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TAXATION OF LIFE INSURANCE COMPANIES

1464-3

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

EIGHTY-SEVENTH CONGRESS

FIRST SESSION

ON

S. 397

A BILL TO AMEND THE INTERNAL REVENUE CODE OF 1954 TO PERMIT A DEDUCTION BY LIFE INSURANCE COMPANIES IN DETERMINING GAIN OR LOSS FROM OPERATIONS OF AN AMOUNT EQUAL TO 2 PERCENT OF THE PREMIUMS FROM INDIVIDUAL ACCIDENT AND HEALTH INSURANCE CONTRACTS

JULY 6, 1961

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TAXATION OF LIFE INSURANCE COMPANIES

THURSDAY, JULY 6, 1961

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to notice, at 10 a.m., in room 2221, Senate Office Building, Senator Robert S. Kerr, presiding.

Present: Senators Kerr, Long, Smathers, Douglas, and Curtis.

Also present: Elizabeth B. Springer, chief clerk.

Senator KERR. The committee will come to order.

(S. 397 is as follows:)

[S. 397, 87th Cong., 1st Sess.]

A BILL To amend the Internal Revenue Code of 1954 to permit a deduction by life insurance companies in determining gain or loss from operations of an amount equal to 2 percent of the premiums from individual accident and health insurance contracts

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) section 809(d)(6) of the Internal Revenue Code of 1954 (relating to deduction for group life, accident, and health insurance) s amended—

(1) by striking out "group life insurance contracts and group accident and health insurance contracts" and inserting in lieu thereof "accident and health insurance contracts and group life insurance contracts" (other than those described in section 809(d)(5)) and group life insurance contracts; and

(2) by striking out the heading and inserting in lieu thereof "Accident and health insurance and group life insurance".

SEC. 2. The amendments made by the first section of this Act shall apply to taxable years beginning after December 31, 1959.

STATEMENT OF RICHARD E. SLITOR, OFFICE OF TAX ANALYSIS, TREASURY DEPARTMENT

Senator KERR. Do you have a copy of your statement?

Mr. SLITOR. I have a copy for you, Senator. I don't have enough for distribution.

Senator KERR. I want to put in at the appropriate place a letter from Mr. Rietz, executive vice president of the Great Southern Life Insurance Co., and one from Mr. Richardson, first vice president of the Berkshire Life Insurance Co., supporting S. 397

(The letters referred to are as follows:)

GREAT SOUTHERN LIFE INSURANCE CO.,
Houston, Tex., July 3, 1961.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: Our attention has been called to Senate bill 397 introduced by Senator Robert S. Kerr to amend section 809(d)(6) of the Internal Revenue Code to allow life insurance companies a phase 2 deduction equal to 2 percent of the taxable premiums for the year on individual accident and health insurance contracts issued or renewed for periods of less than 5 years.

We urge favorable consideration of this legislation to provide more equitable tax treatment with respect to such contracts as compared to the tax treatment now afforded group accident and health contracts under the section this bill proposes to amend and the treatment provided under section 809(d)(5) for individual nonparticipating contracts which are issued or renewed for periods of 5 or more years.

Respectfully yours,

H. LEWIS RIETZ,
Executive Vice President.

BERKSHIRE LIFE INSURANCE CO.,
Pittsfield, Mass., July 3, 1961.

SENATE FINANCE COMMITTEE,
New Senate Office Building, Washington, D.C.

GENTLEMEN: We have been advised that the trade associations of the life insurance industry have taken no position on S. 397, the proposed amendment to section 809(d)(6) of company Federal income tax law.

We should like to be recorded as being strongly in favor of this proposed amendment which appears to us to accomplish an equitable adjustment of the present tax law as it affects mutual life insurance companies writing individual accident and health insurance.

Yours respectfully,

CHARLES F. B. RICHARDSON,
First Vice President.

Mr. SLITOR. My name is Richard E. Slitor, economist in the Office of Tax Analysis, Treasury Department.

I appreciate this opportunity to present the comments of the Treasury Department on S. 397.

S. 397 would extend the special 2-percent reduction allowed life insurance companies for premiums on group life and group health and accident insurance to their individual health and accident insurance business.

The present special 2-percent deduction on group premiums in computing gain or loss from operations of life insurance companies was adopted as part of the Life Insurance Company Income Tax Act of 1959, and is embodied in section 809(d)(6) of the Internal Revenue Code. The amount of the deductions under section 809(d)(6) cannot cumulatively exceed 50 percent of the premiums for the taxable year attributable to group contracts. Together with other special deductions under section 809 for nonparticipating business and policy dividends this deduction cannot exceed the underwriting gain, that is, the excess of gain from operations over taxable investment income, plus $250,000.

At the time of the adoption of the 2-percent deduction, both committee reports stated its purpose as follows:

> This special deduction, which is patterned after the reserve requirement of two States, is designed to compensate for the fact that in group insurance there is less than the usual diversification of risk.

The purpose in mind here was to permit the buildup of reserves to meet possible heavy losses due to concentration of risk and hazard of heavy loss of life or injuries, for example, in catastrophes in a single plant where the employees are covered by group insurance.

This purpose or justification is not present in the case of individual health and accident insurance policies.

Senator KERR. Just one moment there. Is it not possible that it might be?

Mr. SLITOR. I suppose if a company wrote a good deal of its insurance in a particular area, I suppose you could have a problem of nondiversification.

Senator KERR. Isn't that a very distinct possibility with reference to a small insurance company?

Mr. SLITOR. I would rather let the industry people comment on the way they operate and the extent to which they reinsure where there is some local concentration of risk.

Senator KERR. I am sure they will. The only reason I interrupted was because your quote:

> This purpose or justification is not present in the case of individual health and accident insurance policies.

Mr. SLITOR. I believe there is some presumption that the risk would be spread more widely in the case of the individual policies.

Senator KERR. I would think there would be a likelihood of it. But I know of no basis upon which to make the positive statement that there not only is a presumption, but a certainty. I wonder if in the light of this little exchange of remarks you might not want to look at that statement again.

Mr. SLITOR. We shall be very glad to hear what the industry has to say on this problem.

Senator KERR. I am sure they will look at it.

I was wondering if maybe you might not want to.

Mr. SLITOR. Well, Senator, we have been under the impression that there was not a similar problem in the case of the individual policies——

Senator KERR. Then you want the record to stand on the basis of this positive statement:

> Our purpose or justification is not present in the case of individual health and accident insurance policies?

Mr. SLITOR. To the best of our knowledge, the same sort of nondiversification of risk problem does not exist as a general rule.

Senator KERR. Well, I don't see the words "as a general rule" here.

Mr. SLITOR. We should be very glad to learn of the problems of concentration as they occur.

Senator KERR. All right.

Mr. SLITOR. The special deductions under section 809 for group insurance, for nonparticipating contracts, and for policy dividends, and the limitations thereon, were carefully developed by the Congress with the objective of maintaining the competitive balance between the stock and mutual sectors of the life insurance industry. The proposed change in the 2 percent deduction would tend to benefit primarily stock companies, and would alter the competitive situation and the distribution of burden as between the stock and mutual elements of the industry.

Senator KERR. Why would that be?

Mr. SLITOR. Because most of the underwriting gain, this excess of gain from operations over taxable investment income, is in the hands of stock insurance companies.

The mutuals substantially eliminate the phase 2 tax, as was contemplated in the original legislation, with their policy dividends deduction. Therefore, they couldn't benefit by any additional deduction, generally speaking.

Senator KERR. Are they not already in that unfavorable competitive position if there is an unfavorable competitive position by reason of this provision, does it not already exist because of what is already in the law with reference to the 2-percent deduction on the root premiums?

Mr. SLITOR. Senator Kerr, the Treasury has not heard a great deal about any problem of lack of competitive balance under——

Senator KERR. How much insurance, what amount of premium in your judgment is now being paid with reference to which the existing 2 percent deduction applies?

Mr. SLITOR. The 2 percent deduction under present law in 1958 amounted to a little over $75 million.

Senator KERR. Then the 2 percent deduction applied to $3,750 million?

Mr. Slitor. Yes, sir.

Senator KERR. Now, what is your estimate of the amount of premiums not now affected but which would be if this amendment were adopted?

Mr. SLITOR. I believe that there is approximately a billion and a half.

Senator KERR. A billion and a half dollars?

Mr. SLITOR. As my statement later will indicate.

Senator KERR. You cover that later?

Mr. SLITOR. Yes, sir.

Senator KERR. Pardon me.

Mr. SLITOR. It would also appear to raise a problem of comparable treatment for the fire and casualty insurance industry which also writes substantial amounts of both group and individual accident and health insurance, and does not receive such a special deduction as an offset against its underwriting gains.

The premium income of life insurance companies on individual health and accident policies is in the order of one and a half billion dollars annually at the present time. A deduction of 2 percent of that amount would be in the order of $30 million. Even allowing for cases where the deduction would have little or no tax effect, it appears that the proposed amendment would reduce revenues by several million dollars annually.

Senator KERR. You wouldn't want to come any nearer to those words in giving your estimate of what the effect would be?

Mr. SLITOR. No, sir; perhaps the industry has more exact computations.

Senator KERR. It is a little bit unusual, isn't it, for the Treasury to advise the committee that the industry is in a better position to inform the committee of what the effects on tax revenue would be of an amendment, that the industry is in a better position to advise the committee than the Treasury?

Mr. SLITOR. Well, as you know, it is difficult to get exact facts and the exact distribution of this kind of business among companies in relation to their taxable income.

Senator KERR. I believe this is the first amendment or first piece of legislation that I can remember with reference to which hearings have been had by this committee with reference to which the Treasury told us, first, they were unable to advise us what the tax effect would be, and, second, what the effect on the industry would be.

Mr. SLITOR. We estimate that it would be several million dollars, perhaps $3 or $4 million.

Senator KERR. Perhaps $3 or $4 million?

Mr. SLITOR. I believe in that order of magnitude.

Senator KERR. Fine. I thank you for that.

Mr. SLITOR. The Life Insurance Company Income Tax Act of 1959 is still new. There has not been sufficient time to study this aspect of its operation. The revenues under this legislation have already fallen short of original estimates by some $45 million annually, that is, the revenue was $455 million on 1958 income, as against an estimate of $500 million.

There appear to be certain technical deficiencies in S. 397 as presently drafted. While the bill amends the basic deduction provision of section 809(b)(6) to accomplish the intended purpose, it fails to make the accompanying changes in section 815(c)(2)(C) to ensure that the proposed individual accident and health insurance deductions are added to the policyholders' surplus account in the same manner as the existing deductions for group business.

Under the circumstances it would seem undesirable to adopt S. 397.

Senator KERR. I thank you very much for the committee for your statement.

I would like to ask you these two further statements: One, would you provide the committee with the language necessary to correct the technical deficiency referred to in the last paragraph of your statement?

Mr. SLITOR. Yes, sir.

(The following was later received for the record:)

LANGUAGE TO CORRECT TECHNICAL DEFICIENCIES IN THE PROPOSED BILL

(a) The present language of section S. 397 would need to be changed to read as follows:

"Section 809(d)(6) of the Internal Revenue Code of 1954 (relating to deduction for group life, accident, and health insurance) is amended—

"(1) by striking out 'group life insurance contracts and group accident and health insurance contracts' and inserting in lieu thereof 'accident and health insurance contracts (other than those described in section 809(d)(5)) and group life insurance contracts'; and

"(2) by striking out the heading and inserting in lieu thereof 'Certain Accident and Health Insurance and Group Life Insurance".

(b) The following should also be added to section 1 of the bill:

"Section 815(c)(2)(C) (relating to policyholders surplus account) is amended by striking out 'group life and group accident and health insurance contracts' and inserting in lieu thereof 'accident and health insurance contracts and group life insurance contracts".

(c) It should also be noted that section 2 of the bill makes it retroactive in its application. This would, therefore, necessitate the reopening of returns already filed for the taxable year 1960 and in many cases result in tax refunds.

Senator KERR. Two, what would be the attitude of the Treasury if S. 397 were amended so as to apply the limited amount of the premiums that would be affected by it? In other words, you tell the committee that it would apply to approximately $1.5 billion in premiums. Do you have any estimate of the number of companies that produce that premium income?

Mr. SLITOR. No, sir; I do not have an estimate of the number of companies receiving that.

Senator KERR. Would you estimate that any considerable part of this $1.5 billion would be produced by a limited number of larger companies?

Mr. SLITOR. Yes, sir; there is considerable concentration of the health and accident business. On the other hand, while I do not have exact figures, there are several hundred companies that sell accident and health insurance.

Senator KERR. But if the deduction—if the effect of the deduction was limited to the first fixed amounts of premiums to be specified, would it not be possible that its benefit to small companies would be unimpaired, and at the same time its tax effect greatly reduced?

Mr. SLITOR. Senator, I couldn't give you the Treasury's views on that. We would like to study that. And certainly that would to some extent alter its character as a small business feature.

Senator KERR. I wonder if the Treasury would study that and come up with a letter on it?

