VALUATION OF INVESTMENTS

BY

JOSEPH J. MAGRATH

The valuation of investments has always been a subject for discussion in financial and business circles. The insurance world has devoted considerable attention to this question particularly during depression years when security markets have become unbalanced. This paper will treat chiefly with developments in the establishment of "Convention valuation of securities" for the insurance business during the period, from 1931 to 1933 inclusive.

History of Convention Values

The National Convention of Insurance Commissioners is a voluntary association for the interchange of views among state officials charged with supervision of the insurance business. Improved standards for the conduct and supervision of the business are among the objectives of the convention.

During the 24 years which preceded the current series of convention values, i.e., 1907 to 1930, the National Convention of Insurance Commissioners approved a standard of valuation, other than current market quotations for seven of these years. These years and the values approved were as follows:

1907—Market quotations as of the first day of each month and the last day of the year, totalled and divided by thirteen.

1914—Values as of June 30, 1914.

1917—Market Values November 1, 1916, February 1, May 1, August 1, and November 1, 1917 totalled and divided by five.

1918—Add 1917 Convention values to November 30, 1918 market values and divide by two.

1919—Add 1918 Convention values to November 1, 1919 market values and divide by two.

1920—Add 1919 Convention values to November 1, 1920 market values and divide by two.

1921—Add 1920 Convention values to November 1, 1921 market values and divide by two.

In 1907 when the matter of departing from market quotations of securities for annual statements as of December 31st was first presented, the then Superintendent of Insurance of the State of New York submitted this question to the Attorney General, "Is it necessary that the Superintendent be confined to the market quotations of that particular day?"

The opinion furnished was expressive as well as conclusive: It reads, "It is not prescribed in said section (referring to the statute) or elsewhere in any statute of the state that the Superintendent of Insurance shall appraise the securities enumerated in such annual statement at the market value prevailing on any specified day."

"If you were required to arbitrarily appraise values prevailing in the market on December 31, such practice might result in an appraisal widely at variance with the fair market value. Extraordinary circumstances such as reckless manipulation of a security, stringent monetary conditions, or panics might create a price at such a low level as to be utterly inadequate to indicate its actual market value. On the other hand, uncommon situations in the market might cause an extravagantly high market price, one far in excess of its fair or actual market value, as for instance, a few years ago when by some particular process familiar to the security markets, a market price of $1,000.00 a share was created for a brief period of time for the shares of a security of a much lower valuation. The price thus briefly sustained was subsequently recognized as being about seven times greater than the fair market value."

"If an insurance company were the holder of such stock, and the price of $1,000.00 per share temporarily prevailed to December 31st, it could not be fairly contended that the Superintendent of Insurance would be justified in appraising the value of such stock at $1,000.00 per share."

In December 1930 the question of convention valuation of securities for annual statements of that year was brought before the convention. After due consideration of the subject, however, the convention made no recommendation for such action and the convention valuations book was published with market quotations of December 31, 1930.

At Portland, Oregon, in September 1931, the convention committee on "Valuation of Securities" reviewed market conditions and appointed a sub-committee to continue the study and make recommendations to the December meeting.

Market Conditions

For some time prior to the convention action on valuations in December 1931 the security markets had fluctuated violently. Let us trace these markets from 1926, which has been commonly considered a normal year, to 1931 when the current series of convention values began.

The stock price indexes used herein are weighted to the number of shares outstanding and corrected for changes in par value, stock dividends, rights, etc. The scope of the statistical base is reliable since it embraces stocks of approximately 400 corporations having over ½ a billion shares outstanding with a market value on the first trading day of 1926 aggregating over 33½ billions of dollars as compared with the total market value of all stock on the New York Stock Exchange of less than 34½ billions of dollars. The values shown are in relatives of 100 for the year 1926.

Stock Price Averages

	1926	1927	1928	1929	1930	1931
January	101.8	105.6	134.4	185.2	156.3	112.3
February ...	101.8	107.9	132.3	186.5	165.6	119.8
March	95.8	109.1	137.9	189.1	172.4	121.6
April	92.9	111.1	145.9	186.6	181.0	109.2
May	93.2	114.2	152.1	187.8	170.5	98.0
June	97.2	115.4	145.3	190.7	152.8	95.1
July	100.0	117.2	144.2	207.3	149.3	98.2
August	102.9	122.0	148.3	218.1	147.6	95.5
September ..	104.3	127.7	156.6	225.2	148.8	81.7
October	101.6	126.7	159.1	201.7	127.6	69.7
November ..	103.1	129.6	171.1	151.1	116.7	71.7
December ...	105.4	133.1	171.4	153.8	109.4	57.7
Yearly low..	90.8	104.7	130.3	140.3	105.5	54.7
Yearly high.	106.5	134.1	178.9	228.1	184.2	124.6

The manner in which the stock market boom accelerated is brought out in the ratio of increase in each year from 1926 to 1929. The market was fairly stable during 1926 with only a slight setback during the months from March to June, and the maximum fluctuation from the low to the high of the year was 17% of the low.

