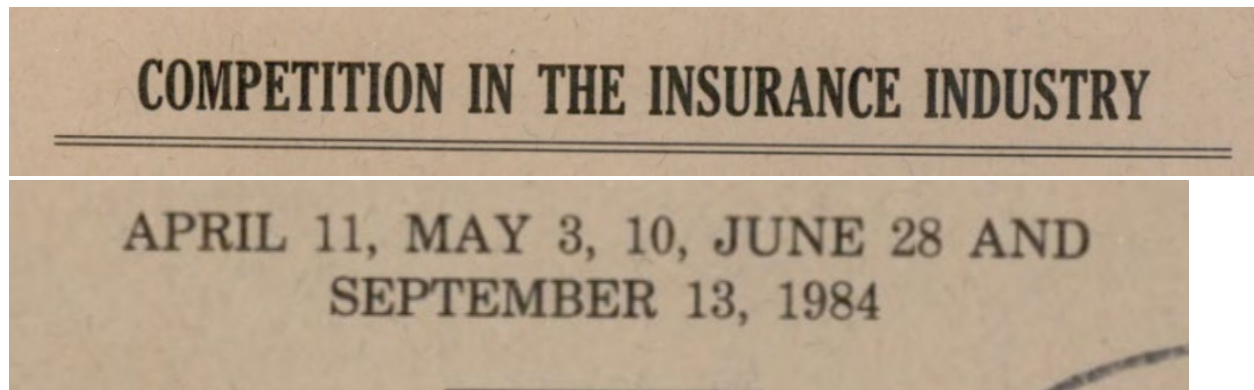


Government Hearings Reports

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via:

Mr. VOGEL. Yes; it seems to me that is a reasonable request, but I would point out that the rate of return on the whole life policy depends very markedly on the premium rate that you impute to the term insurance. I am sure you are familiar with the general nature of this.

Mr. SHAFFER. Yes; I have several questions about that particular point.

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the same policy. I think the rates of return went from about 4 percent to 8 percent, depending on which term insurance rates were used in that calculation. The Society of Actuaries study also makes a point of this. This calculation is sensitive to the term insurance rates.

If the individual really wants to do this, then I think he would have to tell the company that is going to do the calculation what term insurance rates to put into the calculation because the result is quite sensitive to that.

This is a point that I wanted to make when it came my turn to answer this question.

Mr. SHAFFER. Fine. This is interesting. It is not so much that you are philosophically opposed to the idea of a person wanting to make a comparison. It is just that as a practical matter, you don't think there is any easy way to give him the data that validly makes that comparison; is that right?

Mr. VOGEL. I don't want to relinquish the field to you quite that completely. There are a couple of other provisos that go with this.

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The fact is that renewable term to 100 is available, and you can get it in small amounts. Colony will sell it to you but it has to be at least \$10,000 worth. Zurich-American will go down to 5,000 dollars' worth. It is not strictly correct to present the impression that this insurance is unavailable in the market, is it?

Mr. VOGEL. No; but you have to know to look for it. These are perfectly respectable companies, but in point of fact I have never been approached by an agent for one of these companies and I doubt if you have either, really.

Mr. SHAFFER. That is right.

Mr. VOGEL. There are a lot of products in the market, but you have to know where the store is if you are going to buy it. That is the only response I could make to that.

Mr. MINCK. The State of New York will not permit you to sell a term insurance policy there that renews beyond age 70. The New York Insurance Department determined some years ago that such a practice was not in the public interest because of the sort of thing Mr. Vogel referred to earlier, that is, people reaching age 70 or so and having term insurance and the inability to pay the relatively high renewal rates.

For example, if you look at some of these premiums in the 70-75 age range, they go up very, very quickly. While you could in theory purchase them, I think the experience has been that very few people do keep the policies in force. I think that it is the New York limitation that has kept many large companies from offering such a product. That is one of the reasons I think you will find that only a relatively small number of companies is selling it at the moment.

Mr. SHAFFER. Thank you.

Also, at page 16 of your testimony, Mr. Vogel, you state that, "average annual rates of return are quite sensitive to the term rates used." You cite the Society of Actuaries report for the support. But you don't give a citation.

Mr. Moss. I must confess to be somewhat shocked today at hearing statements made earlier by Mr. Anderson and your apparent acquiescence in them because I never recall being sold without a considerable discussion of the investment value. I have never had anyone come to me to try to sell me insurance without discussing that extensively.

I just can't believe I am such a unique case that I invite that kind of discussion and all others ignore it.

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Mr. Moss. Yes, we attempt to have these hearings well rounded. I ordinarily would not discuss it with personnel of a nonsales background, but it is a fact that there are conclusions drawn here which I find so novel and so interesting that I cannot resist the opportunity of comment even though briefly on it.

