

## INSTITUTIONAL SIZE—LIFE INSURANCE

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Although this symposium deals with investment institutions in general, including commercial banks, insurance companies, savings and loan corporations, savings banks, trust companies, and pension funds, this paper is restricted to the life insurance industry. The reasons for this are two fold: first, because most of the questions concerning size have been directed at this industry, and second, in order to limit the scope of the paper to more manageable proportions.

Size has long been a bone of contention and a periodic target of criticism in our economy. This may seem at first somewhat strange in an economy whose very basis is mass production. Bigness has been an indispensable part of the great advance in our standard of living over the past 100 years. Yet it is perhaps only natural that size gives rise to fear, often unreasoning, concerning its possible power.

In the nineteenth century there arose a revolt against size in the form of big business and the trust. The railroads first felt the brunt of the attack shortly after the Civil War and the bitter fight culminated in the Interstate Commerce Act of 1887, and the later Mann-Elkins Act. Government regulation of the railroads was sound economically in that the railroad industry is inherently monopolistic; by virtue of parallel lines, excess capacity, and a high percentage of fixed costs, competition became destructive and inevitably would have resulted in combination and monopoly. Consequently, appropriate regulation to insure sound competition was a constructive step.

A second revolt against bigness took the form of a crusade against the "moneyed interests." Thus it was said that "Wall Street" owned and ruled the country. This revolt took the form of the granger movement and the greenback or inflation movement. It was felt that Wall Street had a monopoly of money and the cure for this was to have the government create more of it by various means. This movement reached its peak in the W. J. Bryan campaign of 1896. The whole fundamental basis of this movement was unsound, and it finally failed, fortunately for the country.

The next attack against bigness was waged against big business in the form of the trust. There was considerable merit in this attack both from an economic and moral point of view; the great trust movement was unquestionably a move in the direction of monopoly, and in the era of unrestrained frontier capitalism numerous

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abuses of big business arose which called for correction. This movement, fanned by a vast literature in magazines, books, and newspapers, resulted in the passage of the Sherman Anti-Trust Act in 1890, and the Clayton and Federal Trade Commission Acts in 1914. It was during this period, likewise, that the Armstrong investigation of insurance companies took place, an investigation which laid the foundations for a great deal of the insurance regulation which exists today. This regulation is dealt with in a subsequent section.

Trust busting reached its most dramatic stage in the reign of Teddy Roosevelt. Even at the height of his campaign Roosevelt did not condemn bigness per se, but tried to distinguish between the good and the bad. Woodrow Wilson carried this further in his *The New Freedom*:<sup>1</sup>

A trust is an arrangement to get rid of competition, and a big business is a business that has survived competition by conquering in the field of intelligence and economy. A trust does not bring efficiency to the aid of business; *it buys efficiency out of business*. I am for big business, and I am against the trusts. Any man who can survive by his brains, any man who can put others out of the business by making the thing cheaper to the consumer at the same time that he is increasing its intrinsic value and quality, I take off my hat to . . .

Thus there evolved out of the hysterical campaign against big business a "rule of reason" adopted by the courts in the enforcement of the antitrust acts—that bigness per se was not evil, but only when it tended toward monopoly or monopolistic practice.

Another attack against bigness set in during the Roosevelt New Deal Era; this took place in a highly charged emotional depression atmosphere, and resulted in considerable legislation, some of it good, but all too much of it of a negative character, based upon restriction of production and consequently ill-founded from an economic standpoint. As a part of this depression psychosis there arose a body of economic thought centered about the idea that our economy had become "mature," and that consequently there would not be sufficient investment opportunities to absorb the savings of our wealthy economy with the result that we were faced with "economic stagnation" unless we did something about it. Keynes' *General Theory*<sup>2</sup> stressed the dynamic relationship between capital investment and income, and pointed out that as income rose savings rose and contended that this made equilibrium very difficult to achieve at high levels of employment. While Keynes undoubtedly contributed to economic theory, his theory was primarily one of short-run analysis, applicable particularly to conditions of under-employment and inflexible wages.

Unfortunately, a great many Keynesians followed his theory without apparently understanding its limitations and qualifications, and applied it often in distorted fashion to long-run problems. Thus out of the somewhat obvious fact developed

<sup>1</sup> Pp. 180-181 (1913).

<sup>2</sup> JOHN M. KEYNES, *THE GENERAL THEORY OF EMPLOYMENT, INTEREST, AND MONEY* (1935).

in consumer budget studies that people with high incomes saved proportionately more than people with lower incomes, there developed a belief that there was a long-run tendency for the proportion of income saved to increase as our economy grew wealthier. There evolved the idea that savings in our economy were causing our difficulties; that we saved too much and could not find outlets for savings. A whole mature-economy school grew up and the remedy was to reduce saving by all manner of measures including more progressive income taxes, stiffer inheritance taxes, lower interest rates, undistributed profits taxes, and government dissaving.

It was, therefore, not unnatural that there should be sought out for attack and control one of the most important avenues of savings—namely, life insurance. This was one of the important motivating factors behind the TNEC investigation.

More objective economic reasoning coupled with time has done much to destroy “mature economy” thinking, and very little has been heard from this school for a number of years. In the first place all available data on savings point to the conclusion that in actual fact there has been no long-term increase in the percentage of our national income saved, and as a matter of fact what empirical evidence is available would better support a thesis that there is possibly a slight long-term downtrend in the savings ratio. Furthermore, the studies of Modigliani<sup>3</sup> and Duesenberry<sup>4</sup> conclusively demonstrate that the tendency of savings to rise with increased incomes is purely a cyclical phenomenon, and not a long-run one.

Thus on the one hand we have gotten over the fear that savings will grow out of proportion to the rest of the economy, and on the other hand we have had ever since the TNEC investigation a tremendous demand for capital investment—a demand so great, both in peace and war, that our problem has been not too much saving but too little. As a result saving has been largely restored to its proper perspective in economic thinking—as the sole means to achieve higher standards of living. This attack on savings was once again an evidence of negativistic thinking of the depression era. If the problem appeared to be that there were insufficient outlets for savings, the method of dealing with it was not the constructive one of what to do to increase these outlets, but primarily the defeatist one of how to reduce savings. It is fortunate that, at least temporarily, this thinking has fallen by the wayside.

Once attention was focused upon life insurance as a major savings instrument, the administration through the TNEC led an attack against the industry in a number of phases. This attack and others charged the industry, among other things, with being of giant size and with having enormous growth, great concentration in the hands of the large companies, monopolistic tendencies, and too great economic power.