During 1927 the market boom got under way and the maximum fluctuation increased to 28%. The results of 1928 were a repetition of those for 1927, with the fluctuation increased to 37%.

The year 1929 must be considered in two parts,—before and after the crash. From January to September the market rose 45 points or 25%. From the high of September to the low of November the market dropped 88 points, or a loss of 38% from the high.

The precipitate plunge of the stock market, from an index of 228 in the third week of September to an index of 140 in the second week of November 1929, was checked and the market rose, reaching 184 in the second week of April 1930. Up to this point, 55% of the values lost in the first market break had been recovered and the market was back to about where it had been during the first half of 1929.

By the fourth week in June 1930 the market had dropped again to 140. It recovered to 153 in the fourth week of July and then dropped to 105 in the third week of December. The loss from the high point to the low point of 1930 represented a shrinkage of 43% of value. The closing values of 1930 were approximately the same as those of 1926.

It might be pertinent to observe at this point that the action of the convention, in withholding action on the establishment of values other than as reflected on the exchanges for annual statements as of December 31, 1930, was warranted by the fact that market values had at that time simply returned to the pre-boom level.

In the beginning of 1931 values recovered somewhat and the index for the last week in February was 125. This value dropped to 90 in the first week of June and then recovered to 103 in the fourth week of June.

While the convention was in session in Portland, Oregon, September 14th to 17th, 1931 the stock market broke to a new low record for a seven year period. The index showed at 81.

During the deliberations of the Committee on Valuation of Securities and its sub-committee appointed to study the valuation problem, the market had continued to break and registered an index of 61 when the convention assembled for its December 1931 session. By the end of that year the index had dropped to 55. From the beginning to the end of 1931 market values had dropped 52 points representing a shrinkage of over 48%.

The bond market had not boomed nor had it deflated as severely as the stock market but it nevertheless presented a serious problem of valuation. Representative long term bonds paying 5% interest had a market price range as shown below:

BOND PRICE INDEX

	High	Low	Range
1926	99.1	95.3	3.8
1927	102.3	99.4	2.9
1928	102.4	99.1	3.3
1929	99.9	96.3	3.6
1930	101.9	92.6	9.3
1931	98.7	68.5	30.2

When the convention assembled on December 7-9, 1931 the bond market ranged between values of 75 and 76 representing a loss of about 25% from par value. The year closed with a bond index of 72½. The maximum fluctuation for the year exceeded 30 points and the change between 1930 and 1931 annual statement dates amounted to a loss of 23 points. Even U. S. Liberty bonds were off 7.6 points from the previous year's close.

About this time insurance company investments other than bonds and stocks began to congeal and become frozen for lack of a ready market.

CONVENTION ACTION

The Committee on Valuation of Securities of the National Convention of Insurance Commissioners recommended to the meeting of that body on December 8, 1931 the use of a basis of valuing securities by a means other than that represented by the then disorganized security markets.

The resolution presented by the committee chairman, Superintendent of Insurance for the State of New York, George S. Van Schaick, follows:

> "*Whereas,* exceptional fluctuations of value of stocks and bonds as reflected on the exchanges have led to the inquiry as to whether the market price quotations for stocks and bonds on any particular day are indicative of the fair market value of such securities; and
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> "*Whereas,* under similar circumstances it has been the policy of the National Convention of Insurance Commissioners to indorse and recommend the substitution of the range of the market and the average prices thus found running through a reasonable period of time as a fair basis of market value of stocks and bonds;