Mr. SLITOR. Yes, sir.

(The following was later received for the record:)

TREASURY DEPARTMENT,
Washington, July 10, 1961.

Hon. ROBERT S. KERR,
U.S. Senate, Washington, D.C.

DEAR SENATOR KERR: During the hearing held by the Finance Committee July 6 on S. 397, introduced by you January 13, 1961, to extend the 2 percent group premium deduction for life insurance companies to their individual accident and health insurance business, at which Mr. Slitor of our staff submitted comments for the Department, you requested the Treasury's views on a possible amendment to your bill limiting the dollar amount of the premiums eligible for the proposed extension, as well as certain other items of information which are submitted herewith.

As I understand the possible amendment which you outlined at the hearing, it would limit the proposed 2 percent deduction to a specified amount of individual accident and health insurance premiums, with the objective of maintaining the benefits of the proposed deduction for small companies while curtailing the overall revenue loss. Such a modification, depending on the level of the limitation used, would partially alter the character of your proposal, making it a form of tax adjustment chiefly of significance for a selected group of small companies writing individual accident and health insurance. While such a curtailment of the scope of the bill would reduce the revenue decrease involved, the Department would still not favor the extension of the 2 percent deduction even in this limited form. As indicated in our statement before your committee on July 6, we feel that the justification for the present 2 percent group deduction based on the concentration or nondiversification of risk under group contracts, as reflected in the reserve requirements of two States, is not present in comparable degree under individual contracts. Considerations of prudent management, State supervision, and available reinsurance procedures would appear to place the writing of individual accident and health policies, like individual life insurance, on a sound actuarial basis within the capacity of the particular company.

The provisions for deferral of tax on half of the underwriting gain of life insurance companies, together with other special deductions accumulated in the shareholders surplus account, provide substantial contingency reserves for the risks inherent in the life insurance business, including individual life as well as individual accident and health insurance contracts. A small business deduction equal to 10 percent of the first $250,000 of investment yield of life insurance companies is provided in both phases 1 and 2 of their tax computation, in addition to the generally applicable $25,000 corporate surtax exemption. The generally available loss carryback and carryover provisions are available to life insurance companies and the carryover provisions have been extended up to 8 years in the case of new life companies.

A 2-percent allowance based on premium receipts would generally represent a large tax exemption or deferral in relation to the net underwriting profit on the accident and health business, unless such business was unusually profitable. Casualty insurance companies conducting accident and health business, some of which are small, do not receive such an allowance. Such a reduction of taxable income is not warranted, in our opinion, to supplement existing reserve and deferral provisions for life companies. Viewed as a method of helping small companies,

the proposed limited deduction would result in highly selective benefits depending on the extent of the particular company's activities in the individual accident and health insurance field.

Thank you for giving us this opportunity for further comment. If I can be of further service in this matter, please let me know.

Sincerely yours,

STANLEY S. HURREY, *Assistant Secretary.*

Senator KERR. Thank you very much.

Senator DOUGLAS. Mr. Chairman?

Senator KERR. The Senator from Illinois.

Senator DOUGLAS. As my memory operates it seems to me that when we had the insurance bill up last year or the year before that we provided for a 2-percent deduction on group insurance; is that correct?

Mr. SLITOR. Yes, sir.

Senator DOUGLAS. And that the argument at that time as to the 2 percent was that since group insurance was consummated that there should be a 2-percent deduction for the possibility of a catastrophe; is that correct?

Mr. SLITOR. Yes, sir; and it was so stated in the committee report

Senator DOUGLAS. Now, these are on individual accident and health policies; isn't that true?

Mr. SLITOR. Yes, sir.

Senator DOUGLAS. Would there not be much better distribution of risk across the board, so to speak, so that the possibility of a catastrophe would be infinitely less, perhaps nonexistent, than in the case of the individual policies?

Mr. SLITOR. Yes, sir; there is certainly a presumption that there would be a spread——

Senator DOUGLAS. And the argument that was used to defend the 2-percent deduction on group policies does not hold when it is applied to individual policies?

Mr. SLITOR. Yes, sir.

Senator DOUGLAS. Now, I would like to ask a question of the chairman, if I may.

Is there a parallel bill to this in the House?

Senator KERR. I do not know.

Is there someone here with the industry who could answer that question?

None that you know of.

Is there anyone here that knows of a parallel bill to this in the House?

If there is, I do not know it.

Senator DOUGLAS. If there is not a parallel bill, I take it no hearings have been held on it in the House, since you cannot hold hearings on a nonexistent bill.

Senator KERR. I appreciate the question of the Senator from Illinois, and would say to him two things: No. 1, the Senator from Oklahoma is of the opinion that in the case of many small companies there is considerable concentration of the risk because of the limited area in which the small company might do business; No. 2, hearings on this bill were called at the request of the Senator from Oklahoma in order that there might be an opportunity for anyone who either favors it or opposes it to be heard to the extent that they desire.

Senator DOUGLAS. The Senator from Illinois wants to make it clear that he is not objecting to the hearings, but he thinks it establishes a very interesting precedent, perhaps, to be used in connection with the general tax bill which seems to be delayed in the House.

Senator KERR. I understood that there had been extended hearings over there.

Senator DOUGLAS. But not over here.

Senator LONG. If I might just say this, it is my impression that any committee can conduct a hearing on practically anything unless the Senate stops them.

Senator KERR. I would say the observation is sound.

Thank you very much, Mr. Slitor.

Mr. SLITOR. Thank you.

Senator KERR. Mr. Peyton Ford?

I am just advised that the House committee reports there is no similar bill.

All right, Mr. Ford.

STATEMENT OF PEYTON FORD, ATTORNEY, WASHINGTON, D.C.

Mr. FORD. I am an attorney for the Texas Legal Reserve Officials Association, and the National Association of Life Companies, Inc., of Atlanta.I appear here in support of S. 397.

Without going into any details, this 2-percent deduction would equalize the individual policy as against the group policy.

From a study of the legislative history, I do not think it was the intent of Congress in enacting the 1959 bill to exclude the 2-percent deduction to individual policies. I think in its solicitude for the greater risk inherent in the group policy that permitted the 2-percent deduction they simply overlooked the 2 percent in the individual policies, and the risk, as I think will be demonstrated, is equally great.

The companies I represent are small stock companies. And the revenue lost as far as taxes are concerned would be de minimus, while the benefit to us would be great.

I would like to introduce the following witnesses: Dewitt Roberts, executive secretary of the National Association of Life Cos., Inc., of Atlanta; followed by Mr. Hunter McLean, president of the American Standard Life Insurance Co., of Fort Worth, and speaking for the Texas Legal Reserve Officials Association; and Mr. J. W. Baker, who is a member of the board of directors of the National Association of Life Cos., and is president of the Continental Service Life & Health Co., of Baton Rouge, La.; and Mr. Carlton Harker, vice president of the Coastal States Life Insurance Co., of Atlanta.

Senator DOUGLAS. Before these witnesses appear, I would like to say that it is a great pleasure for Mr. Ford to appear. He was Deputy Attorney General for many years. And we all know that the interests of these companies are in very competent hands.

Senator KERR. Before we hear Mr. Roberts, I would like to ask Mr. Slitor one more question.

What is the tax effect of the 2-percent deduction now allowed the life insurance companies for premium on group life and group health and accident insurance?

Mr. SLITOR. It appears to be—and I would like to correct this for the record, sir—it appears to be in the vicinity of $8 million or $9 million.

Senator KERR. The present exemption, then, reduces the tax income $8 million or $9 million, and in your judgment the amendment would make a further reduction in the neighborhood of $3 million or $4 million?

Mr. SLITOR. Yes, sir

Senator KERR. But you will recheck that and give us a letter as specifically as you can with reference not only to the existing exemption, but also to the proposed one?

Mr. SLITOR. Yes, sir

Senator DOUGLAS. Mr. Chairman, may I ask another question at this point?

Senator KERR. Yes.

Senator DOUGLAS. I regret that other duties prevented me from hearing the main portion of your paper. I thought I heard at the end of your statement that the total annual premiums of individual accident and health insurance policies came to between $1½ to $2 billion a year. Was I correct in that

Mr. SLITOR. Yes, sir; that is correct.

Senator DOUGLAS. Now, 2 percent of that, that would not be 3 or 4 million dollars, it would be 30 or 40 million dollars; would it not?

Mr. SLITOR. Yes, sir; but some of it would run to waste, would not result in an effective tax reduction

Senator KERR. Before the Senator from Illinois came, the witness told us that the premium income affected by the existing exemption was $7½ billion, and that the premium income that would be affected by this amendment was approximately $1½ billion. Therefore, it occurred to the Senator from Oklahoma that the tax effect of the proposed amendment could not be more than about 25 of the tax effect of the existing law.

Senator DOUGLAS. I take it that the witness will submit a detailed statement on this point.

Senator KERR. Yes.

And I would like in the statement if the effect of the proposed amendment would be as you have suggested and thought it would, how it is that existing law, where the 2 percent applies to a premium income of $7½ billion, I believe you said——

Mr. SLITOR. No, I believe we agreed, Senator, it was about $3,750 million because 2 percent of that amount, I believe, would be $75 million. So I believe that the estimates are approximately consistent, that is, the ratio of a billion and a half to $3,750 million——

Senator KERR. Then if that is the correct data, you will verify it?

Mr. SLITOR. Yes, sir.

(NOTE.—The Treasury estimates that the revenue effect of the group premium deduction in 1958 was between $9 million and $10 million. At estimated 1961 levels of premium income, it would be between $12 million and $14 million.)

Senator KERR. All right.

Thank you very much.

Mr. Dewitt Roberts?

STATEMENT OF DEWITT ROBERTS, NATIONAL ASSOCIATION OF LIFE COMPANIES, INC.

Mr. ROBERTS. My name is Dewitt H. Roberts. I am executive secretary of the National Association of Life Companies. This is a trade association composed of about 170 small- and medium-sized younger, progressive companies scattered from Honolulu to New York.

I hope the members of the committee will recall that NALC asserted that the life insurance industry should pay more taxes, even to the point of preferring the 1942 law because of its simplicity, but we agree the industry had in mind the right principle. While we found some faults with the philosophy of the present law, we are trying to work within its framework.

When you consider that it took 35 years to render the preceding tax legislation for life companies technically workable, by which time credit and similar specialty items had arisen to create entirely new problems, we do not think it extraordinary that some changes and adjustments will be required in the present bill.

This association still thinks that tax exemption for the profit of life companies in the handling of pensions was a mistake, but that criticism is not germane to our appearance here today.

Examining the bill from the standpoint of the younger, smaller, growing companies, we have found four questions that we think will require some kind of treatment.

The first is the issue of tax exempts and intercorporate dividends. We have no quarrel with the attitude of the Congress, which unmistakably declared that these exemptions should be allowed. We do not think that the interpretations and regulations render them tax exempt.

Second, we are disturbed a little about the effect of the deduction of 10 percent of the increase in nonparticipating reserves, in the instance of younger companies. That is the companies under 10 years old.

NALC is now studying the odd result whereby policyholders surplus, subject to the part III tax, increases while a company is actually losing money and which increases in policyholders surplus would subsequently be taxed. Because this is a wholly new problem which the companies came to consider only this year, and for which there may be adequate administrative remedies, we have no requests for legislation.

Third, we are somewhat concerned about the treatment of capital gains, which is specially a small-company problem.

But in the fourth field, that of giving equal treatment to individual accident and health contracts—the same treatment given to group contracts in that field—we are asking for early relief, because it is critical to small companies.

Individual accident and health contracts are written by three types of companies in the United States. One is a nonprofit service corporation, the Blue Cross organization. One are the casualty companies, which have a special tax treatment and no current tax problems. The third are the life companies. Individual accident and health is written, here and there, by large life companies, but the greater part is written by medium-sized and small companies. The small companies are the innovators in the field.

For example, of the Georgia companies writing accident and health, only one goes into more than three States, and nearly all of them are limited to the States of Georgia and perhaps Alabama or perhaps Florida, and many of them as bankers entirely to Georgia.

Of our Oklahoma companies, I think that one writes a good many States, but a majority of them are confined to not more than three States. It is concentration.

Senator KERR. I think a lot of them are limited to Oklahoma, and some of them to specific areas in Oklahoma.

Mr. ROBERTS. That is true.

For instance, we have one fairly prosperous one in Georgia that writes all of its business virtually in three towns, Atlanta, Savannah and Waycross. It is doing very nicely. It even paid some taxes for a change this past year.

But still it is very intensely concentrated.

Now, they use accident and health, some of them, to develop an agency force, some of them write it, the little bit larger ones that are not yet in the medium-sized write it as a matter of accommodation for life policyholders.

It helps to get and keep agents, but it isn't by and large a profitable business, for a variety of reasons, one of which has been the rise in cost of hospitalization.

We don't know how we failed to get this in the bill. Frankly, we thought that it was in the bill, in another spot, and we were rather busy with some other issues in the other bill, and I think we are guilty of carelessness in not drawing it to your attention during the hearings then.

