	Employers of Wausau 3/	340
19.	77250000	Connecticut General 8/	329
20.	77110000	American General 7/	318
21.	77120000	St. Paul Companies	305
22.	77130000	Reliance	304
23.	77140000	Chubb Insurance 9/	290
24.	77150000	Great American	283
25.	77160000	SAFECO 10/	235
		TOTAL	$15,348

1/ Prefix 77 identifies P-L industry and columns 3-4 give each group a unique two-digit number, followed by four zeros.

2/ *Best's Aggregates and Averages: Property-Liability 1969*

3/ Mutual company heads group

4/ Formerly America Fore-Loyalty

5/ Formerly Continental Casualty

6/ Formerly Employers Group

7/ Formerly Maryland Casualty

8/ Formerly Aetna Insurance

9/ Includes $45.9 million of premiums of offices of 5 British companies for which Chubb manages insurance business but not investments

10/ Formerly General of America

Although there are four different legal forms of organizations that underwrite P–L risks, only stock corporations (stock companies) and mutual corporations are significant factors in the industry.[519] These 25 P–L groups include 20 stock groups comprised of stock companies and five mutual groups, each of which is headed by a mutual company. The two legal forms of P–L insurers that were not included in the Study are reciprocal insurance exchanges and Lloyds organizations. Together these two unincorporated forms of P–L organizations wrote only 4.1 percent of 1968 industry net premiums. The one reciprocal insurance exchange that had sufficient 1968 premiums to rank it in the top 25 P–L insurers (19th) was excluded primarily because it had not received earlier Study questionnaires. That reciprocal exchange was omitted from other Study samples because it had a common stock portfolio of less than $100 million.

The remaining 25 largest P–L groups were selected to receive the basic P–L insurance questionnaire, "Property and Liability Insurance Groups," referred to as Study Form I–57. Table VI–162 summarizes the size of the sample of 25 P–L insurance groups selected to receive Form I–57 in relation to the entire P–L industry. Prior to final sample selection, current information was added reflecting any changes in the company composition of each group during 1969. Each group is comprised of at least two P–L companies with the high being 20 companies. Affiliated Canadian and other P–L companies organized outside of the United States are not included.

As seen in Table VI–162, in 1968 there were approximately 820 stock P–L companies, 2,150 mutuals, 45 reciprocal exchanges and 15 Lloyds organizations doing business in the United States.[520] As measured by the volume of net premiums written in 1968, stock companies ranked first with $17,833 million (69 percent), mutuals had $7,111 million (27 percent) (of which $6,878 million was written by only 326 mutual companies), reciprocal exchanges had $1,054 million (four percent) and Lloyds had the balance of $29 million (about 0.1 of 1 percent). Many of these companies are affiliated and operated as parts of one of 350 insurance groups. The 50 largest groups wrote $19,155 million[521] or 74 percent of the total industry's 1968 net premiums, compared to the Study sample of 59 percent as shown in Table VI–162.

---

[519] See ch. VI sec. I.1.a.
[520] Interview with Chester Kellogg, Chairman of A. M. Best Company, March 11, 1970.
[521] *Best's Aggregates and Averages: Property-Liability 1969.*

TABLE VI-162

INSTITUTIONAL INVESTOR STUDY P-L INSURANCE SAMPLE COMPARED WITH INDUSTRY DATA 1/

Form of Organization	P-L Insurance Industry			Study P-L Sample			
	Number of Companies Associations	1968 Net Premiums Written ($ millions)	% Total Industry Net Premiums	Number of Companies	Number of Groups	1968 Net Premiums Written ($ million)	% of Total Industry Premiums
Mutual	2,149 2/	$7,111	27	10	5	$3,451	49% 4/
Stock	819	17,833	69	145	20	11,897	67% 4/
Reciprocal Exchange	45	1,054	4	0	0	0	0
Lloyds Organization	15	29	0.1	0	0	0	0
TOTALS	3,028 3/	$26,026	100.0	155	25	$15,348	59%

1/ Best's Aggregates and Averages: Property-Liability 1969

2/ 326 of the approximately 2,149 mutuals wrote $6.878 billion and the remaining 1,830 mutuals wrote only $233 million in net premiums in 1968.

3/ Insurance Facts 1969, Insurance Information Institute.

4/ Sample as a percent of total net premiums by that form of insurance organization.

These 25 P-L insurance groups received the I–57 questionnaire package consisting of Form I–57 itself and Forms I–57A, I–20, I–21, I–21A, I–24, and I–26.[522] Form I–57A explores the structure and organization of affiliated insurance and other financial enterprises for the entire insurance company complex. The other six documents were completed on an "investment department" basis. If as in most cases, one investment department serves that function for the entire group, only one set of these forms was completed for each group. Two groups had two autonomous investment departments serving different companies in the group and two other groups had three investment departments.

Form I–57 inquires about the investment department organization, policies, practices and investment regulations. It also asked for data on each company's insurance underwriting activities and investment results. Form I–20, "Investment Restrictions and Regulations," Form I–24, "Holdings by Exchange Listing" and Form I–26, "Volume of Trading in Account: Common Equities" were completed once on a consolidated basis for each investment department in an insurance group.

Form I–21, "Asset Holdings," and complementary Form I–21A, "Liabilities and Capital," were completed for each U.S. P-L company in the group reflecting the position at year-end 1969, with the following exception: Groups with eight or more affiliated P-L insurance companies could elect not to complete Forms I–21 and I–21A for any group companies with less than $10 million in admitted assets at the end of 1969. This provision affected only four groups and ten companies were excluded from the I–21, I–21A census. The aggregate assets of the ten excluded companies is approximately $34 million.[253] Statement values were supplied on these forms.

All 25 of the P-L insurance groups that received Form I–57 were recipients of other study questionnaires (for example, Form I–1, I–2, I–3, I–7, I–12, I–29, etc.) as the core P–L groups. Four of the 25 P–L insurance groups were included on the list of core life insurance companies since they are among the top 25 in size in that activity as well. These four groups, Travelers, Aetna Life and Casualty, CNA Financial and Connecticut General (Group I.D. numbers 22, 23, 24 and 25, respectively) were sent the Form I–52 package for their life activities simultaneously with Form I–57 and additional instructions were supplied by telephone.

Aside from the questions requiring responses or entries in Tables I through VIII in Form I–57 and I–57A, the remaining information was supplied to the Study on 80-column punched cards in addition to the written response.

---

[522] See Study Supplementary Volume II.

[523] All reference to asset size throughout this discussion is based on P–L insurance company statement values. This means that common and preferred stocks, which on the average comprise about 40 percent of total assets for stock companies, are at market value. All other investment assets are at "amortized" value, an adjusted cost value that is insensitive to market fluctuations.