Mr. Moss. I think your life insurance is a better investment than your automobile. One is a necessary acquisition and the other is not, but very desirable.

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Mr. SHAFFER. Thank you. I guess this is another instance where we will probably ask the Federal Trade Commission to comment on their view of that data.

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Another reason why we are not in favor of a yardstick is that this is a proposal that I find very much at variance with the way business is done in this country. There are disclosures for the product you are selling, but I don't know of a further requirement to disclose what you can go across the street and get the product for.

Our position is that if an individual is interested in shopping and the buyer's guide encourages him to be interested in shopping, then he has ample opportunity to see life insurance agents and he has ample opportunity to go into any store in the country that says, "Real Estate and Insurance" on the door and the broker there will have the interest adjusted net costs computed on a uniform basis for a wide variety of companies.

My view is that the market is competitive and this seems like an unnecessary intrusion of government into a competitive market.

Mr. SHAFFER. We discussed with Mr. Anderson the idea of the companies providing to the insurance commissioners a Belth type analysis in order to have them police more effectively for manipulation.

Do you have any reaction to that idea?

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So what I am saying is that the Belth calculations cannot get out of a policy anything that isn't there already. The premiums and the dividends and the amounts of insurance and the cash values are all there is to a policy. You can fool around with them any way you like but mostly you can get at all the facts just by looking at those basic things.

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ation.

Admittedly, there are weaknesses in State regulation, as there are weaknesses in all forms of human endeavor. But these weaknesses are not fundamental to the system itself. Such weaknesses as may exist in State regulation are gradually and constantly being sought out and corrected.

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In attempting to put a Federal trade regulation on the books, the FTC must therefore argue in effect that the manner in which life insurance is offered and explained to the public is unfair and deceptive, that it is not adequately regulated by State law, that the McCarran Act, therefore, does not preclude Federal action, and that the FTC Act thus gives the Commission itself jurisdiction to take action.

Soon after the McCarran Act became law, the National Association of Insurance Commissioners adopted a Model Unfair Trade Practices Act, whose stated purpose was "to regulate trade practices in the business of insurance in accordance with the intent of Congress as expressed in" the McCarran Act. The model act is in fact closely patterned after the FTC Act, and it defines unfair

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There are admittedly different methods of disclosing cost information and reasonable men differ as to which is most effective. We have concluded that the only justification which is necessary in support of the NAIC Regulation is its simplicity and understandability. Unfortunately, some of the technicians who operate in the area of cost disclosure believe that insurance applicants either have the same interest in technical details as they do or can be educated to acquire such an interest. There is a limit, however, to the amount of technical data which the average layman can or desires to digest.

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A. M. Best Company, is a complete mystery to us. Since the evidence indicates that consumers do not even make the grosser distinctions, we see no reason to think that they make the finer ones.

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In the particular case of life insurance, we know that in spite of the large number of companies and the large differences in the costliness of their products, there is little price competition. One of the clichés of the industry is, "there is competition in the life insurance industry -- for the agent." This cliché has been cited for over a hundred years to explain the rapid rise in agent commissions and to justify the various expense limitation laws that have been enacted. We believe that the absence of price competition for the policyholder is explained primarily by the simple fact that most people simply cannot compare the price of one policy with another. The industry, and its regulators, have thus far failed to provide people with the means of doing so.

Here we think it reflects consumer ignorance, and we think it reflects a lack of information on what it is the consumer is purchasing as well as basic information about the nature of the choices that are before the consumer.

Mr. SHAFFER. Does the FTC have any data showing whether consumers think all life insurance costs about the same?

Mr. LYNCH. Yes. There have been a number of different surveys ranging from Better Homes and Gardens to the LIMRA surveys, which are called "measuring the attitudes of the public," the MAP surveys that are sponsored by the LIMRA. These surveys indicate that a fairly substantial proportion of the public believe that most life insurance policies cost about the same.

Mr. SHAFFER. Can you provide that for the record?

Mr. LYNCH. Yes, we can.

[See letter dated November 16, 1978, p. 72.]

Mr. LYNCH. I guess the easiest thing to say is that premium is not a very good guide to costliness of a policy. In particular, a policy that appears to have a very low premium may in fact turn out to be a very high-cost policy. Actuaries discovered this. We have as well. So you can do rank correlations of premiums against a company retention and you can show that the correlation is lower than it is for most of the other cost index measures such as interest adjusted surrender costs, for example. But the bottom line is that we feel and others feel that the premium is a rather poor guide to the costliness of a whole life insurance policy.

Mr. LYNCH. Insofar as the agent literally acts as an agent for you, I am speaking personally now, I think it would be useful to know something about your agent's incentives.

So in that case I would like to know particularly whether or not he will make a substantially different amount if he sells me one type of policy rather than another. So I regard that information as being relevant.