It is probable that we did not realize how drastic this change would be. Life insurance companies were not heavily engaged in accident and health business until about the time of the hearings on the Mills-Curtis bill, and their taxes on accident and health were not an important item. The Mills-Curtis bill, after protracted hearings, provided that life companies should be taxed on these policies in the same manner as mutual casualty companies, since the field is dominated by the large mutual casualties. This was a fair basis of taxation, but it was not applicable to the approach adopted in the 1959 measure.

I am not a technical man or an expert. I do not understand all of the actuarial talk in the accident and health field, but I do know that there is no provision anywhere to charge off as a reserve required by law the money that has to be put in the contingency reserves to meet the requirements of a number of States that you can't cancel a cancellable policy, until you have paid on it an amount equal to half the premiums received. You can't make a deduction for that, you have got to somehow get money into your surplus to meet that contingency.

We also know that to some extent individual accident and health is comparable with group. The large companies on the basis of the two States requirement are getting 2 percent, while the small companies, with a far more precarious and diversified operation, are not getting the 2 percent, and they need it.

The cost to the Treasury is small. A great deal of money, if the companies are successful, will be recaptured at a higher tax rate than would be applicable now, because it will go into phase III. The largest amount that we can conceive of the bill costing would be $7 million in the first year.

I don't think that it would cost much more than a third of that on the average. And we think if the revision is made it would go a long ways toward adjusting the inequities the small companies feel exist here and there in the bill in spite of the very great consideration you gave us in the previous hearings.

Senator KERR. Thank you, Mr. Roberts.

Are there any questions?

Senator DOUGLAS. It was not my understanding that the omission of the individual policies from the 2 percent deduction was accidental. My understanding is that the 2 percent deduction was permitted for the group policies, accident and health, because of the concentration of risk, that in an industrial concern such as the plant in Texas which had the blowup during the war and where I believe several hundred lives were lost, that that might well bankrupt not only a small company but a larger company, and that, therefore, this deduction was justified.

But I had understood that the failure to extend it to an individual policy was due to the fact that so far as accidents are concerned, these were being spread across the board of employees in the large variety of companies, and that there, therefore, would be a distribution of risk, and an accident in one company would not mean great losses to the insurance carrier.

As far as the health policies are concerned, while there are differences in sickness rates between different portions of the company, they are not too pronounced, and I assume that to the degree they exist where the company sells policies in a given locality or a given State, it can adjust its premiums accordingly.

And what I would like to have you address yourself to, if you care to do so, is that very subject.

Don't you already have in your individual policies a sufficient distribution of risk so that the precedent established for the group policies does not hold?

Mr. ROBERTS. I think some of the subsequent witnesses will probably cover that, because they are technical men, more effectively than I can.

But I think that accident payments form a very negligible part of the total money paid out in any one year on accident and health claims. The big money paid out is in hospitalization, for illness. And as one illustration, all of the small companies in Colorado were hit very hard 3 years ago with the Asian flu epidemic which was concentrated in an area and had an incidence of morbidity considerably more than the national average for a long time, and which enjoyed rather low local accident and health rates, and they were really squeezed, because they were concentrated in that area. And I think that where actually large companies are doing business in 50 States, the average small company writing individual contracts concentrated in a single State, by and large, or mostly in two, either there are more concentration in the case of the individuals.

Senator DOUGLAS. I wonder how decisive that is. Can't you meet it to the degree that it exists by reinsurance?

Mr. ROBERTS. Reinsurance in this field is, I don't think, too general a thing. The reinsurance companies do not allow as much margin, shall we say, for a small company on accident and health as they do relatively on life, which is a determinable risk.

And it would not be, I think, the general practice to handle the issue.

Senator DOUGLAS. Wouldn't this be a very easy way out of any difficulty which you may experience? I am not at all convinced that the morbidity rates fluctuate as widely as you seem to imply, but even if they did I should think reinsurance could be developed.

Do you think Lloyds would reinsure this?

And there are undoubtedly American equivalents of Lloyds.

Mr. ROBERTS. I think the most of the inquiries are pretty well covered by Mr. Baker and Mr. Harker.

Senator KERR. Thank you very much, Mr. Roberts.

I would like the Treasury to put in the record, if they will, the amount of taxes paid to our Government by Lloyds of London.

Senator DOUGLAS. I am merely using that as an illustration. And I will say that there are undoubtedly American equivalents of Lloyds. I am not trying to stir up business for Lloyds.

Senator KERR. I just thought it might be pertinent in view of the fact that they were referred to as available as a writer of reinsurance policies, I thought it might be well, since we were putting into the record the tax effect of the amendment and the various variations of it, the amount of taxes paid to the U.S. Government by Lloyds of London.

Senator DOUGLAS. Let the record show that the Senator from Illinois has no connection emotionally or financially with Lloyds of London.

Senator KERR. Nor objection to insertion in the record of the information asked for, I assume.

(The following was later received for the record:)

TAX STATUS OF LLOYD'S OF LONDON

Based on their method of operations, Lloyd's of London may be viewed as a governing body which furnishes management and guidance to the elected membership, each one of whom is independently engaged in the insurance business on his own account. On the basis of all the available facts, there is no evidence which would indicate that Lloyd's of London, as such, has engaged in the insurance business within the United States. Therefore, no basis appears to exist for assessing U.S. income tax against this organization.

On the other hand, Lloyd's members, called underwriters, have obtained insurance business from U.S. customers, for their individual accounts, or at other times, for syndicates formed of several of their members. This business takes several forms. In Kentucky and Illinois (the only two States in which Lloyd's is admitted), some underwriters conduct business through attorneys-in-fact. These underwriters have been filing income-tax returns reporting their income from U.S. sources including not only profits and losses from the insurance business referred to but also their other income from U.S. sources. Such income includes the underwriters' share of the investment income derived from the trust funds maintained by Lloyd's for the protection of U.S. policyholders. Their tax liabilities on such income are determined on the basis of regularly applicable income tax rates similar to those imposed on any person engaged in business in the United States.

In States in which Lloyd's members are not admitted, the business is transacted through brokers. A documentary stamp tax of 4 percent or 1 percent of the gross contract premium is paid on such business, depending upon the type of insurance written. In addition, these brokers pay income tax on their earnings arising from their handling of insurance with Lloyd's.

It is estimated that the premiums received by Lloyd's subject to the premium taxes on foreign insurers is in the vicinity of $400 million annually. According to testimony by the chairman of Lloyd's before the Subcommittee on Antitrust and Monopoly of the Committee on the Judiciary of the Senate on June 17, 1960, approximately 60 percent is reinsurance and 40 percent is direct insurance

business. Since direct insurance (other than life) is taxed at 4 percent, and reinsurance is taxed at 1 percent, on this basis it would appear that the total premium excise tax paid on Lloyd's business would amount to some $9 million annually at present levels. Because of the large number of individuals involved, it has been impracticable to ascertain the total U.S. income taxes paid by the various attorneys-in-fact and brokers handling Lloyd's business.

The Treasury has recently recommended that the 1 percent documentary stamp excise tax imposed by section 4371 of the code on premiums paid to nonresident foreign insurers on life insurance policies and reinsurance policies covering casualty and surety risks be increased to 2 percent to align their tax with recommended increases in the tax on domestic mutual insurers which presently pay a tax of 1 percent of gross income or regular corporates rate on their net investment income, whichever is greater.

Mr. Hunter McLean?

STATEMENT OF HUNTER McLEAN, TEXAS LEGAL RESERVE OFFICIALS ASSOCIATION

Mr. McLEAN. My name is Hunter McLean. I am president of the American Standard Life Insurance Co. of Fort Worth, Tex., and my experience in the insurance field dates from 1928, when I went to work as a solicitor. In addition, I speak for the Texas Legal Reserve Officials Association of Austin, Tex.

Subsequently, I was with the Texas Insurance Department from 1933 to 1943 as deputy life insurance commissioner and as senior examiner. I have been active with my company since 1946. It engages in the life, accident and health, and hospitalization fields.

Within a year of the time I entered the insurance business the forerunner of Blue Cross had its beginnings as a cooperative at Baylor Hospital in Dallas. And, in 1933 what may have been the first commercial hospitalization policy in the United States crossed my desk at the Texas Insurance Department.

My commissioner took a dim view of that policy stating that it was economically unfeasible. "No one will buy hospitalization insurance at a premium of $12 yearly when the average hospital bill is only $60," he said. A premium of 20 percent of the promised benefits appeared preposterous to him.

Today 130 million Americans own hospital insurance.

My commissioner's alarm was justified, but for a wholly different reason. His concern should have been for the solvency of the companies experimenting in the business for the premium for that same coverage today is 300 percent of the 1933 amount.

Increasing costs, experimentation, adjudication——

Senator KERR. In order that the record may be clear right there, while the premium for that same coverage is 300 percent, is not the average benefit in excess of $60?

Mr. McLEAN. Yes, sir, the average hospital bill is up considerably.

Senator KERR. Would it be reasonably accurate to say that the liability has increased somewhat in proportion to the premium?

Mr. McLEAN. Yes, sir.

Senator DOUGLAS. What is the average benefit?

Mr. McLEAN. Today, sir?

Senator DOUGLAS. Yes.

Mr. McLEAN. It depends largely on area, Senator Douglas. I don't know what the national average would be. Hospital rooms in California, the customary charge for private rooms is over $40.

Senator DOUGLAS. You say the premium is now $36?

Mr. McLEAN. Well, sir, I have reference to this particular policy here, the one that sold for $12 in 1933.

Senator DOUGLAS. What are the average benefits in that policy?

Mr. McLEAN. It provides a $5 room——

Senator DOUGLAS. I know, but the average amount paid out.

Mr. McLEAN. It would be a $60 hospital bill, about $60 per hospital stay, it would be about average for the hospital.

Senator DOUGLAS. And the premiums were $60?

Mr. McLEAN. No, $12. But the average premiums for the policy today would be $36.

Senator DOUGLAS. I would like to follow up the question of the Senator from Oklahoma. The premium has gone up to $36. What about the benefit?

Mr. McLEAN. Well, we would have to use the same benefits to get a comparable—if a policy today paid the same benefits——

Senator DOUGLAS. This is a maximum of $60?

Mr. McLEAN. No, that was the average hospital bill.

Senator DOUGLAS. Then the premium was $36 for an average benefit of $60?

Mr. McLEAN. No, sir, the premium was $12 for an average benefit of $60. Today the premium would be $36 for an average benefit of approximately three times that amount.

Senator DOUGLAS. That is what I have been trying to find out. With average benefits, then, of $180?

Mr. McLEAN. I misstated the point a minute ago of the average hospital bill as $60, not the average benefit.

Senator DOUGLAS. What is th verage benefit?

Mr. McLEAN. The average benefit of the policy I wouldn't know.

Senator DOUGLAS. Could you find that out for the record for this committee?

Mr. McLEAN. It would take digging into the Department's records for 1933, I could probably——

Senator DOUGLAS. I don't want 1933 or 1943, I want today. You obviously know what the increase in the premiums is. It shouldn't require much more labor to determine the increase in the benefits.

Mr. McLEAN. We can determine the average benefit paid——

Senator DOUGLAS. If you would send it by mail to the clerk of the committee, we would appreciate it.

Mr. McLEAN. We would be delighted to.

(The following was later received for the record:)

While appearing as a witness in support of S. 397, on July 6, 1961, Mr. Hunter McLean, president, American Standard Life Insurance Co., Fort Worth, Tex., and speaking for the Texas Legal Reserve Officials Association, Austin, Tex., was requested by Senator Douglas to furnish certain data bearing upon the increased hospital cost of the patients and insurance companies insuring such risks.

With reference to this request, Mr. McLean has submitted the following:

	1959	1949	Percent increase
Hospital costs:			
Average cost per patient stay in hospital	$253.48	$118.94	98
Average cost per patient per day	$30.19	$14.33	111
Average stay in hospital (days)	7.8	8.3	----------
Benefits paid:			
Persons insured	127,896,000	66,044,000	95
Hospital benefits paid	$2,904,000,000	$528,000,000	450
Average benefit per policy	$22.70	$7	224

The 1960 "Source Book of Health Insurance Data," published by the Health Insurance Institute, contains the above data. The information is taken from its pages. They show startling increases between 1949 and 1959.

Mr. McLEAN. Adjudication of policy terms, errors permitting adverse selection by the public, each contribute to the extreme uncertainty in this field of insurance.

No difference exists in the hazards assumed under group policies and individual policies, except that the noncancellable contracts are limited to the individual field and it is within the individual field that costly experimentation occurs.

For purposes of taxation there should be no distinction between group accident and health insurance and that issued to individuals.

Current evidence of increasing costs in hospital insurance is contained in a release by the Department of Labor reporting that the cost of hospitalization insurance, written by private insurers, has jumped about 80 percent in less than 10 years. And, the statistics of the State of Colorado reflect an 8 percent rise annually in hospital and medical charges in each of the past 4 years.

Senator DOUGLAS. Do you figure on the increase in benefits during this time, or is it simply an increase in premiums?