It is noteworthy that this attack against bigness unlike those outlined previously was not the result of broad popular dissatisfaction and a consequent widespread cry

<sup>3</sup> *Fluctuations in the Saving-Income Ratio: A Problem in Economic Forecasting*, II STUDIES IN INCOME AND WEALTH 371 (NATIONAL BUREAU OF ECONOMIC RESEARCH, 1949).

<sup>4</sup> JAMES S. DUSENBERRY, *INCOME, SAVING AND THE THEORY OF CONSUMER BEHAVIOR* (1949).

to correct alleged abuses. On the contrary, the life insurance industry enjoyed a relatively high degree of esteem among the general public. It was rather the result in large part of the economic thinking of a relatively limited group of men, primarily in government. This lack of broad public support coupled with the excellent record of the industry demonstrated during the investigation was in all probability responsible for the lack of significant legislation produced by the investigation.

Certain aspects of this attack will be considered briefly in subsequent paragraphs.

## I

### SIZE AND GROWTH OF LIFE INSURANCE AS A FORM OF SAVINGS

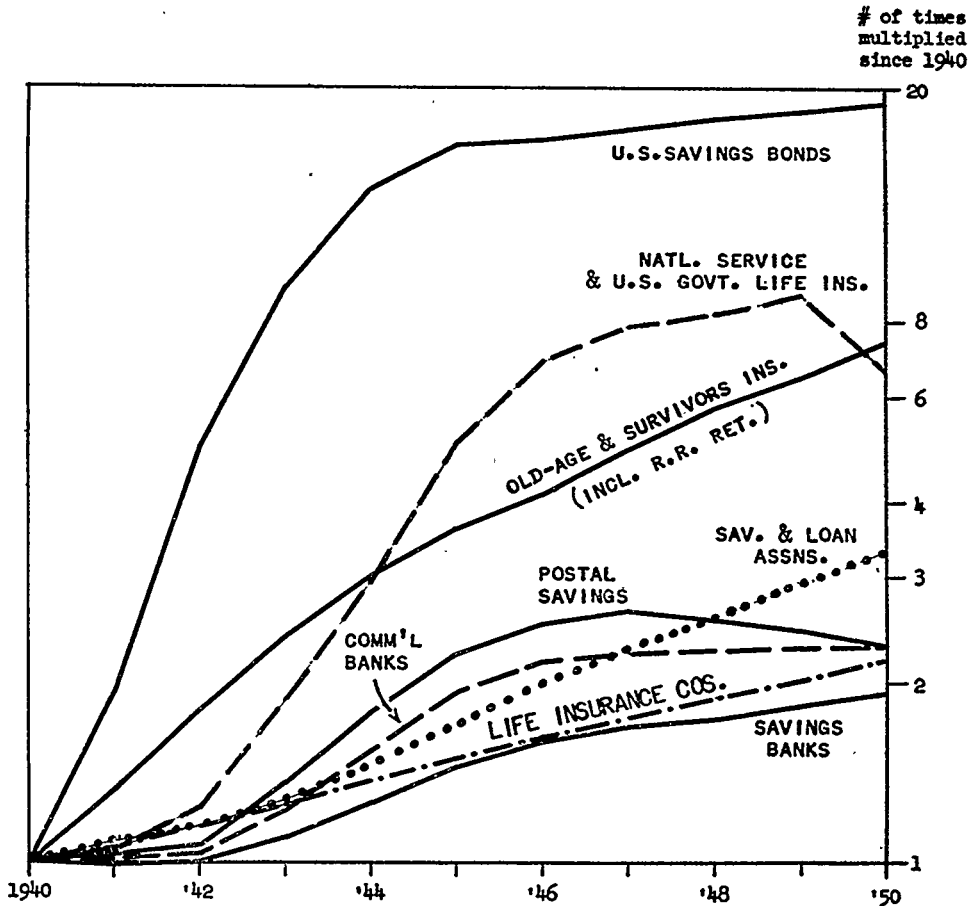
In a number of political investigations there has been considerable distortion of the relative size and growth of savings, and life insurance savings in particular. The impression often conveyed is that of stupendous growth and mammoth size with consequent problems soluble only through federal control.

All too little is known about the long-term trends in savings and its component parts. By all odds the most comprehensive study of this subject has been initiated and financed by the life insurance industry; this study has been under way for a period of several years, and is being conducted objectively by an independent group of economists under the direction of Dr. Raymond Goldsmith. The results should be available within a year and will undoubtedly shed much light on the subject.

In the absence of this study certain comments may be made based upon available data. In the first place there appears to be no upward trend in the over-all relation of savings to national income. Secondly, annual savings in the form of life insurance comprise approximately 15 per cent of total personal savings in the broad economic sense, and approximately 30-40 per cent in the narrower concept of personal financial savings. During the period prior to the late twenties, life insurance savings increased more rapidly than total personal savings. Since then, for the past 20 odd years there appears no tendency for life insurance savings to increase relative to total savings or national income. Over the past 10 years in particular life insurance savings have not grown as fast as certain other savings media. This is clearly brought out in the accompanying chart (Chart 1). Especially noteworthy is the great increase during this period of those forms of savings channeled through the United States Government.

It is certainly true that private life insurance has grown remarkably in the last 100 years. This growth has been an organic growth from within, and has not been a result of mergers and combinations such as characterized the trust movement in big business. In essence, it reflects the desire of millions of men and women to pool their economic risk and secure protection for their families, a protection today unattainable by the vast majority of people in any other fashion. Between 1860 and 1900, our national income roughly quadrupled, while life insurance premiums increased 80 fold; from 1900 to 1930 national income again roughly quadrupled, and

CHART I  
GROWTH OF SAVINGS IN POPULAR CHANNELS IN U. S.



[All curves plotted on logarithmic (or "ratio") scale to facilitate comparisons among them as to relative rate of change.]

life insurance premiums increased more than 10 fold. Today approximately 80 per cent of all American families are protected by life insurance; this is almost double the percentage of family ownership of any other financial asset.

Yet despite this excellent progress of prior years, over the last two decades private life insurance has failed to keep pace with the rest of the economy. From 1930 to 1950 national income has increased approximately 3 fold, whereas life insurance premiums increased but 2.3 times. This is in striking contrast to the period prior to 1930. Furthermore, the purchasing power in real terms which the present average amount of life insurance in force per family represents is actually less than that represented by the average insurance per family 20 years ago.