> "*Resolved,* that the Committee on Valuation of Securities of the National Convention of Insurance Commissioners is of the opinion that under present conditions the market quotations on stocks and bonds for a particular day are not a fair standard for the ascertainment of a fair market value of such securities and recommends as a present substitute therefor the average price of stocks and bonds as reflected by the exchanges for a range of five quarterly periods ending September 30, 1931.
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> "*Further Resolved,* that since the fair average thus ascertained is approximately the closing price of securities on June 30, 1931, the prices of June 30, 1931 be taken as the fair market value during the current year and that such standard be accepted for the annual statements due as of December 31, 1931, except that securities should not be valued at more than purchase price if purchased since June 30, 1931.
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> "*Further Resolved,* that in cases where the condition of companies may require the immediate disposition of securities at present prices it is the opinion of this Committee that the discretion of a Commissioner of Insurance should be exercised to vary the general formula herein set forth so as to adopt the prices then reflected by the exchanges."
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> Supplementing the resolution as to market values of securities upon an average basis instead of the exchange quotations of December 31, 1931, it is further
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> "*Resolved* that in the valuation of bonds which have defaulted in principal or interest since June 30, 1931 and in the valuation of stocks and bonds of corporations in receivership since June 30, 1931, the convention value shall be the exchange quotations of December 31, 1931, instead of the average value as provided in the principal resolutions."

Following the reading of the resolution, Superintendent Van Schaick eloquently addressed the Convention on the subject. The following excerpts from his address are expressive of the thought with which the matter had been considered:

> "There is no magic in the day of December 31 of any particular year. It has grown up as a matter of custom, as a matter of convenience, and it is helpful to have all states adopt that as a day on which they will ascertain by reports of companies the financial condition of companies. There has never been any reason why the precise valuation of that particular day should be taken as above any other particular day. So far in normal times the matter has worked out well, arbitrarily taking that day as the time of valuation, but

> every time we get into a situation where the exchanges on a particular day do not properly represent the value, the real market value of a security, then the question has been presented: Is it necessary? Is it incumbent upon a Superintendent of Insurance, a Commissioner of Insurance, to tie up absolutely and completely to the amount reflected by the exchanges on that day, no matter how dark it may be or how buoyant it may be?"

Then after referring to the ruling of the New York Attorney General in 1907 he went on—

> "There is nothing really revolutionary about that because the policy of the law of all of our states had recognized for some time that it isn't the liquidation value of a particular day that is to govern. In the matter of bonds and mortgages which form the backbone of the investments of our great companies we know they are never valued except in the emergency as to what they can liquidate for on a particular day. If it were otherwise, where would we be in the matter of our mortgage securities at the present time, if the values which we would allow these companies to carry those securities at, were the value at which those would be listed on an exchange, if we had an exchange? The bottom has fallen out of the market for real estate mortgages more than it has on stocks and bonds and anyone who has real estate mortgages, if compelled to liquidate today, is in a more serious situation than though he held depressed bonds and stocks, because there is a market for one and there is not in many places a market for the other.
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> "The Banking Departments of our respective states, the Comptroller of the Currency of the United States, even the Treasury Department, have all recognized this in the matter of the valuation of bonds. Banks cannot sell bonds and liquidate on a particular day at the prices which their bonds are now carried at, either state banks or the national banks. Why? Because they are permitted to go along on the theory that this country is coming back and that those bonds are going to be paid. It isn't absolutely sure. Some of these bonds that are carried at a certain price at the present time may default. Nobody can be absolutely sure. It is only a matter of exercising one's best judgment in the matter of what valuation to put on these various securities.
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> "So your Committee felt that under the extraordinary circumstances that exist at the present time, not only in regard to real estate mortgages, not only in regard to bonds but also in regard to securities of every sort, it is only the fair thing, ascertaining the general condition of a company as a

> going concern, that we should permit a valuation fairly ascertained, to be used in the auditing of the annual statements that would not compel a needless loss upon the great mass of people throughout the United States.
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> "Your Committee was not unmindful of the fact that this convention owed a duty not only to the policyholders and to the companies, but also to the country at large. Looking ahead to December 31 none of us know what that day is going to bring forth—it may be the darkest day in the history of the United States, there may be a combination of circumstances, international and national and state and otherwise that we can't foresee, that may make that the lowest day that we have ever seen—yet, unless some action should be taken by this Convention, such as is proposed, we would be tied up in the dark here to a valuation that we know and everybody knows would not correctly represent fair market value. This might lead to disaster, a tremendous disaster.
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> "Of course, it would be a good deal easier for individual Commissioners to sit back and say, 'Play absolutely safe. We will do it one way because it has been done that way generally and we won't modify it.' That is all right, if any Commissioner must do it that way, or feels that he must, all very well, but it has seemed to your Committee that to do that is to lose sight of the great interests of policyholders generally, who are in these companies. To do that is to lose sight of the fact that we are part of a government where we ought to act prudently, but that we ought to do everything that we legitimately can to save the country when it is in distress; that this is only one of those steps that we are called upon to take, not that we welcome the situation, not that we like to have to deviate from the normal way of handling a situation, but that we feel there is an imperative duty at the present time to use common sense."