Mr. McLEAN. These are an increase in hospital charges, and are not necessarily related to benefits, the benefits under some policies may be flexible and rise with the costs, they may be inflexible and allocated and stay put regardless of the hospital bills.

Senator DOUGLAS. When you speak of the cost of hospitalization insurance, you mean to the company or cost to——

Mr. McLEAN. Cost to the company, not premiums.

Senator DOUGLAS. Now you are speaking about benefits?

Mr. McLEAN. Yes, sir.

Senator DOUGLAS. So you say that the cost of benefits is increased by 80 percent in less than 10 years?

Mr. McLEAN. The hospital bills rendered to the companies have increased by 80 percent in the last 10 years.

In addition to increasing costs, other factors have contributed to losses. Some of them are touched upon below.

Any history of the accident and health field will show that in good times loss ratios are relatively low. Under the same policy contracts, bad times produce higher losses. Without laboring the point, the experience of companies in the accident and health field during the depression support this statement.

Because insurance policies are unilateral in their drafting, the courts quite properly construe them strictly against the authors. Thus, until a contract has been adjudicated thoroughly in its important provisions, the total of its obligations is unknown.

The seriousness of this is illustrated by a Kansas case where a rather routine type of monthly indemnity accident and sickness policy, promising benefits for only 2 years, was construed as a contract obligated to pay monthly indemnities during the entire lifetime of the insureds.

In Texas, insureds suffering a heart disability have been ruled entitled to indemnity even though they continue to work in the same occupation. The theory of the court in this case was that an insured was shortening his life expectancy, reducing the time and total the insurance company would pay, and if he preferred to do that the company should pay regardless of contract language.

Several States through laws or through regulations are becoming more and more insistent upon granting insurance on preexisting diseases. The impact in this area will not be exactly measurable for decades.

Experimentation with hospital policy provisions has produced dramatic losses. Companies have attempted to remove the 6 months waiting period for surgical cases, in an effort to rely completely upon the preexisting disease provisions of policies. Without exception, such companies have suffered severely from surgical cases occurring within the early months following issuance of a policy.

A few years ago major medical policies were offered, having a deductible of some $300 or $500 with very liberal benefits thereafter. The experience under these policies has been most distressing.

The public has evidenced keen interest in noncancellable policies and when the companies first attempted to supply such demand, policies were issued with guaranteed premiums. Again, the losses under such policies have been substantial, and will continue during the lifetime of those policyholders.

This experimentation should not be discouraged for through it shall be achieved the answers so necessary to a final solution to accident and health insurance costs.

One happy result of experimentation was in the field of polio insurance, first issued by a Fort Worth company, a friendly competitor to my company. The first such polio policy was issued with unallocated limits of $5,000 for medical and hospital care.

Parents responded with an almost frantic demand for this coverage for their children. Insurance companies all over the United States began the issuance of similar policies.

Charity wards caring for polio cases had borne 100 percent of the costs. Within a few brief years 60 percent of the costs of the polio wards was paid by insured cases.

The savings to charity permitted the diversion of funds to research and polio vaccine is a direct result.

I would like to digress here on the subject of concentration of risks in connection with polio insurance, because we had a personal experience in that field during the epidemics of some 10 years.

In the city of San Angelo, which is a small community, they had over 350 hospitalized cases at one time, in Fort Worth it ran to 1,200, and Lubbock at one time had 700 cases, and Lubbock recently has been plagued with an encephalitis outbreak.

Senator DOUGLAS. It is true, I think, that in the case of polio you can have great geographical concentration of the sickness?

Mr. MCLEAN. Yes.

Senator KERR. The same is also true of hepatitis, to a very marked degree.

Mr. MCLEAN. To resume, Dr. Frederic E. Elliott, former consultant to the chairman of New York City Blue Shield, adequately summed up the problem in the April 29, 1961 issue of the National Underwriter stating:

> The insurance market is now being offered the major medical and the first dollar coverages of the insurance industry, plus Blue Cross-Blue Shield coverages of the so-called nonprofit plans. None of them would seem to have matured beyond the trial and error stages.

His article continued by quoting Prof. D. L. MacDonald of the University of Michigan, who said:

> The insurer cannot expect to experience its ultimate loss ratio under a new plan of insurance for perhaps many years. At least 5 years will pass before policyholders learn enough about the new cover to begin to utilize their rights and benefits.

As I have pointed out initially, the individual accident and health policies are the primary means of coverage experimentation. These policies are identical in form with the group policies—which are benefited by present section 809(d)(6)—but with the additional hazards to the companies of noncancellability and the uncertainties always present in previously untried types of coverage.

Logically there should be no tax discrimination between group and individual coverages in this field. But section 809(d)(6) of the present law provides this necessary 2-percent deduction for group accident and health policies and nothing is provided for the similar but more hazardous individual policies. Senator Kerr's bill, S. 397, would correct this discrimination and I urge this committee to report that bill favorably.

You mentioned the Texas City disaster a moment ago. I don't correct you, but I would like to enlarge a little.

The great damage there to individuals was to the civilian population. As you will recall, in addition to the group liability that resulted, there were a number of civilians, residents of Texas City, killed and maimed in that thing who had to look to their individual policies for hospital and accident and health benefits, as well as crewmembers and employees of the company that suffered the explosion.

And on the subject of reinsurance, we attempted to get reinsurance on our polio insurance, and we couldn't obtain it on any sort of favorable terms, we had to bear our own risk and carry it in a field between rates and benefits trying to develop the thing with which we could live. We contacted several reinsurers, and they were not familiar with it, and they didn't want the risk.

Senator KERR. Any questions?

Senator DOUGLAS. Mr. McLean, I notice you refer to the individual policies as being more hazardous than the group policies.

Is it your contention that there is a greater concentration of risk in the individual policies than in the group policies?

Mr. MCLEAN. No, sir, I don't contend that.

I say that through epidemics and through a concentration that results from the successful operations of a single agent in a single community, there is a concentration of risk.

In this connection the term "more hazardous" was used to embrace the unknowns, the noncancellable features that can't be remedied, the unknown future decisions of the courts, the uncertainty of experimental coverages, rather than the hazard of risk itself.

Senator DOUGLAS. In the case of accidents, would you grant that there is greater concentration of risk than in the case of individual policies?

Mr. MCLEAN. Yes, sir.

Senator DOUGLAS. You grant that?

Mr. MCLEAN. I grant that.

Senator DOUGLAS. And what about occupational diseases?

Mr. MCLEAN. Yes, sir.

Senator DOUGLAS. And in what respect do you have equal or greater risk on individual policies than group policies?

Mr. McLEAN. Well, we have a concentration of business in single communities as a result of the success of an individual agent in that community.

Our business in our company is grouped around certain communities. We feel, however, that the great hazard in the individual again is in the experimentation and the noncancelable features of the policy. The group policies are cancelable, if they have made a bad guess they can get out in a year, but a noncancelable policy must be kept so long as the insured wants it.

And that is a hazard that is peculiar to the individual policy that the group policy doesn't have.

Senator DOUGLAS. What proportion of the accident and health policies are noncancelable?

Mr. McLEAN. There is an ever-increasing proportion of them.

Senator DOUGLAS. Could you give us a rough guess as to that?

Mr. McLEAN. Those figures may be available in some cumulation, I don't have them at my fingertips.

Senator DOUGLAS. Would you be willing to supply that?

Mr. McLEAN. Yes, I think I can supply it for you.

Twenty years ago the noncancelable policy was a rare thing.

(This information was subsequently furnished and appears on p. 40.)

Senator DOUGLAS. Isn't it true that some of the complaints that have been have been that they have been cancelable?

Mr. McLEAN. Yes, sir. The insured prefers a noncancelable policy.

Senator DOUGLAS. As I understand it, some of the complaints have been that in a very large, major proportion of the cases they are noncancelable.

Mr. McLEAN. Yes. The insureds are the ones that put it in, and we have to meet their requirements for coverage.

Senator DOUGLAS. Why has the noncancelable feature been adopted?

Mr. McLEAN. There are a few companies that don't have noncancelable policies, but not many. Even the big eastern companies are now writing noncancelable health and accident policies as well, it is rather general.

Senator DOUGLAS. Do you know whether articles have been written in insurance publications on the subject?

Mr. McLEAN. Yes, there have been a good amount. Your life reinsurers attempted to experiment with some form of reinsurance, maybe in the medical field, maybe unsuccessfully, and there are a good many papers on the subject.

Senator DOUGLAS. I don't see any member of the staff of the joint committee present, Mr. Chairman.

Isn't there a member here from the joint committee?

Mr. LaMARCHE. Yes, sir.

Senator DOUGLAS. What is your name?

Mr. LaMARCHE. LaMarche.

Senator DOUGLAS. I wonder if you would be willing to go into this question of the relative proportion of individual accident and health policies which are noncancelable?

Mr. LaMARCHE. I would be glad to look into it; yes, sir.

Senator KERR. Thank you very much, Mr. McLean.

Mr. McLEAN. Thank you.

Senator KERR. Mr. Baker?

Senator LONG. Mr. Chairman, I would like to say that J. W. Baker is very well known to me, and has been an outstanding citizen of Baton Rouge, where I make my home, and of my State of Louisiana. I am glad to see you today, Mr. Baker.

Senator KERR. Thank you very much, Senator Long. We think that he is honored by being from your State, and we think he is a credit to your State.

All right, Mr. Baker.

STATEMENT OF J. W. BAKER, MEMBER, BOARD OF DIRECTORS OF THE NATIONAL ASSOCIATION OF LIFE COMPANIES. INC.

Mr. BAKER. My name is J. W. Baker, I am president of Continental Service Life and Health Insurance Co., Baton Rouge, La. The statements contained herein are respectfully submitted on behalf of the National Association of Life Companies, Inc.

Our purpose is to endorse and to support a bill, S. 397, introduced by Senator Kerr in the Senate of the United States, January 13, 1961.

The bill proposes to amend the Internal Revenue Code of 1954 to permit a deduction by life insurance companies in determining gain or loss from operations of an amount equal to 2 percent of the premiums from individual accident and health insurance contracts.

Section 809(d)(6) of the Internal Revenue Code of 1954 provides for a deduction of an amount equal to 2 percent of the premiums from group health and accident insurance contracts.

In the interest of clarity, I should like to mention that accident and health insurance contracts are generally classified according to a terminology which employs such terms as "group," "franchise," "blanket," "family group," and "individual." These terms are useful in the industry's normal day-to-day operations and communications.

For the most part, these terms denote distinctions that are merely administrative in character. In this sense, they are proper and useful terms. However, if such terms should be misconstrued in such a way as to imply basic, functional differences, then misunderstanding and confusion could result.

Our endorsement and support of the bill, S. 397, rests upon the contention that significant differences do not exist among health and accident insurance contracts on the basis of such nominal classifications as "group," "franchise," "blanket," "family group" and "individual" and therefore all such health and accident insurance contracts should be treated uniformly with respect to the 2-percent deduction provided for under section 809(d)(6) of the Internal Revenue Code of 1954.

In order that our contention may receive fair and reasonable consideration, I should like to submit some pertinent observations drawn largely from the experience of the company which I represent. These observations are also representative of other small life insurance companies.

1. All health and accident insurance contracts have a common, primary purpose. That purpose is to provide protection for the policyholder.

2. Selection of risk is essentially the same for the various classifications due to the fact that underwriting information is procured on similar forms through the use of similar questions.

3. Migration—may I digress there and say, that was the reason for the group, the concentration and no migration.

Migration exists among the various classifications; for example, policyholders under a "group" classification have the privilege of converting to an "individual" status.

4. Competition requires that premium rates be held to a minimum, thus tending to eliminate margins which might otherwise be used in maintaining reasonable levels of risk. Such levels of risk could better be achieved through more elaborate procedures of selection, for example, through medical examinations, inspection reports, extensive statements of attending physicians, etc.

5. Each classification of health and accident insurance is subject to highly competitive premium rates and wide fluctuations in claims experience. These factors tend to hamper the maintenance of sufficient surplus to accommodate contingencies of the business. Seasonal illness, contributing weather factors, disasters, endemic diseases are examples of such contingencies.

May I say situations like Audrey, and Texas City.

Unstable fluctuations appear to be characteristic of health and accident insurance claims.

Now, where the group has the protection of nonoccupational insurance like group public liability and workmen's compensation, the hospital and health and accident features of these group contracts are completely relieved of any catastrophies of that nature, while the individual insurer who carries the individual contract has no clause in there that protects the carrier from the hazard of his occupation.

6. Administrative handling costs (records, billing, etc.) commensurate with the various classifications of the business, tend to offset differences in premium rates. To illustrate this point, the handling costs for 500 individual cases would exceed by 20 to 25 percent the handling costs for a like number of cases as a group. Where savings of this nature are made, they are passed on to the group policyholders in the form of lower premium rates.

7. Medical care costs are rising whereas premium rate adjustments lag behind such increases in costs. This phenomenon can be reflected in company losses.