Mr. SHAFFER. On the other hand, I take it there are analogous market situations where this sort of commission disclosure does occur, for example, with real estate agents and stockbrokers?

Mr. LYNCH. Agents in general. There appears to be a fairly common fixed commission structure, and generally the people who avail themselves of those agent's services are usually aware of it. That is not the case in life insurance.

Since we are on agents, let me ask you about the implications of effective cost disclosure for the agency system. If we have effective cost disclosures systems, won't the agency system be in danger? If the agent spends a lot of time explaining insurance to customers and the customers buy the insurance from a cheaper company that does not have many agents; who will want to be an agent?

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Mr. KRAMER. By providing for competition in the sale of the policies, you in turn provide for competition in having a competent agency force and a competent force of sales agents. Companies need the agents in order to make sales. Presumably if they are losing agents because the policy is not competitive, they will respond with changes in the policy structure. That is what we are trying to reach and to induce. That is the purpose of the information disclosure.

Mr. SHAFFER. What is your position on persons establishing themselves as insurance advisers to provide insurance recommendations to customers for a set fee?

Mr. LYNCH. In theory, of course, that seems like a very attractive system to us. It seems to have worked well in other fields, but I do not think anyone knows how well it would work in insurance. We do have some elements of that now. You have brokers and consultants and at least in some cases they do work for a fee.

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Mr. COLLINS. Thank you, Mr. Chairman.

We appreciate your coming here. I have been in Congress six terms and before I came to Congress I was in the life insurance business, and this is the first time I have ever had an opportunity to discuss it. I say that in opening remarks because having worked 20 years in the business I see many of the virtues of the institution.

Mr. COLLINS. You have been there over a year and so you have established a policy. Is it the Government or the individual that has the responsibility for making a private decision?

Mr. KRAMER. For making a private decision?

Mr. COLLINS. It is our belief that it is the private consumers' individual responsibility to make decisions about what their needs are and what they want to purchase.

How do they need the U.S. Government to help them, providing we have outfits that keep the business honest? In other words, by honest I mean their accounts are kept on a regular basis and there is nobody stealing money from the company. Where does the line come where it is your Department's responsibility to interject?

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There are other aspects of this thing that we think are desirable and we would want to go further, and we think those are necessary and important elements of an effective disclosure system, one that will make the marketplace work. if you will.

Mr. COLLINS. As I read the bill, I did not think your particular agency had jurisdiction because of the McCarran Act. Let's first come in and see how you happen to be in this one because you have a wide range without getting into life insurance.

Mr. KRAMER. Staff can give you the more particular history of how we got into this one. I can tell you that in general the criteria we employ are to look for marketplace failure where there is substantial consumer loss, and where helping the marketplace to operate more efficiently—I want to emphasize this—where helping the marketplace operate more efficiently will yield substantial consumer savings.

Do you want to respond to that?

Mr. FIX. Yes; I think the Commission's initial interest in the life insurance investigation was spurred as a result of the hearings of Senator Hart in the early and mid seventies. It became very evident this was an area where there was a serious problem. As a result basically of the initial interest by Senator Hart, there was a preliminary staff study which was designed to determine and to present to the Commission various options. The staff in the summer of 1976 recommended that the Commission authorize an investigation to determine, first, the full nature and extent of the

There is certainly little sense in hastening to adopt the NAIC model regulation if subsequent research reveals that the NAIC system is incomprehensible to most consumers.

That is a rather strong statement. Do you think staff is capable of advising the commissioners around the country?

I go back to Mr. Kramer.

Mr. KRAMER. Representative Collins, I want to emphasize in the statement you just read there is a very important conditional there and the conditional is if subsequent research reveals that the system is incomprehensible—the NAIC system is incomprehensible, excuse me. There is no argument that the system is in fact incom-

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Mr. COLLINS. They call it legal reserve life insurance companies. When you buy a policy, it has a cash value, even on term, they keep an individual analysis of every policyholder, as far as I know every life insurance company does and, as far as I know every life insurance policyholder owns a solvent policy, is that right?

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Mr. LYNCH. Excuse me, just to comment.

I have followed the debates and it seems to me that there have been some technical deficiencies connected with the social security financing as well as some of the civil service pension plans that have been corrected, and I think all of us hope and expect that these plans will indeed be solvent.

Mr. COLLINS. Do you basically—you said in your Buyer's Guide, and I read your Buyer's Guide—it sounds to me like basically you favor term over whole life. Do you stand behind the Buyer's Guide in what it advocates?

Mr. KRAMER. Representative Collins, I think I indicated that we do not favor any particular policy over any other.

The draft guide, which I think is what you are referring to—

Mr. COLLINS. Yes.

Mr. KRAMER [continuing]. Has been criticised on the ground that it appears to have an anti-whole life tone.