Consequently, far from being an aggressively dominating force in the economy,

the life insurance industry, quite on the contrary, has failed to keep pace with the rest of the economy for more than two decades. The average amount of private insurance in force per family in the United States is now only about \$5,000 or less than one year's income. Surely this is an inadequate figure.

At a time when, due to high income and inheritance taxes, life insurance has become more important than ever before in our economic life as the sole means whereby millions can achieve the necessary security by their own efforts, an increasing real amount of life insurance is called for. With the increasing emergence upon the scene of state capitalism in all its forms, with state security in the van of its numerous goals, the further development and progress of life insurance has become not only of greater economic importance, it has become morally far more indispensable, for it stresses the importance and dignity of the individual in earning and providing for his own security, rather than the easier though morally less satisfying alternative of attempting to obtain his security through the fruit of someone else's labor.

## II

### CONCENTRATION WITHIN THE LIFE INSURANCE INDUSTRY

Much is heard in generalities about the enormous size and power concentrated in the few leading life insurance companies. Little, unfortunately, is heard of the facts. Actually there is no above-average concentration in the life insurance industry.

The broadest available sample dealing with concentration in manufacturing industries was covered in a study made in 1949 by the Bureau of the Census at the request of Representative Celler.<sup>5</sup> For each of 452 manufacturing industries this analysis showed what percentage of each industry's total shipments originated in 1947 from the first 4, the first 8, the first 20, and the first 50 companies in each field. When the concentration of the life insurance industry is compared with this study, it is found that the top 4 life insurance companies showed a lower concentration than 206 of the 452 industries surveyed. Furthermore and even more significant, between 1935, the date of an analogous study by another government agency, and 1947, the date of this study, the share of the top life companies declined substantially from over 50 per cent to less than 40 per cent.

Another government study, likewise initiated by Representative Celler, measures the concentration of assets in 1947 in 26 selected industries.<sup>6</sup> Comparing the asset distribution of the life insurance industry with that of these 26 industries, one finds that the concentration of the life insurance industry ranks far down the list. The accompanying chart (Chart 2) and table bring this out clearly.

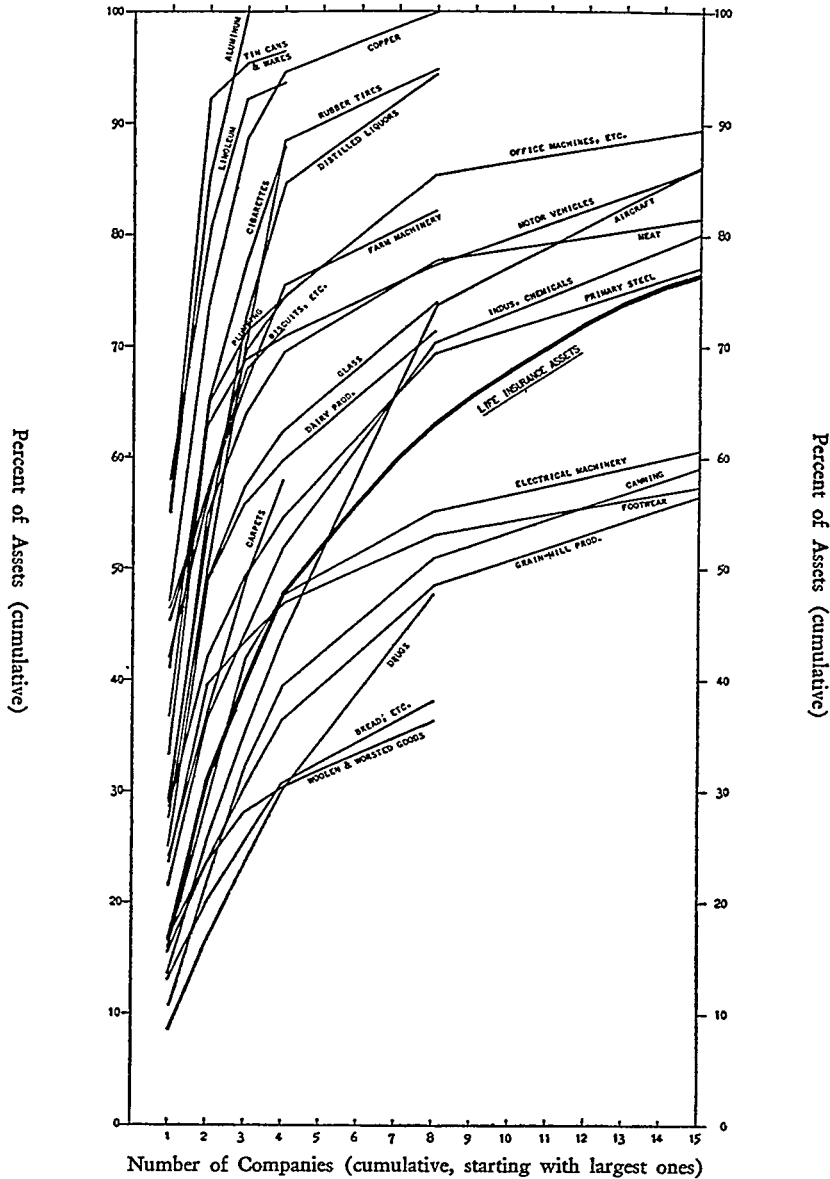
The horizontal scale on the chart refers to the largest companies in each industry

<sup>5</sup> BUREAU OF THE CENSUS, CONCENTRATION OF OUTPUT IN LARGEST MANUFACTURING COMPANIES IN 452 INDUSTRIES AS MEASURED BY THE CENSUS OF MANUFACTURERS OF 1947 (U. S. Dep't Commerce, 1949).

<sup>6</sup> REPORT OF THE FEDERAL TRADE COMMISSION ON THE CONCENTRATION OF PRODUCTIVE FACILITIES, 1947 (1949).

CHART 2

HOW ASSET DISTRIBUTION OF LIFE INSURANCE COMPANIES COMPARES WITH THAT OF THE 26 MANUFACTURING INDUSTRIES COVERED BY FEDERAL TRADE COMMISSION\*



\* In its special study for Celler Committee in 1949 (1947 data), "The Concentration of Productive Facilities. . ."

reading from left to right in cumulative fashion. Thus the figure 1 on this scale refers to the total assets of the largest company in each field, the figure 2, the 2 largest companies, etc.; the vertical axis measures the assets held by these companies as a percentage of the total assets of each industry.