8. The salient facts disclosed by thorough examination of the several classifications of health and accident insurance contracts are facts which establish similarities rather than differences.

Our endorsement and support of the bill, S. 397, is in accord with these findings.

The amendment is regarded as desirable and feasible. Therefore, it is our contention that health and accident insurance contracts should be treated uniformly with respect to the 2 percent deduction provided for under section 809(d)(6) of the Internal Revenue Code of 1954, through adoption of the proposed amendment. Further, we believe that its adoption would serve the best interests of the policyholders, the insurance industry, and the Government.

Senator KERR. All right, Mr. Baker.

Are there any questions?

Senator DOUGLAS. Mr. Baker, is it your understanding that S. 897 provides the 2 percent tax deduction on franchise blanket family groups and individual accident and health policies as well as on so-called group policies?

Mr. BAKER. If adopted.

Senator DOUGLAS. On all accident and health?

Mr. BAKER. Yes.

Senator DOUGLAS. Not purely individual, but it covers the intermediate types as well?

Mr. BAKER. Yes, sir.

I have attempted, sir, to suggest that there is practically no difference in any one of those contracts as set forth in my chart.

Senator DOUGLAS. I wanted to get the scope of the amendment.

Mr. BAKER. The entire health and accident field.

Senator DOUGLAS. Now, you have heard the testimony of Mr. McLean. Would you agree with him that there is a greater concentration of risk in group accident policies than in individual accident policies?

Mr. BAKER. I do, sir, for this reason, and in this degree, that the way the group contract is written, they are surrounded with expert safety devices and expert protection from every source that you can think of. The individual that we insure, he is constantly exposed to everyday hazards that come by, we will say by the area of habitation or by the lack of knowledge of safety rules.

Senator DOUGLAS. That was not quite my question. I was not going into the comparative accident rates under the two types of policy, but rather whether you agreed with Mr. McLean that there was a greater concentration of risk in the group accident policies than in the individual accident policies.

Mr. BAKER. It is true in certain areas, sir.

Senator DOUGLAS. I should think that would be true universally as far as accidents are concerned.

Mr. BAKER. We picked areas with small populations, small towns and small villages, where they buy individually practically as a whole.

Senator DOUGLAS. I am simply speaking of accidents at the moment. Isn't it true that in the case of losses from accidents that there is a greater concentration from risk in the group than individual policies that cut across a large number of plants?

Mr. BAKER. I will answer you this way, that we do find the individual does carry the larger ratio of accidents, due to the—maybe I haven't got your question——

Senator DOUGLAS. My point is, on the concentration of risk, that is, when the accidents come, don't they fall with much heavier incidence upon employees of factories, where the policies are confined to the factories, than if the policies are spread across a number of factories or number of working places?

Mr. BAKER. First you have to determine the number of people, the exposure that they have, and the participation. And I don't think I would be in a position to say definitely.

Senator DOUGLAS. Then what would you say about occupational diseases, is there any greater concentration of risk in the group policies than in the policies which are distributed broadly over a series of companies in industries?

Mr. BAKER. Occupational diseases are more confined to the—say the refinery workers have a certain occupational disease that they might contract, and miners have theirs—so in underwriting we take those things into consideration. But I haven't done the research to furnish the statistics to answer your question maybe as well as Mr. McLean.

Mr. FORD. At the risk of interrupting, the next witness, Mr. Harker, I think, will have answers to the two questions that you have just asked Mr. Baker.

Senator DOUGLAS. Thank you, Mr. Ford.

It is hard for me to keep the various insurance associations clearly distinguished in my mind.

I notice you refer to the association for whom you are appearing as the National Association of Life Companies, Inc. Now, would this include companies such as the Prudential or the Metropolitan or Travelers of Hartford, and so forth?

Mr. BAKER. It might, but it doesn't at this time, because they are not participants in our group.

Senator DOUGLAS. They write a lot of accident and health policies?

Mr. BAKER. They do.

Senator DOUGLAS. What type of company forms its membership of the National Association?

Mr. BAKER. Life, some of them health and accident—not very many of them health and accident. I think in the State of Louisiana we only have four or maybe five companies that participated, incorporated in the State of Louisiana that participated in the health and accident business.

Senator KERR. Do you have a list of your membership, Mr. Baker?

Mr. BAKER. At present?

No, sir.

Senator KERR. Could you furnish that to the committee?

Mr. BAKER. Yes, sir.

Mr. FORD. I will have Mr. Roberts do that.

Senator KERR. Fine.

(The following was later received for the record:)

MEMBERSHIP OF NATIONAL ASSOCIATION OF LIFE COMPANIES, INC.

Cotton States Life, Tuscaloosa, Ala.
Atlantic National Life, Montgomery, Ala.
Home Trust Life, Montgomery, Ala.
Gulf States Life, Birmingham, Ala.
Guaranty Savings Life, Montgomery, Ala.
Equity Life, Andalusia, Ala.
Pioneer Life and Casualty, Gadson, Ala.
National Security Insurance Co., Elba, Ala.
Security State Life, Montgomery, Ala.
Southern United Life, Montgomery, Ala.
Loyal American Life, Mobile, Ala.
Standard Union Life, Montgomery, Ala.
Life Insurance Co. of Alaska, Anchorage, Alaska
Alaska Western Life, Anchorage, Alaska
Christian Foundation Life, Little Rock, Ark.
Dixie Life, Little Rock, Ark.
Empire Life of America, Little Rock, Ark.
Preferred Risk Life, Fayette, Ark.
First Pyramid Life, Little Rock, Ark.
Investors Preferred Life, Little Rock, Ark.
National Investors Life, Little Rock, Ark.
Southern Equitable Life, Little Rock, Ark.
Southland Security Life, Little Rock, Ark.
World Wide Life, Little Rock, Ark.
Professional Life, Fort Smith, Ark.
American Buyers Insurance Co. Phoenix, Ariz.
Bankers Trust Life, Phoenix, Ariz.
Charter Oak Life, Phoenix, Ariz.
First National Life, Phoenix, Ariz.
National Life & Casualty, Phoenix, Ariz.

Producers Life, Phoenix, Ariz.
Intercoast Mutual Life, Sacramento, Calif.
Falcon National Life, Denver, Colo.
Allservice Life, Colorado Springs, Colo.
Capitol Co-Operative Life, Denver, Colo.
Green Shield Life, Boulder, Colo.
General Bankers Life, Denver, Colo.
National Western Life, Denver, Colo.
Perpetual Life, Denver, Colo.
Liberty Life and Casualty, Denver, Colo.
Western Empire Life, Denver, Colo.
Seaboard Life of America, Miami, Fla.
South Atlantic Life, Tampa, Fla.
Cherokee Life, Lincoln, Ga.
Coastal States Life, Atlanta, Ga.
First National Life, Atlanta, Ga.
Farmers National Life, Atlanta, Ga.
Foundation Life, Atlanta, Ga.
Georgia Life & Health, Atlanta, Ga.
National Executive Life, Atlanta, Ga.
State Mutual Insurance Co., Rome, Ga.
Security Life, Macon, Ga.
Grand Pacific Life, Honolulu, Hawaii
Perpetual Life, Boise, Idaho
Acme Life, Springfield, Ill.
Illinois Mid-Continent Life, Chicago, Ill.
First United Life, Gary, Ind.
National Security Life, Indianapolis, Ind.
Rex Insurance Co., Indianapolis, Ind.
Standard Life of Indiana, Indianapolis, Ind.
Wabash Life, Indianapolis, Ind.
Life of Kentucky, Louisville, Ky.
Continental Service Life and Health, Baton Rouge, La.
Guaranty Income Life, Baton Rouge, La.
Gulf Union Life, Baton Rouge, La.
Fireside Commercial Life, Alexandria, La.
Lee National Life, Shreveport, La.
National American Life, Baton Rouge, La.
National Investors Life, Baton Rouge, La.
Tidelands Life, Bunkie, La.
Washington Life of America, Lafayette, La.
Chesapeake Life, Baltimore, Md.
American Republic Life, Jackson, Miss.
Southeastern Life, Hattiesburg, Miss.
The National Bellas-Hess Life, North Kansas City, Mo.
Missouri National Life, Kansas City, Mo.
Missouri Fidelity Life, St. Louis, Mo.
Treasure State Life, Butte, Mont.
United Reserve Life, Billings, Mont.
Union Reserve Life, Minot, N. Dak.
Greensboro National Life, Greensboro, N.C.
The Sturdivant Life, North Wilkesboro, N.C.
New Mexico Life, Albuquerque, N. Mex.
American Home Security Life, Roswell, N. Mex.
Rocky Mountain Life, Albuquerque, N. Mex.
Great American Life, New York, N.Y.
Hamilton Life of New York, New York, N.Y.
Standard Security Life of New York, New York, N.Y.
Western and Southern Life, Cincinnati, Ohio.
National Masonic Providence Association, Mansfield, Ohio
Bankers Service Life, Oklahoma City, Okla.
Great Western Life, Oklahoma City, Okla.
National Investors Life, Oklahoma City, Okla.
Southern Christian Life, Oklahoma City, Okla.
Midwestern Life, Enid, Okla.
Globe Life and Accident, Oklahoma City, Okla.
United Founders Life, Oklahoma City, Okla.
University National Life, Norman, Okla.
Western Security Life, Oklahoma City, Okla.
Investors Insurance Corp., Portland, Oreg.
American Penn Life, Philadelphia, Pa.
Continental Life, Columbia, S.C.
Francis Marion Life, Columbia, S.C.
American Equity Life, Columbia, S.C.
Southern Security Life, North Augusta, S.C.
Lincoln American Life, Memphis, Tenn.
American Capitol Life, Houston, Tex.
American Standard Life, Fort Worth, Tex.
American Trust Life, Wichita Falls Tex.
Citizens Standard Life, Corpus Christi, Tex.
Columbia General Life, Houston, Tex.
Commercial Travelers Life & Accident, Dallas, Tex.
Great Commonwealth Life, Dallas, Tex.
Girardian Insurance Co., Dallas, Tex.
International Fidelity Insurance Co., Dallas, Tex.
Legal Security Life, Dallas, Tex.
National Security Life & Accident, Dallas, Tex.
Permian Basin Life, Odessa, Tex.
The Service Life, Fort Worth, Tex.
Provident Security Life, Houston, Tex.
State General Life, Dallas, Tex.
Southwest Security Life, San Antonio, Tex.

Time Life, San Antonio, Tex.
Transport Life, Dallas, Tex.
United Bankers, Dallas, Tex.
Union Bankers Insurance Co., Dallas, Tex.
Mid-Continent Life, Fort Worth, Tex.
Reliance National Life, Salt Lake City, Utah.
Federal Old Line Insurance Co., Federal Way, Wash.
Stonewall Jackson Life, Huntington, W. Va.
West Virginia Life, Huntington, W. Va.
Appalachian Life, Huntington, W. Va.
Great Plains Life, Casper, Wyo.
Life of Mississippi, Jackson, Miss.
Standard Life & Accident, Oklahoma City, Okla.
Pilgrim National Life, Chicago, Ill.
Old Equity Life, Evanston, Ill.
Investors Security Life, Chicago, Ill.
State Life of Illinois, Springfield, Ill.
Liberty Life & Casualty, Goodland, Kans.
Citizens National Life, Indianapolis, Ind.
Hamilton National Life, Indianapolis, Ind.

Senator KERR. Senator Curtis?

Senator CURTIS. Mr. Baker, I am sorry an important meeting at the Pentagon Building prevented me from hearing your testimony and the earlier witnesses. But I do want to ask you a question or two. I will pursue the record, however, on this matter with respect to the witnesses. In the overall, this is not a matter that involves a great deal of revenue?

Mr. BAKER. I should say not.

Senator KERR. In that regard, Senator, there is a representative of the Treasury that is going to furnish us the exact information. His judgment was that the 2-percent exemption with reference to group life premiums probably loses the Treasury $8 or $9 million, and his judgment was that this would lose it in the neighborhood of $3 to $4 million. One piece of information that is very pertinent in that regard was that his estimate of the premiums affected by the 2-percent exemption in the law are in the neighborhood of $3,750 million, and that the number of premiums that would be affected by this 2-percent amendment if it were adopted would be in the neighborhood of about one-third of that amount.

Senator CURTIS. In your opinion, does this different tax treatment for group health and accident—as compared to individual policies—while it applies to all companies across the board, does this difference inure to the disadvantage of the companies only, or is it to the insurer?

Mr. BAKER. Senator Curtis, I find myself in the same position that the president of the Aetna Life Insurance Co. found himself at this table over here during the hearing. This bill is still astounding and confusing to me as an officer of the company.

Senator KERR. You mean the 1959 bill?

Mr. BAKER. The 1959 bill.

Now, this tax question of losses, that the Government will lose something and that the company will gain something, I may be wrong, but as an individual I say that the Government will not lose anything, and that the company will not gain anything.

Senator CURTIS. It seems to me—go ahead.

Mr. BAKER. Any 2 percent that we get, we don't get; it is transferred over to phase III, and carried.