Opposition to the establishment of convention values was expressed by Colonel Howard P. Dunham, Insurance Commissioner for the State of Connecticut.

Excerpts from Col. Dunham's minority report follow:

> "I believe the State Insurance Departments have a definite obligation to their respective states and to the insuring public to carry out their duty to report to the public the facts in respect of insurance companies which are under their supervision. To use a basis of valuation for securities in excess of the current market value prevailing on the date as of which annual statements are formulated, would be mis-

leading and would constitute a breach of the obligations of our offices, and by such action we would lay ourselves open to criticism and perhaps legal action in the case of policyholders who are misled by statements approved by the insurance departments and who suffered loss due to inability of the companies to pay—said policyholders having been lulled to a sense of security by statements based on fictitious or unsound values of securities.

"I believe we would be treading on decidedly dangerous ground to approve an artificial valuation of securities at figures above the current market values, which is the basis the insurance companies must necessarily use when they turn their securities into cash to pay their obligations when they occur. The companies who are legitimately engaged in the insurance business who were not organized for speculative purposes are not in need of help and the artificial values you propose are for the weaklings only.

"The insurance companies of the country have been fortunate in that no serious conflagrations or epidemic has occurred during recent years. But a large catastrophe may occur at any time and in my estimation state insurance departments have no right to approve or invite false statements on the part of the insurance companies.

"The market values at a given time of stock (whether common or preferred) listed on the New York Stock Exchange can generally be taken to be the prices at which such securities were freely bought and sold at that date. Assets which have no quick market and evidences of debt may legally need to have the values at a given time otherwise ascertained."

Following a further extended discussion the resolution was put to a vote and passed with only three dissenting votes.

Referring to the stock and bond market indexes, we find the following facts pertinent to the convention action:

STOCK MARKET INDEX

Last week of September 1930	142.1
Last week of December 1930	107.6
Last week of March 1931	122.5
Last week of June 1931	103.2
Last week of September 1931	67.
Average of above indexes	108.5
Index of values adopted	103.2
Market quotations December 31, 1931	57.7

BOND MARKET INDEX

September 30, 1930	101.4
December 31, 1930	95.5
March 31, 1931	96.3
June 30, 1931	95.1
September 30, 1931	82.7
Average of above indexes	94.2
Index of values adopted	95.1
Market quotations December 31, 1931	72.5

The action on valuation of securities in 1931 was identical with that in 1914. In both cases the values used were those of June 30th of the respective years.

Convention Action in 1932

At the meeting of the Convention at Chicago on June 23, 1932, the following resolution approving the principle of amortization for bonds held by insurance companies other than life, which latter class already enjoyed the privilege, was adopted:

"*Whereas,* the market price of Government, State, Municipal and other amply secured bonds is widely at variance with their true value and intrinsic worth; and

"*Whereas,* for many years life insurance companies have been permitted to treat such bonds on an investment basis so as to reflect par at maturity, which policy has proved to be wise, safe and equitable to life insurance companies and to the public alike; and

"*Whereas,* many states permit such amortization of amply secured bonds by insurance companies other than life companies in the sound discretion of the Commissioner or Superintendent of Insurance whenever circumstances make such action appropriate;

"*Resolved,* that this Committee on Valuation of Securities of the National Convention of Insurance Commissioners hereby endorses and recommends to the National Convention of Insurance Commissioners the principle of the amortization of amply secured bonds for all types of insurance companies under proper conditions;

"*Further Resolved,* that, in the opinion of this Committee, present economic conditions make this an appropriate time for Insurance Commissioners and Superintendents to permit such amortization;

"*Further Resolved,* that this Committee endorses and recommends legislation which would permit such amortization for all types of insurance companies in the sound discretion of the Insurance Commissioner or Superintendent in states where such authority does not now exist."

The soundness of the principle of valuing bonds by the amortization method had been tested by life companies for a quarter of a century and provoked little debate in the convention or in insurance circles. It might only be subject to question where a company was so situated as to require a liquidation of its bonds to meet necessary payments.