TABLE I

CONCENTRATION OF ASSETS IN LIFE INSURANCE INDUSTRY COMPARED TO CONCENTRATION OF ASSETS IN 26 INDUSTRIES STUDIED BY F.T.C., 1947

<i>Cluster</i>	<i>Share of Assets Life Insurance Ind.</i>	<i>Rank of Life Ins. Among 26 (+ 1) Industries</i>
Top Company	16.5%	21st among 27 industries
Top 2 cos.	30.7	20th among 27 industries
Top 3 cos.	39.4	21st among 27 industries
Top 4 cos.	47.6	18th among 26 industries
Top 8 cos.	63.0	13th among 20 industries
Top 15 cos.	76.5	7th among 11 industries

To illustrate this factor more specifically the following concrete examples are typical. The top 3 insurance companies in 1947 comprised approximately 40 per cent of the industry assets. This compares with 68.7 per cent for the top 3 auto companies, 77.6 per cent for the top 3 cigarette companies, 70.3 per cent for the top 3 tire companies, 72.4 per cent for the top 3 liquor companies, 92.1 per cent for the top 3 linoleum companies, and 88.5 per cent for the top 3 copper companies.

### III

#### DOWNWARD TREND IN CONCENTRATION OF ASSETS WITHIN THE INSURANCE INDUSTRY

Not only is the concentration in the life insurance industry no greater than in industry in general, the trend in concentration is definitely downward. This trend in concentration can be measured in two ways. On the one hand the percentage of assets held by the leading companies in 1900, for example, can be compared with the percentage held by these same companies over subsequent years; on the other hand, the percentage of assets held by the leading companies, for example, the first 5, in 1900 can be compared with the 5 leading companies in subsequent years, even though they are different companies. It is considered that for the purpose of this paper the second method is more meaningful. Using this concept, at the turn of the century, the 5 largest insurance companies held 63.4 per cent of the industry's total assets; by the first World War this percentage had been reduced to 56.7 per cent, by 1940 to 53.6 per cent and by 1950 to 51.3 per cent; in each of the last 8 years this percentage has declined. The same is true if we take the largest 3 companies; in 1900 they comprised 51.2 per cent of the industry's assets; by 1950 the percentage had been reduced to 39 per cent. Likewise, for the top 10 companies the percentage was reduced from 79 per cent in 1900 to 66.9 per cent in 1950.

### IV

#### CONCENTRATION IN PERSPECTIVE

Finally, concentration should be viewed in its proper perspective in our economy. Sumner Slichter's comments along these lines are very appropriate. He points out<sup>7</sup>

<sup>7</sup> *Long Term Economic Trends*, in Papers and Proceedings of the Sixty-Second Annual Meeting of the



that concentration is apparently inherent in our way of life; that, for example, 12 large unions or 6 per cent of all unions have half of the union members in the United States, that 5 out of 223 Protestant Churches have over half of the membership in all Protestant churches; that if a suggestion system is put into a plant, about half of the suggestions will be made by about one tenth of the employees; that about one tenth of the employees will cause one half of the accidents. He concludes that<sup>8</sup> "just as the preferences of people cause most of them to belong to a few large churches or unions, so their preferences will cause most of them to buy one of a few makes of cigarettes, breakfast foods, cars or soap. Consequently, in industry after industry a small percentage of companies will continue to produce one-half to nine-tenths of the goods sold."

Under the circumstances, with concentration such a pervasive force in every aspect of our lives, it is perhaps surprising that the concentration within the life insurance industry is not much greater than it actually is.

## V

### COMPETITIVE FORCES IN THE LIFE INSURANCE INDUSTRY

The life insurance industry cannot objectively be termed monopolistic. It is characterized, more so than in the case of most industries, by freedom of entry into the business and active competition.

## VI

### FREEDOM OF ENTRY

This freedom of entry, moreover, is not only theoretical—it actually takes place, as is attested by the fact that the number of life insurance companies has grown from 84 in 1900 to well over 600 at present, a growth almost 3 times that in industry generally; in the short span of years since World War II, the number of companies has grown by over 150, an increase of over one third. These new entries are successful in competition with larger companies; the smaller companies in the industry have expanded their share of the business at the expense of the larger companies.

There is a well defined trend in the industry for the largest companies to show a persistent deceleration in growth. This is not surprising but to be expected. The smaller and younger companies tend to grow faster and the older and larger companies to grow more slowly. Thus, the companies other than the leading 12 increased 51 fold in assets between 1900 and 1950, or 50 per cent more than the leading companies, and increased their share of industry assets from 21 per cent to almost 30 per cent. This same tendency has been generally persistent throughout this period. If we analyze the experience of the leading 50 companies over the past