Now, the benefit that you mentioned that we might get, or some company might get that is in distress, is simply this, that that 2 percent may be the difference between that company being impaired and being solvent. But if that company is saved, maybe in 2 or 3 years it may be that it will go back to the taxpayers. But all that 2 percent that we transfer over into phase III into that reserve is going to

net the Federal Government, the Revenue Service, more than if we didn't—if it hadn't been transferred, because we would have had it out on a 30 percent, and when you take it out, we are on a 52. I don't want to get into that because I am not a mathematician.

Senator CURTIS. The point I am getting at is this: It seems to me that there is an argument in favor of the fact that an individual who buys his own insurance of this type, through the company he selects, that transaction should be subject to the same tax consequences as the individual who buys it from the group.

Mr. BAKER. True.

Senator CURTIS. I disagree with the thesis that the group has the heavier risk. Group insurance isn't necessarily confined to people working in one place, or to hazardous occupations. For instance, as a member of the American Bar Association, you are eligible for certain group insurance. As a member of the Nebraska Bar Association, we have group insurance. The employees of the Federal Government, including all employees on Capitol Hill, have an opportunity to buy group insurance.

Now, in the rural States, the small communities, and so on, there are fewer of the people that are in a position to participate in group insurance. And while apparently the amount we are talking about is very small in the overall, I think it is worth considering whether or not the individual purchaser of this type of insurance will have to buy into a transaction that has a heavier taxload proportionately than the group insurance. I think that might be an argument for the bill.

Senator KERR. Any further questions?

Thank you very much, Mr. Baker.

Mr. Carlton Harker?

I believe there are copies of Mr. Harker's statement available.

All right, Mr. Harker.

STATEMENT OF CARLTON HARKER, VICE PRESIDENT AND ACTUARY, COASTAL STATES LIFE INSURANCE CO., ON BEHALF OF THE NATIONAL ASSOCIATION OF LIFE COMPANIES.

Mr. HARKER. My name is Carlton Harker. I am vice president and actuary of Coastal States Life Insurance Co., of Atlanta, Ga. My company is in the medium-small class with $37 million assets and $376 million insurance in force. I am an associate of the Society of Actuaries.

I am persuaded for reasons which follow that a more reasonable and equitable tax treatment will be afforded the insurance industry by allowing the 2-percent deductions for individual accident and sickness as well as group accident and sickness premium.

My company would not have benefited in tax years 1959 and 1960 due to the application of the inside limit provided by section 809(f).

Senator KERR. Let me interrupt you right there.

I must say that my concept of this bill as I introduced it was not based primarily on the effect that it would have in terms of revenue to the Federal Government.

No. 1, it was based on my concept of what was equity between the taxpayers; No. 2, my thought was and is that the effect of this bill would be to provide a more equitable situation on the one hand and

on the other hand it would be a provision, a sound provision benefiting the solvency of the smaller taxpayers, certainly with the realization that as to certain years it might be of benefit to the taxpayer taxwise, but in the long run any success or benefit that might come to him by reason of this would result in equalization of tax revenue to the Federal Government by reason of his having become a more successful business operator, and thereby have more funds available that would be subject to the general provisions of the 1959 tax law.

Mr. HARKER. Yes, sir; I believe that is what I would like to go on and demonstrate, if I might.

Senator KERR. I am very happy if that is what you are going to do.

Mr. HARKER. Yes, sir.

The first question that I would like to discuss for a moment is the catastrophe hazard question. A catastrophe hazard exists for individual accident and sickness to as great an extent as for group accident and sickness. Experience in loss-of-time coverages during the great depression and more recently with the Asian flu epidemic illustrates this problem, which have caused the companies a great deal of loss.

Some catastrophe hazard of the group type, a plant fire, for example, may exist where an industrial company has a heavy concentration of individual accident and sickness on a debit where the workers in the debit are predominantely working in the same plant.

I would like to illustrate this point this way: And it is actually the case in the company with which I am connected.

We have in a town in the southeast a large group case on a textile mill. Now, within this area of maybe 2 or 3 miles surrounding this textile mill is what in the weekly premium company is called a debit. Years ago my company had a debit surrounding that plant. There was another company that had a debit surrounding that plant. There was yet a third company that had a debit surrounding that plant.

Events have been such that through mergers those companies are now one company, and we actually have a much greater concentration of risk, actually in our individual area than we have in our group area.

I wouldn't want to have you think that that was the general casea, because it is not, nor was it an exception where an industrial-type operation in group insurance can have a heavy accident and industrial illness concentration of risk, in both the group and the individual.

And it is for this reason, I say, that I am persuaded that more equity would come by having the 2 percent to both rather than only to the group.

Senator DOUGLAS. May I ask a question at this point?

Mr. HARKER. Yes.

Senator DOUGLAS. I am quite struck by this statement where you say that a catastrophe has existed for individual accident and sickness to a greater extent than the group accident and sickness.

Do you know, can you cite other actuaries not connected with companies or writers upon this subject who take the same position that you do, namely, that the catastrophe hazard is as great for individuals as for those under group policies in a given plant?

Mr. HARKER. I wouldn't care to speak for the others. I meant to qualify that statement by proceeding to the question of the effects of outside influence——

Senator DOUGLAS. Yes, but this is a pretty strong statement.

Now, you are an actuary——

Senator KERR. I don't believe the witness said that that was the general situation, I believe he said that he did not make the claim it was general, but he also stated that he was of the conviction that it was not a rare exception, and he gave an illustration of the situation where experience had demonstrated that the outside risk was as great as the group risk.

Senator DOUGLAS. I wanted to have the record clear as to whether or not the witness as an actuary wishes to qualify that sentence.

Mr. HARKER. I think, in the sense that you are asking the question, I think it should be qualified, most definitely. However, I did want to make my point that the catastrophe hazard from accidents, acts of God, so to speak, will be more profound for groups than individuals as to accidents, that is, fires, storms, and earthquakes. However, other events can have a more profound effect on individuals than groups, for example, great depressions, or Asian flu, because you can escape the ravages of that in groups, but you cannot as an individual.

So it all depends upon what is the cause of the catastrophe.

Senator DOUGLAS. Presumably with the coming of a depression which increases the accident rates, it would be greater inside the factory than individual policies which includes those outside as well as inside?

Mr. HARKER. I feel that I know what you are getting at, and I certainly agree with you, and to the extent that my statement would be too strong, I would want to modify it.

Mr. FORD. The factories were closed down during the depression.

You still didn't answer Senator Douglas' question, whether you knew, or whether actuary writers in this field agreed with the statement you made. He asked you if you knew of any.

Mr. HARKER. I couldn't give you a positive answer that I knew of any and I had talked with them on it, no, I would dare say that there would be some that I feel strongly, when put in this context, would agree with me, but specifically I don't know of any that would come out foursquare and agree 100 percent with what I said.

The 2 percent deduction would allow and/or encourage the accumulation of a contingency fund to mitigate any catastrophe losses.

The second area I would like to cover briefly is the question of the reserves on individual accident and sickness policies.

The 2 percent deduction would afford relief to those companies who recognize the actuarial desirability of maintaining some reserves against their in-force policies even though such reserves are not required by law.

North Carolina, for example, restricts by statute the degree within which the company may exercise its normal option to refuse a policy renewal. A company, then, writing an optionally renewable policy in this State must properly establish a reserve to give recognition to the rising costs under such policy. Yet the cost of such reserve is not deductible since—

(*a*) The policy is neither noncancellable nor guaranteed renewable as recognized by the tax law.

(*b*) The reserve is not formally required by law.

A case in point that we could discuss is North Carolina. North Carolina is a State that restricts a company in its option to exercise renewal features, even in policies with optional renewals, it says that

in 2 or 3 years a company cannot change the policy in any way solely because of a deterioration of health, or words to that effect.

Now, the immediate effect of that on a company's financial operations is that it must, to be proper, actuarially proper, recognize the need of maintaining reserves on that policy.

Now, the company then finds itself in the position of setting up reserves against policies that are neither noncancellable or nonguaranteed renewal as recognized by the tax law.

So that the reserves, while not formally required by law, is in good judgment required by law.

Now, it puts up the reserves out of its own money for which it would receive no tax relief. This is one equitable area that I think we should have in the record that would be corrected by the 2-percent deduction, it would go a long way in solving it.

The third area that has been elaborated on by Mr. Baker is the classifying question, that is, what is individual and what is group. And you have the so-called franchise or semigroup, and in the grayer area in between.

Now, depending upon the State laws—depending upon the State of domicile of the company, the State of residence of the group, company management practices, and miscellaneous factors, a company may have a choice of whether you call the group a true group and get the 2-percent deduction, or whether it calls it an individual or does not get the 2-percent deduction.

So in many areas it can go either way, which is another reason why the 2-percent deduction will eliminate an area of discrimination and inequity.

Senator CURTIS. How do you figure that 2 percent, 2 percent of what?

Mr. HARKER. Two percent of the premiums, Mr. Curtis.

Senator CURTIS. Two percent of the gross premiums?

Mr. HARKER. Two percent of the gross premiums is correct.

That would be an allowable deduction as defined in a certain section, which also has an inside limit on it.

Senator KERR. But that deduction, when made—and I want to make this point clear—results in the transferral of that amount of money into a reserve fund to which earnings are taxable at a higher rate than if it were not transferred?

Mr. HARKER. That is right.

Senator KERR. They transfer that money to another fund, and it constitutes reserve. And that is treated taxwise even less favorably as though it were not, and in the long run that results primarily in the solvency of the company's reserves, while it might not result in material loss of revenue to the Government.

Mr. HARKER. You gain now to lose later, but you will lose at a greater rate than you gain.

It is a deferral of a gain.

Senator KERR. I interrupted the Senator from Nebraska.

I thought I would make a clarifying point.

Senator CURTIS. In other words, the point is that it goes into the category of underwriting profits, and investment income, rather than the tax treatment of the payment of premiums?

Senator KERR. I think it is just the opposite.

Mr. HARKER. Well, it is a deduction that decreases——

Senator CURTIS. I mean, if you get the deduction and put your money over.

Mr. HARKER. Yes.

Senator KERR. It goes into a reserve rather than an underwriting profit.

Mr. HARKER. It is assigned to be taxed at a later date, it is a deferral sort of thing.

Senator DOUGLAS. Following up the question of the Senator from Nebraska, may I ask a further question for the purposes of clarification, Mr. Chairman?

Is this 2-percent deduction for tax credit deducted from taxes which would otherwise be paid, or is it a deduction from taxable income?

Mr. HARKER. From taxable income.

Senator CURTIS. Your gross premium is not all taxable income, is it?

Mr. HARKER. The 2 percent of the gross premium becomes a deduction from the income for tax purposes. It is merely——

Senator DOUGLAS. There is a great difference between deduction of the tax income and the tax credit, which is a dollar-for-dollar deduction from taxes.

Mr. HARKER. This is a deduction from taxable income.

Senator KERR. Actually, it is a deduction from income with reference to which only a portion is taxed.

Mr. HARKER. That is correct.

Senator DOUGLAS. Does the Treasury agree on that that this is a deduction from tax income and not ipso facto a dollar-for-dollar deduction for taxes?

Mr. SLITOR. Senator, it would be a deduction in computing gain or loss from operations, which is a part of the taxable income.

Senator CURTIS. May I ask you at that point, the 2 percent is figured on the gross premium receipts from this category of insurance?

Mr. SLITOR. Actually, Senator Curtis, I believe that the 2 percent would apply to the net premium, in the sense of the gross less return premium and less reinsurance premiums paid. But it is what the ordinary layman would call a gross income item.

Mr. HARKER. Do you want me to clarify it any more?

Senator CURTIS. Go ahead and make any answer you want to.

Mr. HARKER. I will agree that that is what it is. The net premium he used is not net premium in a mercantile sense. It is a net premium in another sense, you base the 2 percent on an adjustment of the gross premium.

Senator KERR. But it is not on the gross premium paid by the insured?

Mr. HARKER. Yes, sir.

Senator KERR. Then why do you say it is on an adjusted gross premium?

Mr. HARKER. No, it is not, it is on what the insured pays less any reinsurance payments.

Senator KERR. All right, proceed.

Mr. FORD. And this goes to phase III, as you have stated before.

Senator KERR. The money is transferred into a reserve account which becomes then subject to the phase II provisions of the tax law.

Mr. HARKER. Phase III provisions.

Senator KERR. All right, Mr. Harker.

Mr. HARKER. I would like, if I may, to just stress once again my personal concern and the concern of my company and the association as to this general question of classifying the business. And you put a certain burden, the way it is now, a certain burden of decision is put upon the companies as to what they should call something that is really not a true group, but is called a true group in order to get the 2-percent deduction.

Senator KERR. In other words, a company that writes a lot of business might write a policy on a lot of lawyers, and some companies might say that that would be a group picture, and others might say it is an assemblage of individual pictures.

Mr. HARKER. Exactly.

