The Disclosure Solution to the Problems Consumers Face in the Life Insurance Marketplace

Pervasive, costly problems exist in the life insurance marketplace because of terribly inadequate disclosure, and the misrepresentations and misconceptions it engenders. Effective disclosure is now available. Publicized, it will transform this age-old dysfunctional marketplace, producing the benefits of genuine competition. Accomplishing such depends upon citizens, not regulators.

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In his last years, Justice Brandeis, hailed as The People's Attorney prior to his appointment to the Supreme Court, when asked what he regarded as his greatest accomplishment would respond, "Savings Bank Life Insurance." In 1905 when retained to represent two aggrieved policyholders regarding that era's managerial fraud rampant in the life insurance industry, fraud that gave rise to the historic New York State Armstrong Investigation of the entire life insurance industry, Brandeis became interested in crafting his own comprehensive solution. Two years later, the Massachusetts legislature adopted a statute, meticulously drafted by Brandeis, which authorized the creation of no-load, mutual life insurance departments within, yet separate from, the state's mutual savings banks. Less than ninety years later, however, SBLI was demutualized following a multi-year, clandestine effort by savings bankers, in which they magically acquired complete ownership of Brandeis' system without having ever contributed to its capital/surplus. The bankers avowed, "SBLI policyholders do not lose one iota of the bargain of their insurance contracts" from the demutualization.[2] With financial legerdemain rivaling Madoff's – that is, it was as brazen and as plain as the nose on a face to anyone with merely modest financial forensic abilities -policyholders lost all of Brandeis' crafted safeguards, which at the time included an exclusive claim to all of the system's ongoing annual profits. Approved by the 1991 MA Commissioner of Insurance, a regulator who subsequently left office under another cloud of ethical misconduct, the financial looting that began at more than $110 million has, of course, risen over the years. One of the first actions of the demutualized company's pirate-like senior management team was to make one of the largest, if not the largest ever, dividend cuts in the history of American participating whole life insurance policies. Given that no one in the consumer movement publicly wrote or did anything at all about the destruction of Justice Brandeis' greatest accomplishment, it is sad to consider what Brandeis would say about his creation's un-mourned death, as it now operates as a stockholder company paying agents traditional commissions. The final paragraph of Professor Alpheus T. Mason's 1938 book, *The Brandeis Way* – a 300 page story of SBLI's creation, begins with words that have proven to be not merely a historical summary but inconceivably shockingly prophetic: "Thus regarded, the story of savings bank life insurance is revolting proof of the obstacles that entrenched economic interest places in the path of our fitfully advancing democracy."

For the last fifty years, Professor Joseph M. Belth has written extensively in academic journals and *The Insurance Forum*, his George Polk award winning monthly newsletter, about the pervasive, fundamental problems in the life insurance industry and marketplace. Belth's work is legendary. In 1973 Belth testified before Congress, "The life insurance market is characterized not only by an absence of reliable price information, but also by the presence of deceptive price information. In my opinion, Mr. Chairman, the deceptive sales practices found in the life insurance industry constitute a national scandal."[3] In the early 1990s, New York Superintendent of Insurance Salvatore Curiale stated, "The conduct of the life insurance industry with regard to its sales and marketing practices has been inexcusable."[4] About the same time, leaders of two national agent organizations declared, "A cleanup of our industry is coming whether we do it ourselves or get prodded into it," and "These standards: 'openness and honesty in all transactions' and concern over 'the overall impression that sales materials may reasonably be expected to create upon a person not knowledgeable in insurance matters' [standards touted by some as new, namely, Curiale who had proposed them] are part of the existing life insurance advertising regulations in most states. They have simply never been enforced."[5] You read that correctly. The laws promulgating standards of openness and honesty have never been enforced in the life insurance marketplace. This is as true today as when it was first stated.