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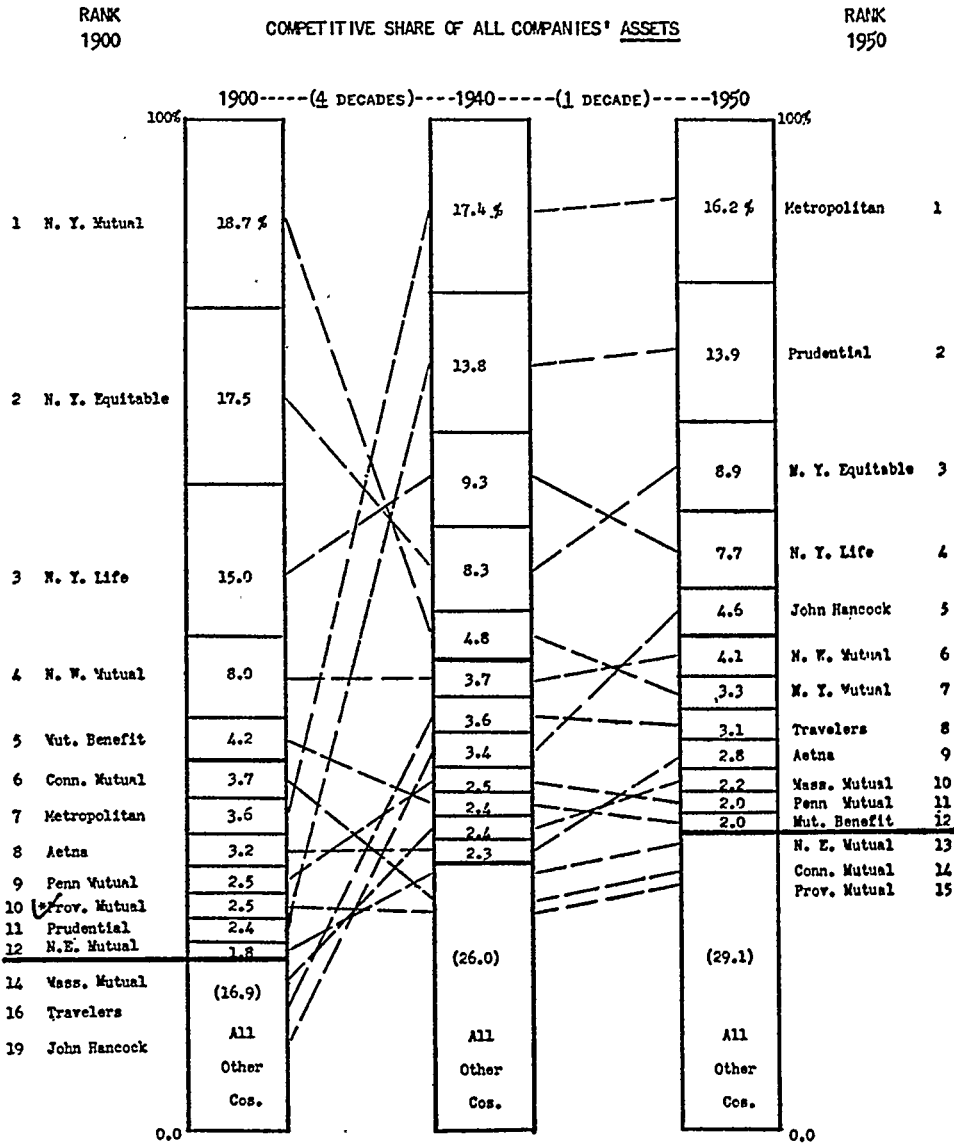
American Economic Association, December 27-30, 1949, 40 AM. ECON. REV. 457 (1950). See also The Commercial and Financial Chronicle, Jan. 5, 1950, p. 1, col. 3.

<sup>8</sup> 40 AM. ECON. REV. 457, 463-464; The Commercial and Financial Chronicle, Jan. 5, 1950, p. 35, col. 3.

20 years we find that the largest third of these companies had grown 225.6 per cent by 1950, whereas the middle third grew 246.3 per cent, and the smallest third grew 398.5 per cent.

These factors have been responsible for the fact often noted that the combined assets of all United States life insurance companies have approximately doubled

CHART 3  
SHIFTS IN COMPETITIVE STANDINGS OF LIFE INSURANCE COMPANIES



✓ Then known as Provident Life & Trust.

every 10 years. In other words, it has only been true because the younger and smaller companies grow faster than the older and larger companies, and because new companies continue to enter the business at a rapid pace.

## VII

### SHIFTS IN INDUSTRY LEADERSHIP

Not only is there active free entry into the life insurance industry and active competition between the small and the large companies; there is also intensive competition among the largest companies, so much so that there have been striking shifts in industry leadership over the past 50 years. The accompanying chart (Chart 3) demonstrates this point.

It can be seen from this chart that none of the top dozen companies in 1900 now holds the same relative rank in the industry; moreover, neither the big 3 nor the big 5 in 1900 are today's big 3 or big 5. The leading company in 1900 is not even among the first 5 in 1950, and the 2 leaders today were not even in the big 5 in 1900. Even within the short space of the last five years there has been a change in the composition of the big five.

Over recent years there has been a noticeable closing of the gap between the leading company and the runner up and between these two and a group of other companies. Thus, further shifts in industry leadership appear to be in the offing in the future.

## VIII

### PRICE DISPERSION

Still further evidence of competition within the industry is the difference among companies in net cost for a given insurance policy. Net cost is the closest life insurance equivalent of price. In the TNEC investigation it was brought out that for 197 companies studied there were 163 different net costs for a 20 payment life policy issued at age 35. Such a wide price dispersion is definitely not characteristic of monopoly pricing.

Thus, in summary, the freedom of entry in the life insurance industry, the above average growth in the number of companies, the increasing share of the smaller companies, the dynamic shifts in industry leadership, and the wide dispersion in prices conclusively demonstrate the competitive nature of the industry.

## IX

### LARGE SIZE AND INEFFICIENCY—DIMINISHING RETURNS?

In recent years there has grown up in some quarters the belief that large companies are inherently inefficient relative to smaller companies. A good part of this has been due to TNEC *Monograph No. 13*,<sup>9</sup> prepared by the Federal Trade Commission, with reference to this subject. This Monograph has been the subject of

<sup>9</sup> FEDERAL TRADE COMMISSION, *RELATIVE EFFICIENCY OF LARGE, MEDIUM-SIZED, AND SMALL BUSINESS* (TNEC Monograph 13, 1941).

vigorous criticism by well known statisticians. For example, John M. Blair<sup>10</sup> derived exactly opposite results from the same data used by the F.T.C.

The most recent study of the question is that of Richard C. Osborn. With regard to the TNEC *Monograph No. 13*, he states:<sup>11</sup>

Not only did the data used represent a conglomeration of materials, but they were treated in such a manner to raise serious doubts as to the validity of any results accruing therefrom. . . . Unfortunately, the Federal Trade Commission did not make any attempt to fulfill the requirements necessary for valid cost studies . . .

Osborn concluded from his study<sup>12</sup> that "there is not a clear case for either side. Certainly the evidence is of neither such bulk nor such quality as to establish the greater relative efficiency of medium size or smaller firms."

Another recent study<sup>13</sup> which examines the relationship between corporate size and profitability reaches the same general conclusion<sup>14</sup>—"Our general conclusion, from a more extended analysis which will not be reproduced here, is that for our selected sample there is no significant simple association of firm size with profit rate. . . ."

## X

### LIFE INSURANCE SIZE AND DIMINISHING RETURNS

If the study of cost in relation to size has been inconclusive to date with reference to manufacturing concerns, it is even less conclusive with reference to life insurance companies, for no worth while study of this subject has yet been made. Furthermore, a study of this nature would be fraught with such difficulties that worth while results may never be obtainable.

Nevertheless, several general considerations lead one to believe that the concept of diminishing returns is much less applicable to the insurance field than to extractive and manufacturing enterprise.