Between December 31, 1931 and the time of the action on amortization, the bond market had suffered a further decline as indicated by the following indexes:

Some Bond Market Indexes in 1932

January 2, 1932	72.3
March 10, 1932—yearly high	78.1
June 1, 1932—yearly low	57.5
June 23, 1932	60.7
June 30, 1932	59.4

During the meeting of the National Convention of Insurance Commissioners at Dallas, Texas, on October 17 and 18, 1932 there was considerable discussion and several papers were read on the subject of Valuation of Securities. There was no formal action on the subject, however, by the convention.

The following excerpts from papers read are of interest:

Commissioner Kidd, of Indiana

"In providing a legal rule to be followed by Insurance Companies when listing, in annual statements, securities having no fixed term and interest rate, the two simple words 'market value' are employed by sixteen states. Eleven specify "current market value", six use the phrase "actual market value" while others call for "cash market value", "reasonable market value", "not above current market value", "reasonable cash market value" and "reasonable value determined by Commissioner." Boiled down, it appears that the several state law-making bodies had in mind a common purpose, adequately covered by the unqualified term 'market value'.

" 'Market Value' is that reasonable sum which the property will bring on a fair sale when sold by a man willing, but not obliged, to sell, to a man willing, but not compelled, to buy. Allen v. Chicago & N. W. Ry. Co., 129 N. W. 1094, 1095, 145 Wis. 263.

"Insurance is a business of deferred liabilities and in that particular is fundamentally different from any other line of commercial activity.

"Assuming that a company has ample liquid assets promptly to meet its current liabiilties, it seems to me that our chief concern is to determine the value that present assets will have at the time deferred or future liabilities mature.

"We likely would all agree that the immediate price one can secure in cash for an article offered at quick sale is its "liquidating value"; such as the price that can be had any particular moment for listed securities at the exchanges. It is my belief that liquidating values thus determined rarely reflect the "actual value", the "market value", the "actual market value" or the "reasonable market value" contemplated by creators of the various insurance statutes. Liquidating value may be higher or lower than true "market value". It depends largely upon the trend of the times, the urgency of the sale, and the amount of window dressing preceding the transaction.

"A typical example of preparing the public to absorb a large issue of questionable value is to be found in manipulations preceding the listing on stock exchanges of Insull Utilities Investment, Inc. in the early part of 1929. Some two hundred and five individuals known nationally and whose investment in any stock would attract numerous buyers, were allotted 250,000 shares at $12.00 each. In due season the public was permitted to "get its feet wet" and the public did get its feet wet—it jumped in up to its speculative neck and the stock soared to $149. In less than three years receivers were in charge and they now report the stock valueless.

Commissioner Dulaney, of Arkansas

"Market value, in both legal and common parlance, is the price at which one is willing to sell and another is willing to buy a given piece of property. The time and circumstances under which a sale is or must be made have much to do in determining the price, and often we think that the market price is fixed where one has to sell and another is compelled to buy. This is in the nature of a forced sale and not a true criterion."

Prior to the December 1932 meeting, conferences were held by staff members of the insurance departments represented on the Committee on Valuation of Securities. These representatives reported to the Committee a recommendation which was substantially to the effect that the values adopted for annual statements as of December 31, 1931 be continued for annual statements of 1932. Following consideration of this report, the committee, through its chairman, Superintendent Van Schaick, presented the following resolution to the convention on December 6, 1932:

> "*Whereas,* since the inquiry conducted last year by the National Convention of Insurance Commissioners as to whether market price quotations of stocks and bonds on any particular day are indicative of the fair value of such securities, exceptional price fluctuations of such securities on the exchanges have continued; and
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> "*Whereas,* close study of the range of markets over various periods, together with various tests as to the range of markets through times of prosperity and depression alike, up to and including September 30, 1932, leads to the conclusion that the real value cannot be definitely determined and that the Convention values of 1931 are indicative of a fair value of securities for inventory purposes at the present time; and
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> "*Whereas,* the trend of the markets indicates a situation that over a period of years normal market conditions may reasonably be anticipated, in which there will be willing sellers and willing and able buyers in the free rather than a forced market;
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> "*Resolved,* that the Committee on Valuation of the National Convention of Insurance Commissioners is of the opinion, that under present condition, the Convention values for stocks and bonds adopted for the annual statements due as of December 31, 1931, reflects fair value for the inventory of such securities in the annual statements due as of December 31, 1932, except as hereinafter provided, and that the same shall be adopted as the Convention values for 1932.
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> "*Further Resolved,* that in cases where the condition of companies may require the immediate disposition of securities, it is the opinion of this Committee that the discretion of the Commissioner of Insurance should be exercised to vary the general formula herein set forth so as to adopt the prices reflected by the exchanges.
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> "*Further Resolved,* that in the opinion of this Committee, securities should not be valued at more than the purchase price, if purchased since June 30, 1931, unless such purchase was in effect a bona fide exchange of securities, resulting in betterment of a portfolio, in which event the value herein

provided should be allowed but not so as to exceed the Convention value of the securities disposed of in connection with such purchases; and no such special value should be allowed unless such exchange is separately indicated in Parts 3 and 4, Schedule 'D', of the annual statement.