There are certain States—and then I am grieved to say this actually happens—you could have all the residents of an apartment building, all the members—and I have seen this done, too—all the residents of a rural delivery route, anybody that lives on that particular rural delivery route is a member of a group. So it is not a group, but they call it a group.

Senator CURTIS. But they use a group contract?

Mr. HARKER. They might and they might not. You can have a group with individual policies.

Senator CURTIS. Now, if they took such assemblages of people and wrote contracts which are obviously individual contracts, by calling them a group they couldn't get this 2 percent under the existing law, could they?

Senator KERR. The company.

Mr. HARKER. What they would do—I wouldn't attempt to answer what they would do on that. I think it would be possible they would be taken in by the belief——

Senator CURTIS. Whether or not you have group insurance or individual insurance depends upon the contract, does it not?

Mr. HARKER. Not necessarily all the time.

Senator KERR. Suppose it were a contract that said, any individual who receives mail on rural route No. 2 out of Atlanta, Ga., is eligible to come under the provisions of this policy that is being written, and actually its provisions might be identical with those if they all took a policy unrelated to each other, and yet what you are saying is that it would be possible for the company to designate it as a group insurance policy, available—of course individually, which all group insurance policies are—to any person receiving mail under rural No. 2 out of Atlanta, Ga.

Mr. HARKER. Yes, sir.

Of course I am not going to speak as to how the companies handle this in their tax forms, but I am suspicious that the company's annual statement may call it group insurance. I am not going to speak for them, and I don't know, but it is possible.

Senator KERR. Would the Treasury advise the committee if such a situation were possible?

Mr. SLITOR. Sir, we would have to look into that and try to answer it for the record.

Mr. FORD. This is the gray area.

Mr. HARKER. I am not attempting in any way to answer the question; I am attempting to merely draw attention to the fact that this matter of decision does exist, and the 2 percent would certainly,

under the conditions, with all the other advantages it would have, have to be clarified.

Senator KERR. But you say the term "group insurance" is one which is interpreted differently or which is subject to different interpretation by different taxpayers?

Mr. HARKER. Exactly.

Senator KERR. Would the Treasury agree to that?

Mr. SLITOR. I wish you would state it again.

Senator KERR. Does the Treasury have fixed and definite regulations with reference to the application of this 2-percent deduction in which the term "group insurance" is specifically defined and interpreted so that there is no elasticity available to the taxpayer as to how it might be applied or interpreted?

Mr. SLITOR. I don't believe that it is spelled out in great detail in the regulations.

Senator KERR. [Or] In the regulations?

Mr. SLITOR. In the regulations.

I believe that to some extent it is a term of art, and to some extent it would be, I suppose, determined by the State regulatory authorities.

Senator KERR. Then there is the elasticity of interpretation of it as between taxpayers?

Mr. SLITOR. I am not sure that there would be.

Senator KERR. Are you sure that this wouldn't be?

Mr. SLITOR. We will attempt to look into that.

Senator KERR. And advise the committee?

Mr. SLITOR. Yes, sir.

Senator KERR. Fine.

(The following was later received for the record:)

DEFINITION OF GROUP INSURANCE

Section 809(d)(6), as presently enacted, provides a deduction in an amount equal to 2 percent of the net premiums for the taxable year attributable to group life and group accident and health insurance contracts. The deduction provided by section 809(d)(6) is limited by other provisions of the code and is taken into account in determining the policyholders, surplus account for purposes of the phase 3 tax. The regulations under this section follow the statutory language.

"Group insurance" is a term of art within the insurance industry. The commonly accepted meaning of the term is an insurance arrangement in which a master policy is issued to a person or organization to cover a minimum number of persons, each of whom is individually identified and receives a certificate evidencing his coverage. Requirements of State law must also be met. Premiums may be paid entirely by the holder of the master policy, by the policyholder and the covered individuals jointly, or by the covered individuals alone. See Gregg, "Life and Health Insurance Handbook" (1959).

Whether or not a particular contract qualifies as a group contract within the statutory intent will depend upon the facts and circumstances present in each case. To date, the Treasury Department has not been aware of particular administrative problems in the application of the group premium deduction. However, a continuing study is being made under this and other provisions of the new law to insure effective and uniform application of the 1959 act.

Mr. HARKER. I will be brief and close, with your permission.

Senator KERR. You always have our permission to close.

Mr. HARKER. I was persuaded by certain phases that I have covered—the theory is a matter of an opinion of mine, and I think it is shared by some others—that the 2 percent deduction would have a favorable effect upon the individual A. & S. in a matter of growth and the conduct of the business. It would be an encouragement for

companies to enter the individual A. & S. field, it would be an encouragement for them to offer experimental coverage, liberalize as regards renewal and other policy feature, and extend coverage to groups before considered uninsurable, one of the largest experimental areas that is being considered in this industry at this time.

This is so because it has this contingency or reserve fund to protect the venture.

Senator CURTIS. May I ask you, is the entire insurance industry in accord on this bill?

Mr. HARKER. I would not be in a position to answer you on that.

Mr. FORD. The record has reflected no adverse comments.

Senator CURTIS. You mean the witnesses here today?

Mr. FORD. No, I mean there have been no adverse statements filed.

Senator CURTIS. No adverse statements filed. But these things are discussed around the various associations, and so on.

Mr. FORD. This bill was introduced in January, and I would think if adverse comments were to come forward, they would have done so by this time.

Senator KERR. There are no records within the committee of witnesses desiring to appear against it.

Mr. FORD. In closing, may I state one thing?

I am aware of the technical deficiencies, the highly technical deficiency. And I have a version of this which I will give to the clerk here.

Senator KERR. The Treasury has offered to do that, and when that is done, I would like for the proponents of those favoring the amendment to look at it and see if they concur in it——

Mr. FORD. I am sure they will.

Senator KERR (continuing). In the accomplishment of the purpose by the language submitted by the Treasury.

Mr. FORD. And, too, may I ask that these full statements be included in the record, because they skipped back and forth.

Senator KERR. They will be.

(The statements referred to are as follows:)

STATEMENT OF WM. HUNTER MCLEAN

My name is Hunter McLean. I am president of American Standard Life Insurance Co. of Fort Worth, Tex., and my experience in the insurance field dates from 1928, when I went to work as a solicitor. In addition, I speak for the Texas Legal Reserve Officials Association of Austin, Tex.

Subsequently, I was with the Texas Insurance Department from 1933 to 1943 as deputy life insurance commissioner and as senior examiner. I have been active with my company since 1946. It engages in the life, accident and health, and hospitalization fields.

Within a year of the time I entered the insurance business, the forerunner of Blue Cross had its beginnings as a cooperative at Baylor Hospital in Dallas. And, in 1933 what may have been the first commercial hospitalization policy in the United States crossed my desk at the Texas Insurance Department.

My commissioner took a dim view of that policy stating that it was economically unfeasible. "No one will buy hospitalization insurance at a premium of $12 yearly when the average hospital bill is only $60," he said. A premium of 20 percent of the promised benefits appeared preposterous to him.

Today 130 million Americans own hospital insurance.

My Commissioner's alarm was justified, but for a wholly different reason. His concern should have been for the solvency of the companies experimenting in the business for the premium for that same coverage today is 300 percent of the 1933 amount.

Increasing costs, experimentation, adjudication of policy terms, errors permitting adverse selection by the public, each contribute to the extreme uncertainty in this field of insurance.

No difference exists in the hazards assumed under group policies and individual policies, except that the noncancelable contracts are limited to the individual field and it is within the individual field that costly experimentation occurs.

For purposes of taxation there should be no distinction between group accident and health insurance and that issued to individuals.

Current evidence of increasing costs in hospital insurance is contained in a release by the Department of Labor reporting that the cost of hospitalization insurance, written by private insurers, has jumped about 80 percent in less than 10 years. And, the statistics of the State of Colorado reflect an 8 percent rise annually in hospital and medical charges in each of the past 4 years.

In addition to increasing costs, other factors have contributed to losses. Some of them are touched upon below.

Any history of the accident and health field will show that in good times loss ratios are relatively low. Under the same policy contracts, bad times produce higher losses. Without laboring the point, the experience of companies in the accident and health field during the depression support this statement.

Because insurance policies are unilateral in their drafting, the courts quite properly construe them strictly against the authors. Thus, until a contract has been adjudicated thoroughly in its important provisions, the total of its obligations is unknown.

The seriousness of this is illustrated by a Kansas case where a rather routine type of monthly indemnity accident and sickness policy, promising benefits for only 2 years, was construed as a contract obligated to pay monthly indemnities during the entire lifetime of the insureds.

In Texas, insureds suffering a heart disability have been ruled entitled to indemnity even though they continue to work in the same occupation. The theory of the court in this case was that an insured was shortening his life expectancy, reducing the time and total the insurance company would pay, and if he preferred to do that the company should pay regardless of contract language.

Several States through laws or through regulations are becoming more and more insistent upon granting insurance on preexisting diseases. The impact in this area will not be exactly measurable for decades.

Experimentation with hospital policy provisions has produced dramatic losses. Companies have attempted to remove the 6 months waiting period for surgical cases, in an effort to rely completely upon the preexisting disease provisions of policies. Without exception, such companies have suffered severely from surgical cases occurring within the early months following issuance of a policy.

A few years ago major medical policies were offered, having a deductible of some $300 or $500, with very liberal benefits thereafter. The experience under these policies has been most distressing.

The public has evidenced keen interest in noncancelable policies and when the companies first attempted to supply such demand, policies were issued with guaranteed premiums. Again, the losses under such policies have been substantial and will continue during the lifetime of those policyholders.

This experimentation should not be discouraged for through it shall be achieved the answers so necessary to a final solution to accident and health insurance costs.

One happy result of experimentation was in the field of polio insurance, first issued by a Fort Worth company, a friendly competitor to my company. The first such polio policy was issued with unallocated limits of $5,000 for medical and hospital care.

Parents responded with an almost frantic demand for this coverage for their children. Insurance companies all over the United States bagen the issuance of similar policies.

Charity wards caring for polio cases had borne 100 percent of the costs. Within a few brief years 60 percent of the costs of the polio wards was paid by insured cases.

The savings to charity permitted the diversion of funds to research and polio vaccine is a direct result.

Dr. Frederic E. Elliott, former consultant to the chairman of New York City Blue Shield, adequately summed up the problem in the April 29, 1961, issue of the National Underwriter stating: "The insurance market is now being offered the major medical and the first dollar coverages of the insurance industry, plus Blue Cross-Blue Shield coverages of the so-called nonprofit plans. None of them would seem to have matured beyond the trial and error stages."

His article continued by quoting Prof. D. L. MacDonald of the University of Michigan, who said: "The insurer cannot expect to experience its ultimate loss ratio under a new plan of insurance for perhaps many years. At least 5 years will pass before policyholders learn enough about the new cover to begin to utilize their rights and benefits."

As I have pointed out initially, the individual accident and health policies are the primary means of coverage experimentation. These policies are identical in form with the group policies—which are benefited by present section 809(d)(6)—but with the additional hazards to the companies of noncancellability and the uncertainties always present in previously untried types of coverage.

Logically there should be no tax discrimination between group and individual coverages in this field. But section 809(d)(6) of the present law provides this necessary 2-percent deduction for group accident and health policies and nothing is provided for the similar but more hazardous individual policies. Senator Kerr's bill, S. 397, would correct this discrimination and I urge this committee to report that bill favorably.

STATEMENT ON BEHALF OF THE NATIONAL ASSOCIATION OF LIFE COMPANIES BY DEWITT H. ROBERTS, EXECUTIVE SECRETARY

My Name is DeWitt H. Roberts. I am executive secretary of the National Association of Life Companies. This is a trade association composed of about 170 small and medium sized younger, progressive companies scattered from Juneau to Miami.

I hope the members of the committee will recall that NALC asserted that the life insurance industry should pay more taxes, even to the point of preferring the 1942 law because of its simplicity. While we found some faults with the philosophy of the present law, we are trying to work within its framework.

When you consider that it took 35 years to render the preceding tax legislation for life companies technically workable, by which time credit and similar specialty items had arisen to create entirely new problems, we do not think it extraordinary that some changes and adjustments will be required in the present bill.

This association still thinks that tax exemption for the profit of life companies in the handling of pensions was a mistake, but that criticism is not germane to our appearance here today.

Examining the bill from the standpoint of the younger, smaller, growing companies, we have found four questions that we think will require some kind of treatment.

The first is the issue of tax exempts and intercorporate dividends. We have no quarrel with the attitude of the Congress, which unmistakably declared that these exemptions should be allowed. We do not think that the interpretations and regulations render them tax exempt.

Second, we are disturbed a little about the effect of the deduction of 10 percent of the increase in nonparticipating reserves, in the instance of younger companies. NALC is now studying the odd result whereby policyholder's surplus, subject to a part III tax, increases while a company is actually losing money and which increases in policyholder's surplus would subsequently be taxed. Because this is a wholly new problem which the companies came to consider only this year, and for which there may be adequate administrative remedies, we have no requests for legislation.

Third, we are somewhat concerned about the treatment of capital gains, which is specially a small company problem.