The concept of diminishing returns evolved early in economic theory. It was first applied to land and can be summarized as follows. In a given state of the arts, after a certain point has been reached in the utilization of land, increasing applications of labor and capital to land will yield progressively smaller increases in product. This concept was later extended to extractive and manufacturing industry. Two important factors were indispensable in this theorem: (1) one factor of production, whether it be land, labor or capital, was kept fixed while the others were increased; and (2) technology was postulated as constant.

Apparently in loose reasoning this concept of diminishing returns has been the basis for the conclusions reached in some quarters that the large size of leading corporations necessarily leads to increased costs—*i.e.*, diminishing returns.

<sup>10</sup> *The Relation Between Size and Efficiency of Business*, 24 REV. ECON. STATISTICS 125-135 (1942).

<sup>11</sup> *Efficiency and Profitability in Relation to Size*, 29 HARV. BUS. REV. 82, 84 (1951).

<sup>12</sup> *Id.* at 85.

<sup>13</sup> Bain, *The Relation of Profit Rate to Industry Concentration: American Manufacturing 1936-40*, 65 Q. J. ECON. 293 (1951).

<sup>14</sup> *Id.* at 322.

The insurance business, as in the case of any financial business, is not concerned with three major factors of production in the sense that manufacturing enterprise is. Labor is the primary factor; land and capital are of relative insignificance. Consequently, the interaction between these three factors, basic in the concept of diminishing returns, is present here in only a limited sense. Furthermore, there is no fixed supply of one factor with which to contend. Consequently, purely from a theoretical point of view one would expect the application of the concept of diminishing returns to be of considerably more limited significance in the case of life insurance companies, than in the case of manufacturing enterprise.

Consider the nature of the life insurance business. There are four primary activities of a life insurance company—namely, (1) actuarial, (2) agency or selling, (3) underwriting, and (4) investment. Other activities are largely of a supplementary nature to these primary functions. In the case of the small or medium sized company, the same actuarial and investment problems are faced as in the case of the large company, and these problems are by no means proportionately magnified as the size of the company increases. There is theoretically no greater actuarial work involved in getting up a rate book for a large company than for a medium sized company. Similarly, a decision to make a bond investment of \$1,000,000 for a company with \$300,000,000 in assets involves just as much work and responsibility as an investment of \$30,000,000 for a 10 billion dollar company.<sup>14a</sup> On the average, the medium sized company may make just as many bond investment transactions during the year as the large company, and the investment staff required by the large company is by no means proportional to the size of its investment portfolio. Furthermore, the large companies, despite the large amount of funds which they have to invest, have not experienced undue difficulty in investing their funds. For example, the gross rate of return earned on its assets by the largest company has in most years been above that of the industry in general.

From either an actuarial or investment point of view there appears to be no necessary tendency toward diminishing returns. From an agency or underwriting standpoint the same problems exist for both the large and small companies, but there is a much more direct relationship between the size of the company and the workload in these functions. The same is broadly true of the other supporting activities of a company.

The only basis for a contention of diminishing returns in life insurance would have to center about the problems of supervision and administration of personnel. There is no problem of physical production, such as is the case in manufacturing industries, with the consequent necessity for co-ordinating men and plant and equipment, not for one item but for perhaps several hundred items; there is no problem of inventories, and rapidly fluctuating prices and markets. A host of problems which

<sup>14a</sup> As a matter of fact, in the case of a direct placement, a smaller direct placement to a smaller, lesser known, corporation should involve greater work than a larger one to a well-known corporation.

beset the manufacturing or trading enterprise are simply not present in the case of a life insurance company.

Therefore, in attempting roughly to measure whether life insurance companies have reached a size which necessitate increasing costs, the best criterion to measure the size of the problem of management is the number of personnel which has to be administered. *The size of the company in terms of dollar assets has little, if anything, to do with any tendency toward diminishing returns*, except as it is reflected in personnel. In this respect some comparisons can be drawn which should serve to deflate any conception of mammoth size of life insurance companies, and consequent inherently increasing costs.

Take, for example, a company such as General Motors; surely no one conversant with the facts would call General Motors an inefficient high-cost producer. Yet it has truly tremendous problems of management when compared to those of a life insurance company. Consider that it manufactures and distributes throughout the United States and, in many cases, throughout the world, not alone 5 makes of passenger cars, but, likewise, trucks and busses, diesel locomotives, refrigerators, automatic washers, freezers, all types of heating equipment, airplane engines, air conditioning equipment, and a host of other products. In managing this enterprise, the management must administer and supervise approximately 350,000 employees. Compare these problems to those of a life company with a relatively homogeneous product, where the largest company has total employees, both home office and field, of 46,000, and where the *entire* life insurance industry of over 600 companies has fewer employees than this one industrial enterprise. Other examples can be cited such as General Electric with 207,000 employees, Standard Oil of New Jersey with 120,000 employees, etc.

Further, to take a case where problems likewise are primarily of an administrative nature, consider the Post Office Department with over 500,000 employees, the Veterans Administration with almost 200,000, the Army, Navy and Air Force with civilian employment of about 900,000, the Department of Agriculture with 86,000, and the Treasury Department with 89,000.<sup>14b</sup>

There simply does not seem to be any *prima facie* reason why life companies under good management have reached a size where diminishing returns necessarily follow.

As further evidence of the same point, an examination of the net cost data of the various companies, with all its admitted deficiencies as a yardstick, nevertheless discloses no tendency toward increasing cost with size.

## XI

### LIFE INSURANCE AND ECONOMIC POWER

Another charge frequently made in investigations is that the life insurance companies have too great economic power and this power is usually attributed to the

<sup>14b</sup> Figures as of June, 1949. STATISTICAL ABSTRACT OF THE UNITED STATES (1950).

investment side of the business. The most recent such charge was made by Adolph A. Berle in an address made before the Life Insurance Association in May of this year.<sup>15</sup> It would, therefore, appear timely to examine Berle's argument in this connection.

In this paper, Berle's main thesis is that a revolution has taken place in this country shifting economic power from the hands of the government to the hands of the insurance companies.