"*Further Resolved*, that inasmuch as a number of worthy industrial and commercial corporations are in emergency receivership and a number of corporate bonds are in default as to interest and/or principal by reason of lack of liquidity rather than by reason of lack of underlying value, stocks of corporations in receivership and bonds in default should be valued on the 1931 Convention basis less 30 per cent of the difference between such Convention value and the exchange quotation as of December 1, 1932, unless the value underlying such securities has been heavily depleted or has disappeared to such an extent that a lower value is required by reason of such special circumstances.

"*Further Resolved*, that in the application of this resolution, recognition should be given to the fact that Convention values as herein defined are based upon the range of the market and are subject to revision as the actualities of the market from day to day develop, and that it be recommended that companies set up voluntary reserves to be designated in the annual statements 'contingency reserves'. 'That at regular periods thereafter the actual market value of securities as reflected by the exchanges from day to day be averaged in so as to bring the range of the market used in accord with actual future developments, or that there be adopted some other method to accomplish such result, so that the difference between the Convention values as herein determined and the actual exchange quotations shall be absorbed over a reasonable period.'

"*Resolved*, that for 1932, this Convention hereby ratifies and confirms the action taken by its Committee on Valuation of Securities pursuant to the recommendation of the financial adviser to the Convention, with respect to moderate and reasonable adjustments in the 1931 Convention values for municipal bonds."

The resolution was unanimously adopted.

The underlying facts which led to the foregoing action deserve consideration.

The stock exchange quotations had dropped to panic price levels during the summer of 1932 and had not recovered sufficiently to represent reasonable values during the year. The following stock market indexes show the extent of the decline:

STOCK INDEXES IN 1932

Month of January 1932	58.0
Month of February 1932	56.5
Month of March 1932	56.8
Month of April 1932	43.9
Month of May 1932	39.8
Month of June 1932	34.0
Month of July 1932	35.9
Month of August 1932	53.3
Month of September 1932	58.2
Month of October 1932	49.9
Month of November 1932	47.5
Month of December 1932	47.4
Yearly low, week of June 29, 1932	32.3
Yearly high, week of September 7, 1932	64.1

The actions of the securities markets in 1932 were clearly indicative of the fact that they had ceased to be in any sense a barometer of fair values. The average stock values depreciated 44% from the January index to the index of the last week in June when the lowest ebb of the depression was reached. Then these averages leaped upward showing a 98% increase from the low point within a period of 2 months. From the yearly high in the week of September 7, to the last week in the year values dropped again losing 28% of the high.

Bond values were similarly unstable during 1932. In the less than three months from March 10th to June 1st the index dropped from 78.1 to 57.5 or a loss of 26%.

Let us now examine the statistics which the insurance commissioners had before them when they determined to continue the previous convention value, lest some may think the action was without reasonable foundation.

CONVENTION VALUE INDEX 103

Stock Exchange Index

December 31, 1921	59
December 31, 1922	71
December 31, 1923	70
December 31, 1924	83
December 31, 1925	101
December 31, 1926	106
December 31, 1927	134
December 31, 1928	178
December 31, 1929	151
December 31, 1930	108
December 31, 1931	55
September 30, 1932	58

Average Exchange Value

10 years 1922-1931	105
December, 1928 to 1931 and September 30, 1932	110
December, 1923 to 1931 and September 30, 1932	105
13 quarters ended September 30, 1932	109
Highest exchange value 3rd week in September, 1929	228
Lowest exchange value last week in June, 1932	32.5

It will be seen from the foregoing that the convention value index of 103 compares favorably with the average market quotations as of the ten preceding annual statement dates which was 105. It likewise was somewhat lower than the average index produced by the latest four years and the latest quarter which resulted in an index of 110. The same was true of the latest nine years averaged with the latest quarter, which indexed 105.

Another strange coincidence was that the values as of the latest 13 quarters averaged 109 or slightly over the convention value.