But in the fourth field, that of giving equal treatment to individual accident and health contracts—the same treatment given to group contracts in that field—we are asking for early relief.

Individual accident and health contracts are written by three types of companies in the United States. One is the nonprofit service corporation, the Blue Cross organization. One is the casualty companies, which have a special tax treatment and no current tax problems. The third are the life companies. Individual accident and health is written, here and there, by large life companies, but the greater part is written by medium sized and small companies. The small companies are the innovators in the field. They are the ones who introduced each of the improved types of contracts. They are also the companies who write accident and health to some extent, on an accommodation basis for their customers for life insurance. They are also the type company that sells accident and health as an incidental in developing an agency force.

We do not know how individual accident and health failed to receive the same deduction as group accident and health when the bill was originally written. It was our impression that it had, or we would have raised the issue at that time. But if you will recall, the hearings were largely devoted to other aspects, and more important aspects, of the tax bill.

It is probable that we did not realize how drastic this change would be. Life insurance companies were not heavily engaged in accident and health business until about the time of the hearings on the Mills-Curtis bill, and their taxes on accident and health were not an important item. The Mills-Curtis bill, after protracted hearings, provided that life companies should be taxed on these policies in the same manner as mutual casualty companies, since the field is dominated by the large mutual casualties. This was a fair basis of taxation, but it was not applicable to the approach adopted in the 1959 measure.

I do not profess to be a technical man, or even a halfway expert, in the field of individual accident and health insurance. I know that the problem of maintaining reserves to meet such contingencies as compulsory maintenance of cancelable contracts do not constitute "reserves required by law" as defined in the 1959 act and the Treasury's regulations. I know that the business is one that is subject to wide fluctuations of profit and loss; and I know that all these problems were brought out pretty thoroughly in reference to group accident and health 2 years ago, and that the Congress permitted the 2-percent deduction there. All we ask is that the smaller companies, which write individual contracts rather than group contracts, be given the same deduction for individual accident and health that the large companies get in their group operations.

The cost to the Treasury will be small. I doubt that it would exceed $7 or $8 million the first year, and that will be reducible in subsequent years by recaptures under part 3, since the money would go into the policyholders' surplus. We think that this revision would go a long way toward adjusting inequitites in the bill and make it substantially easier for the small companies to live with the measure.

STATEMENT ON BEHALF OF THE NATIONAL ASSOCIATION OF LIFE COS., INC., BY J. W. BAKER, MEMBER OF THE BOARD OF DIRECTORS

My name is J. W. Baker. I am president of Continental Service Life & Health Insurance Co., Baton Rouge, La. The statements contained herein are respectfully submitted on behalf of the National Association of Life Cos., Inc.

Our purpose is to endorse and to support a bill (S. 397) introduced by Senator Kerr in the Senate of the United States, January 13, 1961. The bill proposes to amend the Internal Revenue Code of 1954 to permit a deduction by life insurance companies in determining gain or loss from operations of an amount equal to 2 percent of the premiums from individual accident and health insurance contracts.

Section 809(d)(6) of the Internal Revenue Code of 1954 provides for a deduction of an amount equal to 2 percent of the premiums from group health and accident insurance contracts. In the interest of clarity, I should like to mention that accident and health insurance contracts are generally classified according to a terminology which employs such terms as "group," "franchise," "blanket," "family group," and "individual." These terms are useful in the industry's normal day-to-day operations and communications. For the most part, these terms denote distinctions that are merely administrative in character. In this sense, they are proper and useful terms. However, if such terms should be misconstrued in such a way as to imply basic, functional differences, then misunderstanding and confusion could result.

Our endorsement and support of the bill (S. 397) rests upon the contention that significant differences do not exist among health and accident insurance contracts on the basis of such nominal classifications as "group," "franchise," "blanket," "family group," and "individual," and therefore all such health and accident insurance contracts should be treated uniformly with respect to the 2-percent deduction provided for under section 809(d)(6) of the Internal Revenue Code of 1954.

In order that our contention may receive fair and reasonable consideration, I should like to submit some pertinent observations drawn largely from the experience of the company which I represent. These observations are also representative of other small life insurance companies.

1. All health and accident insurance contracts have a common, primary purpose. That purpose is to provide protection for the policyholder.

2. Selection of risk is essentially the same for the various classifications due to the fact that underwriting information is procured on similar forms through the use of similar questions.

3. Migration exists among the various classifications; for example, policyholders under a group classification have the privilege of converting to an individual status.

4. Competition requires that premium rates be held to a minimum. Thus tending to eliminate margins which might otherwise be used in maintaining reasonable levels of risk. Such levels of risk could better be achieved through more elaborate procedures of selection; for example, through medical examinations, inspection reports, extensive statements of attending physicians, etc.

5. Each classification of health and accident insurance is subject to highly competitive premium rates and wide fluctuations in claims experience. These factors tend to hamper the maintenance of sufficient surplus to accommodate contingencies of the business. Seasonal illness, contributing weather factors, disasters, endemic diseases are examples of such contingencies. Unstable fluctuations appear to be characteristic of health and accident insurance claims.

6. Administrative handling costs (records, billing, etc.), commensurate with the various classifications of the business, tend to offset differences in premium rates. To illustrate this point, the handling costs for 500 individual cases would exceed by 20 to 25 percent the handling costs for a like number of cases as a group. Where savings of this nature are made, they are passed on to the group policyholders in the form of lower premium rates.

7. Medical care costs are rising whereas premium rate adjustments lag behind such increases in costs. This phenomenon can be reflected in company losses.

8. The salient facts disclosed by thorough examination of the several classifications of health and accident insurance contracts are facts which establish similarities rather than differences.

Our endorsement and support of the bill (S. 397) is in accord with these findings. The amendment is regarded as desirable and feasible. Therefore, it is our contention that health and accident insurance contracts should be treated uniformly with respect to the 2 percent deduction provided for under section 809(d)(6) of the Internal Revenue Code of 1954, through adoption of the proposed amendment. Further, we believe that its adoption would serve the best interests of the policyholders, the insurance industry, and the Government.

DEFINITIONS

1. Group health and accident insurance

Group health and accident insurance is any policy of health and accident insurance covering more than one person, except family group, blanket, and franchise policies hereinafter specifically provided for, which shall conform to the following requirements: (See table A.)

2. Franchise health and accident insurance

Franchise health and accident insurance is that issued to 5 or more employees of a common employer or to 10 or more members or employees of members of any trade or professional association or of a labor union or of any other association having had an active existence for at least 2 years where such association or union has a constitution or bylaws and is formed in good faith for purposes other than that of obtaining insurance: (See table B.)

3. Blanket health and accident insurance

Blanket health and accident insurance is any policy covering special groups of persons as enumerated in one of the following paragraphs: (See table C.)

4. Family group health and accident insurance

Family group health and accident insurance is any policy covering members of any one family, including husband, wife, and children under 19 years of age, and any other person dependent upon the policyholders, written under a master policy issued to the head of such family, which policy shall contain a provision that the policy, and the application of the head of the family if attached thereto, shall constitute the entire contract between the parties.

TABLE A.—*Group health and accident insurance*

May be issued to	A—Employer	B—Association	C—Trustees of a fund established by A or B
Provided that it conforms to the following requirements:			
1	It covers not less than 10 employees.	It covers not less than 25 members or employees of members.	Same as B.
2	The plan precludes individual selection.	Same as A	Same as A.
3	If the entire premium is not paid by A or B, the group shall comprise not less than 50 percent of all employees or members, or not less than 50 percent of the class or classes of eligible employees or members.	do	Do.
4	Any class or classes are determined by conditions pertaining to their employment or age.		
5		The association has a constitution or bylaws and has been organized and is maintained in good faith for purposes other than those of obtaining insurance.	Same as B.

NOTE.—C includes trustees of a fund established by 2 or more employers in the same industry or by 1 or more labor unions, or by 1 or more employers and 1 or more labor unions.

TABLE B.—*Franchise health and accident insurance*

May be issued to	A—Employer	B—Association
Provided that it conforms to the following requirements:		
1	It covers not less than 5 employees.	It covers not less than 10 members or employees of members.
2	Persons are issued the same form of an individual policy varying only as to amounts and kinds of coverage applied for by such persons.	Same as A.

TABLE C.—*Blanket health and accident insurance*

May be issued to—

1. Any common carrier (covering all passengers).
2. An employer (covering any group of employees defined by reference to exceptional hazards incident to such employment).
3. A college, school, or other institution of learning (covering students or teachers).
4. Any volunteer fire department, first aid, or other such volunteer group (covering all members of such department or group).
5. A creditor (to insure debtors of the creditor).
6. Any other substantially similar group (in the discretion of the commissioner of insurance).

NOTE.—All benefits shall be payable to the insured.

STATEMENT ON BEHALF OF THE NATIONAL ASSOCIATION OF LIFE COMPANIES, BY CARLTON HARKER, VICE PRESIDENT AND ACTUARY, COASTAL STATES LIFE INSURANCE CO.

My name is Carlton Harker. I am vice president and actuary of Coastal States Life Insurance Co., of Atlanta, Ga. My company is in the medium-small class with $37 million assets and $376 million insurance in force. I am an associate of the Society of Actuaries.

I am persuaded for reasons which follow that a more reasonable and equitable tax treatment will be afforded the insurance industry by allowing the 2-percent deductions for individual accident and sickness as well as group accident and sickness premium.

My company would not have benefited in tax years 1959 and 1960 due to the application of the inside limit provided by section 809(f).

THE CATASTROPHE HAZARD QUESTION

A catastrophe hazard exists for individual accident and sickness to as great an extent as for group accident and sickness. Experience in loss of time coverages during the great depression and more recently with the Asian flu epidemic illustrates this problem.

Some catastrophe hazard of the group type (e.g., a plant fire) may exist where an industrial company has a heavy concentration of individual accident and sickness on a debit where the workers in the debit are predominately working in the same plant.

The 2-percent deduction would allow and/or encourage the accumulation of a contingency fund to mitigate any catastrophe losses.

THE RESERVE QUESTION

The 2 percent deduction will afford relief to those companies who recognize the actuarial desirability of maintaining some reserves against their in-force policies even though such reserves are not required by law.

North Carolina, e.g., restricts by statute the degree within which the company may exercise its normal option to refuse a policy renewal. A company, then, writing an optionally renewable policy in this State must properly establish a reserve to give recognition to the rising costs under such policy. Yet the cost of such reserve is not deductible since—

(*a*) The policy is neither noncancellable nor guaranteed renewable as recognized by the tax law.

(*b*) The reserve is not formally required by law.

THE CLASSIFYING QUESTION

Semigroup coverage (franchise or association group) may be classified by the company as true group (thus receiving the 2 percent deduction) or as individual accident and sickness (thus losing the 2-percent deduction) depending on one or more of the following:

(*a*) State of domicile of company.

(*b*) State of residence of group.

(*c*) Company management practice.

(*d*) Miscellaneous factors (size of group, competition, benefits involved, etc.).

To allow one company to gain a tax advantage by such a small act as calling semigroup as true group appears inequitable.

SEVERAL MISCELLANEOUS QUESTIONS

To allow a 2-percent deduction will be an encouragement for companies to—

(*a*) Enter the individual accident and sickness field.

(*b*) Offer experimental coverages.

(*c*) Liberalize as regard renewal and other policy features.

(*d*) Extend coverage to groups before considered uninsurable.

This is so because there will be an encouragement for the company to accumulate a contingency fund (earmarked or not) to protect the adventure and also to act as a buffer against any fluctuations.

The deduction will equalize what has become an uneven race between group accident and sickness and individual accident and sickness.

Senator KERR. Thank you very much.

(The following suggested amendment was subsequently submitted by Mr. Peyton Ford in behalf of National Association of Life Companies, Inc.)

TECHNICAL AMENDMENTS TO S. 397 SUGGESTED BY NATIONAL ASSOCIATION OF LIFE COMPANIES.

S. 397 should be corrected as follows:
Page 1, line 3, "(a)" should appear before "That" rather than after.
Page 2, line 1, strike the quotation marks after "contracts".
Page 2, line 2, insert quotation marks after final parenthesis; strike "and group."
Page 2, line 3, strike "life insurance contracts."
Page 2, lines 6–7, insert new paragraph (b) as follows:
"(b) That section 815(c)(2)(C) is amended by striking 'group life and group accident and health insurance contracts,' substituting in lieu thereof 'accident and health insurance and group life insurance contracts'."

Now, we will go to the hearings on H.R. 856 and S. 977.

(The following information, referred to on p. 19, was later received for the record:)

Premiums paid for the past 10 years with reference to noncancelable hospitalization policies

	Millions		*Millions*
1950	$61	1956	157
1951	62	1957	189
1952	66	1958	219
1953	81	1959	261
1954	97	1960	[1] 280
1955	160		

[1] This is a projected figure.

This information was furnished by the Health Insurance Association and represents the best figures obtainable.

(Whereupon, at 11:40 a.m., the committee proceeded to further business.)

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