Thus, he writes:<sup>16</sup>

An issue was joined as to management of the monetary and credit policy of the U. S. This substantially since 1933 had been held by the political government at Washington and administered by the U. S. Treasury in loose but substantial cooperation with the Federal Reserve Board. A substantial body of outside opinion came into opposition. It was chiefly expressed by some of the commercial banks, and almost unanimously held by the great life insurance companies. Their precise complaint was that the Federal Reserve was pegging the long term government bond market and maintained a government long term interest rate at approximately 2½% with short term rates correspondingly lower. This, the opposition maintained was inflationary; higher interest rates were indicated and would exist in a free market. Consequently, the Federal Reserve was increasingly called upon to buy governments thereby increasing the supply of cash and bank credit to or beyond the inflationary point. . . . The Federal Reserve Board was brought into sympathy with this view and found itself in opposition to the Treasury. Agreement was ultimately reached . . . making it clear that the view of the life insurance companies had prevailed. . . . For practical purposes *from March 1951 onward a new focal point of determining American economic policy had been established. Economic initiative came to rest in a concentrated<sup>17</sup> group of companies capable of determining policy. . . . The great institutions who have and must invest enormous capital funds<sup>18</sup> have the substantial power in their hands to determine the long term interest rate for capital in the U. S.*

It is almost unbelievable that a well informed person such as Mr. Berle could come to the conclusion that economic power of the nation has now become centered in the life companies, and that they had the power to set interest rates. Such a statement could hardly be further from the truth.

It is perfectly true that the life insurance companies argued strongly against the artificial and inflationary pegging of Government bonds; so also did practically every financial institution and an overwhelming majority of economists; so too did

<sup>15</sup> Address before the Spring meeting of the Life Insurance Association of America, Virginia Beach, Va., on May 25, 1951.

<sup>16</sup> *Ibid.*

<sup>17</sup> In discussing concentration, Berle states that in 1948 70% of life insurance assets were in the hands of 10 companies, and the percentage is not diminishing. This statement is not in accord with the facts. In 1948 the largest 10 companies held 67.7% of the industry assets; this figure has declined steadily from a figure of 79% in 1900 to 67.7% in 1948. Since 1948, this figure has declined further to 66.9% in 1950.

<sup>18</sup> In characterizing the funds which the insurance companies have to invest as enormous, Berle uses a gross figure for such funds which is clearly inflated and has little significance. This gross figure, for example, include switches from one security to another. As a specific example of the distortion which can arise from the use of this figure, the exchange of long-term government 2½s into non-marketable 2¾s in accordance with the Treasury offer in March 1951 will be included in the gross figure for 1951, and inflate it by approximately 3 billion dollars.

the statesmanlike committee of Senator Douglas on monetary policy. In fact there was extremely little defense of the policy outside of the Treasury Department. By all odds the most powerful and influential opponents were the Federal Reserve Board, particularly its chairman, Thomas McCabe, who will probably never receive due recognition for his self-less statesmanship in this respect, and the respected Douglas Committee. It would certainly have been a feather in the cap of the insurance companies if they could claim credit for having caused this change in policy. The facts indicate otherwise, however.

The actual force of events—the surge of inflationary forces unleashed after the Korean outbreak, which led to one of the most rapid price rises in our history—this caused the policy to be changed for it created a genuine fear on the part of the Government as to what would happen if the policy did not change, and this fear enabled the Federal Reserve Board finally to win its point of view, a point of view for which it had been arguing not just at this time, but over a long period of years.

A second misconception of Berle is that the reasoning of the Federal Reserve and other opponents of Treasury policy was to increase interest rates in order to check inflation. This was definitely not the reasoning; the Federal Reserve placed no great faith in a rise of interest rates by itself to curb inflation; what the Federal Reserve wished to do was to be able to restrict effectively the availability of credit, and as a result of steps taken to do this, higher interest rates resulted. Thus, higher interest rates were not the primary consideration; they were a by-product.

Furthermore, even under the assumption that the Government had bowed out of the interest rate picture, and left it to free market forces, it is nevertheless still completely unrealistic to conclude that under these circumstances the life insurance companies would have the power to determine interest rates. Even the most elementary economic reasoning would contradict this conclusion. The life insurance companies represent only a *portion of one side* of the market—namely, the supply side. The other and more important side of the market is the *demand* side for funds. The supply side of this market plays a more passive role in the determination of interest rates than the demand, because the supply is much steadier than the demand. Thus, money for investment flows rather constantly into the life insurance companies, and is invested just as constantly, for as a matter of policy, they do not build up large cash balances. The demand for these funds in the form of mortgages, corporate bond issues, etc., fluctuates widely from year to year; consequently, the demand side is a more dynamic factor in the determination of interest rates.

Moreover, on the supply side there is active competition for investments not only among the various life insurance companies, but also between the life companies on the one hand, and the savings and loan associations, the mutual savings banks, the commercial banks, the trust companies, and the pension funds on the other. Not only is there competition among investors for desirable investments; there is also a considerable difference in investment policy and opinion from one company to



another and from one institution to another. As a concrete example, the buying interest of the big 5 life insurance companies is not at all necessary to the success of a bond offering, even though the offering is of large size. The most recent large corporate offering at this writing is the \$20,000,000 issue of Southern California Edison bonds; this issue was priced to yield 3.01 per cent—the lowest yield for this quality bond for some months, and a yield which most insurance companies apparently did not find attractive because life insurance buying of the issue was negligible in amount. None of the leading life companies bought the issue. Nevertheless, even without life insurance buying, the issue was a definite success—selling right out, as a result of the buying on the part of trust companies, savings banks, and pension trust funds. This is not an isolated case; it happens with frequency, and numerous similar instances could be cited. It clearly demonstrates the competition within the market.

The market currently and for the past few months has been more nearly a "Free Market" than it has been since 1933; this has been true because a free market under inflationary conditions has suited the purpose of the Federal Reserve. Given a change in business conditions and the Federal Reserve would quickly re-enter the market and demonstrate its control actively. Nevertheless, even without such control, if business should decline as it is apt to do after the first half of next year, the demand for funds would likewise decline and life insurance companies, or any other investing institutions, would be *powerless* to check or prevent a consequent decline in interest rates. This is as certain to follow as it is certain that night will follow day. We have even seen these forces at work within the past two and a half months. With the Federal Reserve completely out of the market, nevertheless a very slight easing of the demand-supply relation in the market has brought about a very considerable easing of interest rates. Thus, toward the end of June "A" rated corporate bonds were coming out at a yield of 3.62 per cent; in September these bonds were successfully offered at 3.12 per cent basis, a drastic change over so short a period. Two months later these issues were back to a 3.50-3.60 basis. Certainly, this does not bespeak control over interest rates by life insurance companies, or any other financial institutions.

