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Fixing the Life Insurance Marketplace

"The life insurance market is characterized not only by an absence of reliable price information, but also by the presence of deceptive price information...the deceptive sales practices found in the life insurance industry constitute a national scandal." So testified Professor Joseph Belth, an expert on the life insurance industry, before Congress in 1973. Can this statement, from almost 40 years ago, still be as true today? And is it possible for such deplorable industry practices to be occurring without being in the spotlight of public attention?

The short answer is yes. To this day, the life insurance industry relies on inadequate product disclosure, misinformation and fraudulent practices, thereby costing consumers billions of dollars annually. The free market economic system is built upon there being informed buyers making educated decisions. Yet so many life insurance industry chieftains who regularly sing the praise of our economic system fail to acknowledge that their businesses have never satisfied the system's prerequisites or played by its rules.

Empirical proof of the life insurance market's dysfunction is readily apparent by examining the very products life insurers and their agents sell. While a select few cash-value life insurance policies can provide excellent competitive value, perhaps 95% of such policies sold provide value no informed consumer would accept. This marketplace's dearth of information also afflicts tens of millions of policyholders at annual renewal; if properly informed, millions of them currently could readily obtain much better value. Consumers of the industry's other main products, annuities and long term care insurance, also face enormous disclosure-related problems.

The root of the age-old problem is the inadequate disclosure of information surrounding cash-value policies, such as whole life policies, where the annual cost is not the annual premium. Professor Belth and I have both long recommended disclosure about a policy's annual costs and rate of return on its cash-values.

Belth, however, has reported: "One company executive told me that companies could not survive disclosure of yearly prices," and, "Yearly prices [of cash-value policies] are so revealing that the companies took extraordinary action to prevent disclosure of the information." While the first statement is clearly hyperbole, the second is practically an indictment of the state regulators, as they have never confronted such matters and fulfilled their regulatory duties.

A cash value policy's performance is a function of annual costs and annual compounding rates, as summarized for the 14th and 15th years of an actual $250,000 whole life policy with a $5,815 annual premium issued to a healthy 45-year-old male and where dividends had been retained in the policy growing the death benefit and providing a cash value at the end of the prior, 13th, policy year of $99,309:

Age During Year	Insurance	Cash-Value	Annual Dividend Rate	Total Annual Costs	At-Risk Amount (in 000s)	Ann. Cost/ M$AR*
58	354,658	112,782	8.20%	889	239	3.7
59	366,807	126,628	7.70%	1,022	238	4.3

*At-Risk is the actual amount of insurance provided and Cost/M$AR is cost per thousand dollars of coverage. As this policy was issued in 1989, policy years 14 and 15 occurred during parts of calendar years 2003 - 2005.

Similar cost and rate information can now be calculated on any and all prospective new and in-force policies (for individual years as shown above or summarized over a period of years) via online consumer-friendly analytical tools. Understanding policies from this framework, and with solid knowledge of the differences between illustrated future values and actual future performance, enables consumers to assess the competitiveness of a policy's costs and rates by comparing such with benchmarks that are available in the marketplace (i.e., costs of coverage on a 58 or 59 year-old male and rates of return on comparable investments).

A cash-value life insurance policy's unique intrinsic economic advantages arise from its Congressionally granted tax privileges, not its highly touted permanence which is, after all, matched by the conversion option in term policies. These tax privileges, which are given directly to policyholders, however, are not a basis for which insurers can charge consumers. No one pays thousands of dollars to set-up an IRA. Consequently, when selling such cash-value policies as whole life agents routinely

Most insurance companies see only policies.

make assorted misrepresentations, i.e., that one pays for the lifetime of costs up-front, that buying a policy at a younger age locks in a lower level cost for life, and that the annual costs of a whole life policy actually decline as the insured ages because these policies, for instance, involve owning not renting insurance and can pay dividends.

Regulations prohibit such misrepresentations, but they have never been enforced. These and other misrepresentations are all designed to distort a cash value policy's fundamental difference. For agents, the essential difference between whole life and term is the quantum difference in the sales commissions – up to 5-9 times larger on whole life policies than on term policies. No one familiar with the paramount role that compensation incentives—tied to the origination of subprime mortgages and the repackaging of such default-inevitable, toxic securities—played in creating the Great Recession can doubt the perniciousness of the life insurance industry's age-old problematic sales practices. Financial problems should not need to have to drive the country to the edge of a financial abyss to warrant fixing; 40 years of documented but unindicted frauds ought to be sufficient.

While inadequate disclosure appears to be in the insurers' and agents' interest, it actually has made consumers so leery of agents that the age-old distribution process is so terribly inefficient and ineffective. Americans' under-insurance reaches new records every year. Some insurers' policy lapse rates raise fundamental questions regarding the products' suitability that regulators have never examined. And, the facts that the typical life insurance agent sells less than one policy per week and that four out of five new sales recruits fail out of the business within a few years are further proof of this failed business model's dysfunction.

Given the nature of the problem, improved disclosure and publicity of such have always been known to be two indispensable parts of the inevitable solution. As is shown in the table, life insurance policies, like an automobiles' horsepower or MPG, can be disclosed, not only by the manufacturer, but by anyone with the necessary expertise and this information is now available online.

Without publicity though, this public good of disclosure remains undiscovered. Reform of the life insurance industry, which has never been technically challenging, has always merely been a battle of wills. Reformers have had to contest an aggressively opposed industry, an uninterested or uninformed media, regulators not understanding their jobs or unwilling or unable to do them, and/or reformers' own doubts about ever succeeding or how best, if at all, to next attack the monolith. But as recent world events show, tyrants can be overthrown when people act. Most relevantly and significantly, financial markets can be fixed when appropriate policy disclosure for consumers is heralded and becomes pervasive.

The only real remaining question is this: When will this information be publicly disseminated, so that everyone knows about it and can use it, thereby initiating the long-overdue repair of the life insurance marketplace? After all, this disclosure driven transformation will produce the myriad and well-documented benefits of genuine economic competition: consumers will obtain better value; insurers will improve the efficiency of their production processes; and agents will act and be seen as trustworthy professionals.

R. Brian Fechtel, CFA, Agent & Founder of BreadwinnersInsurance.com. Based upon "The Disclosure Solution to the Problems Consumers Face in the Life Insurance Marketplace" in the 2011 Consumer Interests Annual, published by the American Council on Consumer Interests.