The next most important thing in the convention resolution was the manner of valuing stocks of corporations in receivership and bonds in default. This part of the resolution was in recognition of the fact that the market quotations no more represented the fair value of such securities than they did for other securities. With securities generally in little demand and commanding poor prices, it was quite evident that the stocks of corporations in emergency receivership and bonds in default would be grossly undervalued on the exchanges. It was therefore felt that a mark off of 30% of the depreciation from previous convention value to current market would leave a fair value remaining, except where property values had been heavily depleted. These latter securities were determined and valued on specific review at current market by the conventions investment counsel.

The supplemental resolution concerning municipal bonds resulted from a report by the conventions investment counsel that the values used for these securities in the previous year were not fairly representative of market values as of the date used by the convention.

Many municipal securities are rarely traded on the market so that it had become necessary to use considerable judgment. Counsel recommended a downward adjustment of approximately 10%.

Convention Action in 1933

No action was taken with respect to the valuation of securities during 1933 until shortly before the December meeting of the Convention. The procedure followed was similar to that of 1932 in the matter of determining what action should be taken.

A staff committee, selected from the departments represented on the valuations committee, studied the problems involved. Their recommendations were presented to the committee and subsequently to the convention in the following resolution:

> "*Whereas,* since the inquiry conducted last year by the National Convention of Insurance Commissioners as to whether market price quotations of stocks and bonds on any particular day are indicative of the fair market value of such securities, exceptional price fluctuations on such securities on the exchanges have continued; and
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> "*Whereas,* close study of the range of markets over various periods, together with various tests as to the range of markets in times of prosperity and depression alike up to and including December 1, 1933, leads to the conclusion that real value of securities cannot be definitely determined by the market price quotations of stocks and bonds on any particular day, and that the Convention values of 1932, adjusted to reflect the influence of market price quotations of 1933 in the degree hereinafter provided, are indicative of a fair market value of securities for inventory purposes at the present time; and
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> "*Whereas,* the trend of the markets indicates that over a period of time normal market conditions may reasonably be anticipated in which there will be willing sellers and willing and able buyers in a free rather than a forced market;
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> "*Resolved,* that the Committee on Valuation of Securities of the National Convention of Insurance Commissioners is of the opinion that the following basis of valuing stocks and bonds reflects fair market value for the inventory of such securities in the annual statements of insurance companies as of December 31, 1933, and recommends that same be adopted as Convention values for 1933:
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> 1. Stocks and bonds other than bonds of governments, states, and political subdivisions thereof, should be valued at the average of Convention values used for annual statements as of December 31, 1932, and market quotations of November 1, 1933, except as hereinafter provided.

2. Bonds amply secured and not in default should be valued on an amortized basis wherever permitted by law.
3. All bonds of governments, states and political subdivisions thereof should be valued at the Convention values used for annual statements as of December 31, 1932, except that where such bonds shall have been in default for a period longer than one year prior to November 1, 1933, the values to be used should be the Convention values used for annual statements as of December 31, 1931, less 30% of the difference between such values and the market price quotations on November 1, 1933.
4. The Committee on Valuation of Securities is authorized to modify the foregoing formula in cases where circumstances warrant.

*"*Further Resolved,* that the cost or book value of stocks, whichever is lower in the aggregate held by life insurance companies, as of November 1, 1933, may be used in the aggregate as the fair market value of such stocks, provided the income received by such companies on such stocks during each of the five years preceding the date of valuation shall have been at the rate sufficient to meet the interest required to maintain policy reserves and other policy obligations, and provided further that the net investment income received by such companies on their ledger assets shall not have been less than required to maintain the reserve. This shall not apply to stocks of corporations in receivership or similar status. Cost as used herein shall be held to include stocks received as exchanges or rights received as dividends or otherwise at not to exceed the market value quoted on the date acquired.

"*Further Resolved,* that in cases where the condition of insurance companies may require the immediate disposition of securities, it is the opinion of this committee that the discretion of the State Supervisory Officials of Insurance should be exercised to vary the general formula herein set forth, so as to adopt prices reflected by the exchanges.

"*Further Resolved,* that in the opinion of the Committee on Valuation, companies should be urged to maintain a reserve for contingencies to provide for fluctuations in the market price quotations of stocks and bonds not subject to amortization."

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*5. Bonds and stocks purchased, other than by exchange, since June 30, 1931 shall be valued at the market price quotations on November 1, 1933.

(Subsequently adopted by the Convention)

Developments in the security markets during 1933 were a decided improvement over those of the several preceding years. This might give rise to the question as to why the convention values were lowered at such a time with the market improving.