## XII

### INSURANCE SIZE AND DIRECT PLACEMENTS

Another aspect of the investment side of life insurance which has been subject to frequent government attack has been the question of direct placements (frequently called private placements). This attack is along two lines. The assertion is made (1) that direct placements benefit the giant corporations, and are not available to the small borrower who is elbowed aside, and (2) that direct placements benefit the large insurance companies and are not available to small insurance companies. Both of these allegations are dealt with in considerable detail in a previous article of mine,<sup>19</sup> and will only be touched upon here.

<sup>19</sup> *Direct Placements*, 6 J. FINANCE 85-118 (1951).

As far as direct placements benefiting the giant corporations only and being unavailable to the small corporations, this assertion simply is not true. The fact of the matter is that there is some reason to question the benefit of direct placements to large corporations, but for the small well-established business the benefit of direct placements cannot be gainsaid. As a matter of fact, the greatest single contribution of direct placements has been in opening up a new and, in many cases, the only avenue of long-term financing to the small established business. The large corporations always have the ready and inexpensive alternative of a public offering; to small corporations the public markets are often unavailable, and when available are excessively costly. Of the total estimated number of industrial direct placements in 1949, approximately 25 per cent were for amounts less than \$500,000, Contrast this with the picture of public offerings where for the three year period 1945-47 only 2 bond issues of less than \$500,000 were offered publicly.

As for the second point, that direct placements are not available to the small insurances companies, there is considerably more merit in this contention. Public utility bonds and railroad bonds are primarily publicly offered and thus available to even the smallest investor; mortgages are likewise available freely to such an investor. In the case of industrial issues this is not the case, for practically all industrial issues are directly placed. The very small insurance company is unable to participate in such direct placements due to the very small unit size of its typical purchase, and the impracticability of setting up an adequate staff to make direct placements. This is a significant problem within the industry, and one which is receiving increasing attention. It should not be overemphasized, however, for the small insurance company has not faced any above-average difficulty in investing its funds profitably in the past, nor is it likely to do so in the future.

### XIII

#### REGULATION OF LIFE INSURANCE

The institution of life insurance partakes a great deal of the nature of a trusteeship; as such, the life insurance companies bear a heavy load of responsibility to their policyholders and the public. This has long been recognized within the industry, and is fully reflected in the regulation of the industry by public authority. The average person, however, is unaware of the extent to which the activities of life insurance companies are supervised and regulated. Life insurance is probably more closely supervised by regulatory authority than any other industry, with the possible exception of banking.

This supervision is exercised by state regulatory authority. A high degree of uniformity is achieved by the National Association of Insurance Commissioners, a body comprised, as the title indicates, by the Insurance Commissioners of the various states, and designed to coordinate regulation among the states. Thus, through the auspices of this body, each insurance company files uniform reports concerning its assets, liabilities, income, and expenses.

A further factor tending toward uniformity of regulation is the fact that an insurance company domiciled, say in Iowa, and wishing to conduct business in another state must conform substantially to the regulation standards of that state. In this way, especially for those companies doing business on a nationwide basis, the regulations of the strictest states tend to govern. New York State insurance law has had wide influence in this respect, since companies doing business in New York hold well over four fifths of all United States companies' assets.

Regulation deals with every aspect of the life insurance business. The amount of insurance which can be written is subject to broad regulation; the expenses which can be incurred for agents' compensation, for total agency expenses, and for total over all company expense, are controlled. The amount of surplus which can be accumulated is regulated; likewise, the actuarial basis for valuation of liabilities has to meet minimum standards; investments are closely regulated and supervised.

For regulatory purposes the United States is divided up into 6 area zones by the National Association of Insurance Commissioners. Each zone has a chairman. Every insurance company is examined at least once every 3 years. The examinations are conducted by the insurance department of the state in which the company is domiciled, together with representatives from the zones in which the company operates.

In general, the main purpose of such an examination is to inform the public and supervising officials of various states relative to the progress and management policies of the company, its internal management and plan of operation, the soundness of its investment policy and agency organization, the nature of its policy contracts, its treatment of policyholders, the nature and accuracy of its accounts and records, the value and diversity of its assets, the adequacy of its reserves, and its ability to meet all future policy obligations with an adequate margin of assets in excess of liabilities for contingencies that may arise.

These examinations are not cursory in character; they are very thorough. Some conception of this thoroughness can be gained by the length of time required by the examination. The examination of the largest companies, for instance, takes about a year and a half every 3 years. Thus, on the average they are undergoing examination approximately half of the time.

This system has been tested and tried, and has proved its merit. One indication of its effectiveness is the unparalleled safety record of life insurance. During the great depression, for example, when failures of virtually all other types of institutions were widespread, less than 1 per cent of life insurance assets were impaired by virtue of liens, and these liens have since been reduced to negligible proportions. Moreover, even where liens existed, death claims were honored in almost all instances. Further evidence of the soundness of the system of regulation is indicated in the excellent showing which the industry made in the TNEC investigation; in the words of the chairman of that investigation "Life insurance came through with flying colors."

## CONCLUSION

In my opinion the following conclusions may be drawn with respect to the questions which have been considered in this paper.

(1). Savings in our economy have shown no long-run tendency to rise as a percentage of income.

(2). Savings in the form of life insurance for the past two decades have shown no tendency to rise as a percentage of total savings.

(3). The life insurance industry has shown tremendous growth over the past 100 years.

(4). Over the past two decades the life insurance industry has lagged behind the rest of the economy, so that far from the industry having grown to too great a size, considerably greater insurance protection is needed than now exists.

(5). The concentration of assets in the largest companies in the life insurance industry is no greater than for industry generally.

(6). The trend in the insurance industry has been toward a lesser concentration of assets over a long period of time.

(7). The insurance industry is not monopolistic in character; there is freedom of entry and active competition.

(8). There is no evidence available, whether empirical or theoretical, that the large insurance companies have reached a size which necessarily leads to higher costs and lower efficiency.

(9). There is no evidence available that the life insurance companies wield substantial economic power.

(10). The life insurance industry has a great responsibility to its policy-holders and the public.

(11). Reflecting this responsibility, well recognized within the industry, life insurance is subject to probably closer supervision by regulatory authority than any other industry, with the possible exception of banking.

(12). The excellent record of the life insurance industry testifies to the soundness of the industry supervision, and enabled it to come through the TNEC investigation in the words of the chairman of the TNEC "with flying colors."