These facts have not been the exclusive, secret knowledge of industry insiders. The second sentence in *The Wall Street Journal's*, Lifetime Guide to Money's chapter on life insurance reads, "There are lots of problems in the way it is sold." For decades, many others have documented as much.[6] In their 2008 book on personal financial planning Professor Laurence J. Kotlikoff and financial columnist Scott Burns declare, "Life insurance agents have a well-deserved reputation for being hucksters." More diplomatically, Professor Harold D. Skipper in 1995 wrote, "Changing a system [characterized in the article as a system with inadequate agent training and supervision, and an agent compensation structure incompatible with modern consumer demands] of such long tradition and wide acceptance will be difficult, but change seems both essential and inevitable."[7]Despite all these condemning facts and words, as of March 2011, the imperative change has not come to American life insurance consumers.

The root of the age-old problem is the inadequate disclosure of cash-value policies, such as whole life policies, where the annual cost is not the annual premium. Belth in his seminal 1975 *Drake Law Review* article recommended disclosure about a policy's annual costs and rate of return on its cash-values.[8] The NAIC and its state affiliates did not adopt such a straightforward approach, but instead introduced a Life Insurance Buyer's Guide and an inherently defective policy comparison metric. Their original Buyer's Guide, possibly still used in some states, presents a misleading dichotomy between whole life and term that actually facilitates agents' misrepresentations. Subsequent versions have endeavored to minimize, but not entirely correct, such. Perhaps even more incredibly, no version of the Buyer's Guide has ever mentioned the tax advantages of cash-value policies. The NAIC's policy comparative metric, the interest-adjusted (IA) indices, have never been able to be used to compare different types of policies, are bizarrely calculated based on illustrations the insurer itself creates, have never been found useful by consumers (cause they're not), and have never been understood or used by agents. The ludicrousness of the indices is only exceeded by the longevity with which such a profoundly flawed consumer tool/aid has been mandated. More than thirty years ago, a 1980 NAIC task force recommended replacement of the defective indices; and actuarial organizations have seconded that call.

Regarding the task-force's recommendation, Belth has written, "The companies did not just stifle the committee report; the individuals primarily responsible for the preparation of the report lost their jobs. There were other heavy-handed actions, including an unsuccessful attempt to have me fired by Indiana University…Yearly prices [of cash-value policies] are so revealing that the companies took extraordinary action to prevent disclosure of the information." Elsewhere Belth has continued, "One company executive told me that companies could not survive disclosure of yearly prices. I disagree. I think companies would prosper if price disclosure were routine. However, if he is right and I am wrong, and if companies cannot survive price disclosure, they should leave the business. Companies that can survive only by concealing the price of their product do not deserve to survive."

Informed buyers are a prerequisite of economic competition. Yet somehow so many life insurance industry chieftains who so regularly sing the praise of the marketplace fail to recognize that their businesses have never played according to such competitive prerequisites and rules of fairness. The difference between the misinformation in most markets and with that of the life insurance marketplace is like the difference between strolling in a neighborhood park and wading through the Everglades. The life insurance marketplace is a swamp of misinformation with pits of quicksand created by inadequate disclosure.[9] The proof of such 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 those sold no *adequately informed* individual would even consider buying. Yet, the past nine years alone, approximately 62 million cash-value policies were sold with an average death benefit of $80,000.[10] This marketplace's dearth of information also afflicts more than a hundred million policyholders at annual renewal; if properly informed, tens of millions currently could readily obtain much better value. Any who wonders how this marketplace can be so running amuck without alarms being sounded would do well to recall our recent financial history, the title of Madoff's unheard whistleblower, Markopolos' book, *No One Would Listen*, and Plato's caveat: "Everything that deceives can be said to enchant."