It is quite obvious that from June 30, 1931 which served as the basis for 1931 and 1932 convention values the markets had been steadily and consistently below the level of that date. Premium volume had fallen off in the companies so that deferred liabilities threatened to turn more current than had been the case theretofore. Companies had generally been able to retrench sufficiently so as to meet a more severe valuation test.

The following developments as to stock market quotations show the better trend in the market following the reopening of the banks of the nation:

STOCK INDEXES IN 1933

Last week in December 1932	45.7
Average for January 1933	49.1
Average for February 1933	44.9
Average for March 1933	43.2
Average for April 1933	47.5
Average for May 1933	62.9
Average for June 1933	74.9
Average for July 1933	80.4
Average for August 1933	75.1
Average for September 1933	74.8
Average for October 1933	69.5
Average for November 1933	69.1
Average for December 1933	70.4
Former Convention Value	103
Averaged with November 1, 1933 value of	65
Convention Index for 1933	84

Evidence of continued stability of values may be found by following the stock indexes for the first part of 1934. These are:

STOCK INDEXES IN 1934

Average for January 1934	75.6
Average for February 1934	80.5
Average for March 1934	77.1
Second week in April 1934	79.9

Municipal Bonds

Special consideration was given to the valuing of municipal bonds in item 3 of the convention resolution. This action was due to the fact that municipal bonds are considered prime securities even when of little demand in the markets.

Stocks Held by Life Companies

The provision for valuing stocks held by life insurance companies on the aggregate of book values, provided the earnings of such stocks covered the requirements of policy reserve interest, was an important new development. It was not undertaken with the thought that such investments were proper for life insurance funds but rather to meet a practical situation that merited the action taken. It is unquestionably sound theory that the fundamentals of life insurance demand (1) investments that might reasonably be expected to be sold in normal markets at investment cost and (2) investment earnings sufficient to meet reserve requirements. While the second requirement is the only one mentioned in the resolution it must be remembered that the period for testing this feature as set forth thereon is the most severe in the financial history of life insurance.

Convention Value Limitation

A stop limit was placed on the extent by which convention values would be permitted to exceed market quotations. Item 4 in the 1933 resolution refers to the authority of the Committee on Valuation of Securities to vary the general formula provided therein. This authority was exercised to limit the convention value to not exceeding twice the market quotation.

General Observations

The whole theory of establishing a value for securities, to be used for financial statement purposes, must be based upon the principle that exchange quotations do not invariably represent *fair* value.

Insurance companies are particularly well situated for valuing assets on a range of the market basis by reason of the deferred character of their liabilities and the rarity of demands for liquidation of any substantial part of their portfolios.

The provision, carried throughout the resolutions adopted by the convention, for adopting current exchanges on securities held by companies faced with demands for liquidation of assets covered the exceptional cases where the contrary is true.

The valuation program had its inevitable shortcomings. These may be listed as follows:

1. Insurance commissioners were slow to or neglected to require exchange quotations on companies in condition requiring liquidation of portfolios.
2. Poor distribution or diversification of investments resulted in more than average exchange losses and indicated a possibility of inadequate recovery over a future period.
3. Universal public confidence in the outcome was unattainable and led to loss of business by those relying heavily on Convention values.
4. Where loss of business was heavy it led to sacrifice of securities on bad markets in order to meet reserve liquidation.
5. Stocks of the highly speculative type enjoyed unwarranted advantages through receiving the same consideration accorded the less speculative issues.

When the issue is raised, however, there are few who will say that the benefits, resulting from the convention program of valuing securities, do not greatly outweigh the known and alleged disadvantages.

The convention is giving consideration to the question of whether or not a permanent plan of valuing securities held by insurance companies should be evolved. Those who hold firmly that the market of June 1932 was not a fair one, cannot avoid the conclusion that the same was true of the market of September 1929.

A permanent plan of valuation which would moderate the peaks and valleys of market values would tend to turn insurance companies from speculative stocks particularly during periods of high prices. Investment in bonds less susceptible to fluctuation would be encouraged. Asset deflation of a sudden character would not threaten the business. Paper profits would not encourage speculative development of insurance companies.

We may be thankful that the stock exchanges cannot be looked to for the valuation of all forms of assets and investments. The daily trading of speculators appears to reflect little as to the true values on any particular day but shows simply supply and demand frequently subjected to artificial manipulation. It is unfortunate that many people are difficult to convince of that fact.