CORRESPONDENCE

Dormans, Boxgrove Avenue,
Guildford,
Surrey, *5th September* 1955.

The Editor,
T.F.A.

Dear Sir,

On reading with great interest the valuable paper on with-profits pension schemes by Elphinstone and Melton and the equally valuable discussion thereon, I am left with the strong impression that there still remains an unwillingness to accept the vital logical distinctions between with-profits and without-profits business in relation to changing rates of interest, investments and paid-up policy options. May I, therefore, in as simple terms and as shortly as possible, express the position as G. V. Bayley and I see it ?

For without-profits pensions business the grave danger is a prolonged period of such a low rate of interest as will make the guaranteed premium rates unprofitable. To attempt to hedge against this by the process of investing overlong (on Redington's " total immunisation " plan) is usually impossible for pensions business, although growth equities at exceptionally low current yields and ground rents with valuable ultimate reversions might help. There is really no practicable hedge against cheap money. On the other hand, when interest rates rise the exercise of full paid-up pension rights would not produce a loss if the investment position is not over-long, but there might be switching to obtain better terms for future premiums. To impose a penalty on conversion to paid-up policy in these conditions is only a gambler's *quid pro quo* for a different kind of loss in the reverse conditions of low interest rates and provides no kind of safeguard against the real dangers of guaranteed without-profits rates. Moreover, the collection of high premium rates on existing business (in the face of reduced premiums for new schemes) and the emergence and retention of large interest profits could not continue for long ; adjustment of future premiums or benefits or both would be inevitable. That this would be so is suggested by the history of industrial assurance and would at once become apparent if any favourable change in the tax law of annuity funds is enacted. Even the gambler's *quid pro quo* may thus be largely illusory.

The position for with-profits business is entirely different. A prolonged period of low rates of interest is catered for by the future

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bonus loadings. A change to high rates of interest should be reflected by improved bonuses from the higher investment income from new investments. Attempting to invest over-long would be unnecessary and, in fact, very unwise—" paid-up immunisation " would be ideal —and full paid-up values could be granted without danger. Switching should then provide no advantage.

The impression gained from the paper is that too much emphasis is laid on the " bonus reserve " as defined in the paper (i.e. bonus loadings received less value of bonuses already cashed or existing as guaranteed benefits) as if this relatively small amount is required to offset the combined effects of switching in times of high interest rates and of an unsuitable investment policy. The real protection of with-profits business lies in the *future* bonus loadings as an offset to low rates of interest. I cannot pursue here the related questions of valuation and bonus policy (or indeed of the bonus system itself), but I hope that I have made clear the reasons why Bayley and I think that certain ideas and justifiable fears relating to without-profits business have no place in relation to with-profits business which after all is the only sound foundation for life assurance and deferred annuity business by periodical premiums in variable conditions.

Yours very truly,

WILFRED PERKS.

28 St. Andrew Square,
Edinburgh 2, 11*th November* 1955.

The Editor,
T.F.A.

Dear Sir,

With reference to my letter of 13th September 1954 (*T.F.A.* 23, page 82) the table herewith gives the percentages invested in various classes of security as at 31st December 1954 by the ten life offices in respect of which similar figures were given in the appendix to Mr. A. C. Murray's paper " The Investment Policy of Life Assurance Offices " (*T.F.A.* 16, page 263). The percentages as at 31st December 1953 are given for comparison.

Yours faithfully,

C. M. GULLAND.

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