Cash-value life insurance policies' unique intrinsic economic advantages arise from their Congressionally-granted tax privileges, not their highly touted permanence which is matched by term policies' embedded conversion privilege/option. Tax privileges, however, are free, non-proprietary inputs. In a competitive marketplace, sellers cannot charge buyers for free, non-proprietary inputs; that is, they cannot extract value from buyers for such inputs. Agents routinely make assorted misrepresentations to sell such cash-value whole life policies, i.e., that it is not renting, 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, etc. These misrepresentations distort a cash-value policy's fundamental difference. For insurers and agents, however, the real, fundamental differences between whole life and term are the quantum differences in commissions. Anyone who thinks whole life and term are somehow drastically different *types* of life insurance with the former somehow magically solving all the pejorative aspects agents cite regarding the later ought to be reminded that 'whole life' acquired its name because it was originally called 'level payment term for your whole life.' The industry's age-old compensation differential of paying commissions 5-9 times larger on whole life than on term cannot be sustained in a competitive marketplace; that is, it cannot be sustained in front of an informed buyer.

While Woody Allen and others from Hollywood have so often memorably mocked life insurance agents, quality control legend Deming would point out that such mockery-inducing, persistent problems are fundamentally problems of poor systems. By definition, systemic problems are managerial concerns. The American life insurance system has been known to be terribly dysfunctional for generations, if not centuries. If America any longer believes in accountability, it would seem the following individuals should be held accountable for this multi-generational national scandal: insurance commissioners, life insurers' boards of directors and CEOs, compliance officers, and others who knew or should have known about the problem and yet did not do or failed to implement the solution, the imperative disclosure that cash-value policies have always required.[11] If such a request seems impertinent, please consider that the NAIC's and everyone else's copy of the Society of Actuaries' 1992 journal, *Transactions*, contains a statement by a leading life insurer's actuary that his company could not conduct focus groups with recent policy purchasers because approximately 90% would leave very dissatisfied with what they learned about their recent purchase -its woeful "sub-optimum" value -and the company's agents were stridently opposed to such focus group research.[12] In 1933 Ferdinand Pecora uncovered no bigger, more irrefutable smoking gun of financial misconduct.

Life insurance policies may seem complex to the ordinary consumer, but that does not mean that their operations and mechanics cannot be readily and succinctly explained and understood. Belth's recommendation that consumers have always needed information about a policy's annual costs and annual rates of return on cash-values is undeniably irrefutable. Unfortunately, his actual proposed approach contains at least two technical problems. Most significantly, it is not a disclosure approach because it is dependent upon a consumer provided opportunity cost of capital, and hence could never be reconciled with an insurer's actual financial performance data. Even Einstein, though, needed help on the technical, mathematical aspects of special and general relativity. Also, despite his forty year advocacy of the need for disclosure, Belth has never published such comparative disclosures on the top selling insurers' products, neither as illustrated nor based on historical performances. To some, myself included, this fact has been perplexingly disappointing. Much more troubling, though, is the recommendation of the NAIC's 1980 task-force. Its disclosure approach is perhaps even worse – if that is possible -than the original IA indices. Its' Probable Cost Index (PCI) is absolutely unusable and suffers from many of the same problems of the IA indices (interest rate related mistakes) as well as some new problems (actuarial adjustments for usage duration, etc.) The blatant error with all of the NAIC's failed policy disclosure efforts is that consumers' informational needs are solved only by genuine information about costs and compounding rates, not via worthless PCIs or IA indices.

Life insurance policy illustrations and their pre-computer printed book predecessors have been used for generations. The disclosure problems do not, per se, arise from an illustration itself, they arise from its incompleteness and the typical agent's misrepresentations that accompany it. While illustrations need to be supplemented with explanatory text, calls to eliminate illustrations are as sensible as a suggestion that blueprints be eliminated in construction-related industries. An illustration is nothing but a visual representation of the consequences of mathematical and accounting formulas and various input assumptions; it is merely a visual aid showing such consequences on a policy's various values over future years. A policy illustration, however, because of the uncertainty of future financial performance, is not a blueprint, nor a credible projection, because its non-guaranteed values can only be determined as the future unfolds. Life insurance policy disclosure therefore consists of a two step process: 1) demystifying the illustration by explaining every policy's fundamental components, and then 2) providing relevant financial information regarding those components. For instance, a policy illustration constructed with a 6% dividend rate can be deconstructed by using a 6% discount rate to ascertain another of its primary components' assumptions, its stream of assumed annual costs. No decision can be based on such deconstructed values, as they are after all merely based on an illustration. However, from this understanding, consumers begin to move to the second step. That is, once disclosure of an illustration demystifies it, consumers are then motivated to demand and obtain the necessary actual relevant financial information by readily asking such natural follow-up questions as: 'This is a *very pretty illustration* that your insurer has made for me, but what information, Mr. Agent, can you provide me with respect to its actual past performance, or its current cost control and investment practices that will be necessary to actually produce favorable competitive future performance?' Appropriate policy disclosure also starkly reveals the lies in commonplace agent misrepresentations. 'Why again is it that you, Mr. Agent, recommend this whole life policy with these huge first years' costs *and* ever increasing costs as I age, the latter being what you had said was bad about term insurance?' My disclosure approach renders illustrations understandable, thereby fostering the demand for relevant actual financial performance data.[13] My disclosure approach then continues, using such data, to show it being reconciled with policy specific performance. Life insurance policy disclosure has never been a profoundly technical challenge. It has, however, heretofore been a profoundly challenging battle of wills, which the industry has won, or been allowed to win.

Writing in this Journal three years ago about the need for a Consumer Financial Product Safety agency, Professor Elizabeth Warren wrote, "The agency could review mortgages, credit cards, car loans, and so on. It could also exercise jurisdiction over life insurance and annuity contracts." Congress, however, granted the Consumer Financial Protection Board no authority over life insurance and annuities. This *little* omission of a financial products industry with multi-trillion dollar assets and half-trillion dollar annual premiums would almost seem to defy comprehension except for the fact that the CFPB is a Congressional creation. For decades, Belth has been adamant that disclosure will never be brought to the life insurance marketplace. In a 2009 conversation, Belth updated his often repeated and quoted statement: “Developments during the past forty plus years suggest that rigorous disclosure requirements will never be mandated by the state insurance departments. Industry opposition to such requirements is too strong. Nor do recent developments at the federal level offer any hope for consumers.” Many others, similarly, though, could also never conceive of the eradication of their society’s problematic traditions of slavery, disenfranchisement, or other forms of oppression.

Indeed, an insightful and useful perspective regarding a course of constructive action can be found in Frederick Douglass’ statement, “The limits of tyrants are prescribed by the endurance of those whom they oppress.” Margaret Mead also counsels, “Never doubt that a small group of thoughtful, committed citizens can change the world; indeed it’s the only thing that ever has.” Given that the problems in the life insurance marketplace arise from inadequate information, the solution has always depended upon nothing more than appropriate disclosure and publicity of such. Waiting for the insurance regulators to do this part of their job is like waiting for Godot to arrive. There is, however, no need to wait for another to do what we can do for ourselves and our fellow consumers. Disclosure is now available that can transform the life insurance marketplace. Disclosure of policy illustrations demystifies them, highlights the fallacies in pervasive misrepresentations, and leads to comprehension of policies and the concomitant demand for relevant, meaningful financial performance data. And, as much as the industry powers may be opposed to the dissemination of appropriate information, there is nothing they can do to stop it, especially in this age of the internet. The disclosure of fanciful illustrations is just the essential first step in the transformation of this age-old dysfunctional marketplace; it just needs to be publicized. This disclosure driven transformation will produce the myriad and well-documented benefits of genuine economic competition; consumers will obtain better value, quality, and other intangibles such as confidence and usage, and producers (insurers and their agents) will need to more efficiently allocate society’s scarce resources in their production processes as they will finally be facing the constraint informed buyers have always imposed on producers of other, properly marketed, products. The question is really just: When will a small group of thoughtful, committed citizen use this information to begin to fix the life insurance marketplace? The annual benefits to America’s consumers of the life industry’s products will be measured in the tens of billions of dollars.

Endnotes

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[2] Choate, Hall & Stewart LLC. 1987 Brief to MA Supreme Judicial Court. 2 International Place, Boston, MA 02110.

[3] Belth, Joseph M. 1994. The Insurance Forum. August issue.

[4] Skipper, Harold D. 1995. Market Conduct Issues and the Transformation of the U.S. Life Insurance Business. Journal of the American Society of CLU & ChFC. XLIX (March): 36-45.

[5] Press, Alan. 1995. A Personal Perspective on Disclosure as a Future Ethical Imperative. Journal of the American Society of CLU & ChFC. XLIX (March): 58-67.

[6] Lieberman, Trudy, and the Editors of Consumer Reports Books. 1988. Life Insurance. (in particular, Chapter 10, “How Life Insurance Is Sold”).

[7] Skipper, Harold D. Jr., 1995. Market Conduct Issues and the Transformation of the U.S. Life Insurance Business. Journal of the American Society of CLU & ChFC. XLIX (March): 36-45

[8] Belth, Joseph M. 1975. Drake Law Review Insurance Law Annual. Volume 24. Number 4. Dec. 1975. p727-52.

[9] The life insurance industry’s problems are hardly limited to its eponymous product. It is impossible for consumers to currently conduct due diligence on long-term care insurance policies. Furthermore, these non-transferable policies grant insurers an option to increase the annual premium, thereby allowing many policyholders to be shot like fish in a barrel with 30 and 40% premium increases. Annuities are equally replete with sales and management misconduct.

[10] Many readers could be surprised at the viability of whole life; unaware, for instance, that a 2010 Wall Street Journal headline trumpeted “Whole Life Insurance, Long Derided, Gets New Lease.” Long derided for sure, but often with incorrect arguments. Belth has repeatedly stated, “Some of those deceptive methods are used by advocates of cash-value insurance, and some of those deceptive methods are used by advocates of term insurance, [underline added].” The mistakes of proponents who essentially only advocate term are many, and actually often facilitate agents’ relationship building efforts with prospects – by allowing agents, in person, to point out a term-only proponent’s mistakes. More fundamentally, term proponents’ failure to aid Belth’s call for disclosure – disclosure that accurately compares any and all policies – has allowed the genuine excessive costs that motivate

agents' misrepresentations to remain obscure and thus continue being highly effective incentives of agents' persistent efforts. The way to attack an informational problem is to expose it to sunlight, not to spew misleading and/or erroneous ideological rhetoric. The millions of consumers of cash-value policies who have paid excessive costs have clearly not been well served by consumer organizations that have never recognized Belth's wisdom in his advocacy of disclosure of policies' costs and rates; millions of others have had to deal with the myriad ramifications of a marketplace treacherous without good disclosure: avoidance, confusion, inefficiency, etc. Only to state the obvious, because not infrequently the obvious is somehow ignored, consumer organizations and their advocates would be wise to evaluate their own abilities and efficacy when there is no progress on solving problems. In the life insurance arena, there is unfortunately extensive evidence of extraordinary failure to do such. For instance, I contend, that consumer organizations' acceptance of the patently fraudulent Insurance Marketplace Standards Association (IMSA) – an insurer sponsored organization that provided insurers with 'Good Housekeeping Seal of Approval' was unconscionable. IMSA never enforced its own principles and allowed members to use its Seal of Approval without an inherently necessary and mandatory post-use audit.

[11] As part of my own efforts to seek accountability for the job the NAIC should have done, but has not, my recent letter to 2011 NAIC President asks her to obtain consent to salary and pension claw-backs from current and past commissioners. http://www.breadwinnersinsurance.com/naic-president-january-2011/ Her reply is also posted online.

[12] The Society of Actuaries. Transactions. 1992.

[13] BreadwinnersInsurnace.com. "Policy Disclosure – Press Release" http://www.breadwinnersinsurance.com/policy-disclosure-press-release/