Mr. COLLINS. That is right.

Mr. KRAMER. I think, as Mr. Lynch indicated, if you go through the guide you will find more references to negative things about whole life insurance than you will to negative things about term insurance. The guide is presently being reexamined. To the extent

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I believe in permanent life. So when we go into this, the trend is completely to sell people term, the trend is completely that way. It is not cheaper, it just looks cheaper.

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come up with excellent defenses of the disclosures that occur.

Mr. SHAFFER. Is it not possible that implementation of effective cost disclosure will put pressure on high-cost companies to inflate their dividend illustrations?

Dr. BELTH. That is possible, yes.

Mr. SHAFFER. What is your solution to that particular problem?

Dr. BELTH. Well, I think that that particular problem not only will happen, but is happening and to an increasing degree because of the emphasis being placed on point of sale indexes of various kinds.

Dr. BELTH. Right offhand, I cannot think of any justification. The reason I am having difficulty with that question is the fact that I am not altogether clear on why any justification is necessary in the first place. It seems to me in our economic system if a company wants to push the sale of cash value insurance over term insurance and reward agents handsomely for selling it, I think they ought to be allowed to do that.

Mr. SHAFFER. I will withdraw the word justified and insert the word explained.

Dr. BELTH. I guess I cannot explain it either, nor do I understand why any explanation would be necessary, Mr. Shaffer.

Mr Shaffer. OK.

The idea of that proposal is to provide consumers with ongoing information about the price structure of their policies. This is the system, the best one I have been able to work out, to try to come to grips with the problem of placing emphasis on sales illustrations and then later on, perhaps, making changes in the price structure that might not be readily known to policyholders.

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How can you determine what is a fair interest rate?

Dr. BELTH. In the system that I have recommended, for that matter in the system that the National Association of Insurance Commissioners has recommended, there is an assumed interest rate.

Mr. COLLINS. Which is what?

Dr. BELTH. Well, in the system that the NAIC has recommended most recently, the rate is 5 percent.

In the illustration that I provided in the Drake Law Review article, the assumption that I used was 5 percent. On this particular day it so happens I would probably be recommending the use of 5¼ percent. But the point is that an interest rate must be designated as the assumed interest rate for purposes of developing the disclosure system.

In other words, it would be a uniform rate used by all companies in providing price information to their buyers. The choice of the interest rate has to do not so much with what the companies are earning on their invested assets, but rather, it has to do with an opportunity cost notion. From the buyer's point of view, the choice

Mr. COLLINS. I remember when I was in the business I had occasion to check what they had estimated 20 years before and what their performance was. It really does give marketing people a wide spectrum to make estimates. How come they cannot do the same thing and claim everything through their disclosures?

Dr. BELTH. That is the problem Mr. Shaffer was referring to earlier. The fact is that they can, and the primary safeguard that I have suggested—and I would be delighted to have someone suggest an improvement on this—is a system of periodic disclosure after the sale, piggybacked on the annual premium notice, providing certain information that would tip off the policyholder if he is getting shortchanged down the road.

Dr. BELTH. One of the other assumptions, Congressman Collins, is a mortality table in the system I recommended. This mortality table will show the year-by-year probabilities of death. We use this in evaluating dollar amounts that are payable at various times and their relative significance.

The fact is that the summary measures that I come up with, such as the company retention index, do take into account probabilities of death, and the same system can be used for either participating insurance or nonparticipating insurance. These things are weighted in.

What I am asking you, you know the life insurance business, should we stay with the example of Genesis of teaching through the parables or should we turn to the actuaries going for all this disclosure business?

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making very much profit on this particular kind of policy.

Mr. COLLINS. You have been recognized by the agencies before State commissions so I am sure you understand the agent's viewpoint. What do you think will happen to the agency system if instead of selling the policy they spend half of the interview on disclosure, trying to make an actuarial presentation?

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Dr. BELTH. I agree with that completely, Congressman Collins. In fact, it has been my feeling that the primary impact of rigorous disclosure, if it is ever mandated, at whatever level it would be mandated, will be upon the agents. In other words, the agents will finally be provided with information about the price of the insurance they are selling to their customers. Even if the customer never looks at it, the agent will be provided with the information, and I think this is where the primary competitive impact of disclosure will take place.

Mr. COLLINS. The strength of it is the agent knowing in his heart what the facts are, and what you are saying is that is where their primary need begins?

Dr. BELTH. That is right.

Mr. COLLINS. Dr. Belth, you have been in this business a long time. Do you think price is why they buy or because they love their family? It goes back to basics. It is not this cash element that really motivates a person. You cannot sell a selfish person life insurance.

Dr. BELTH. I think the basic motivation is love of family and fear.

Mr. COLLINS. What is the fear? That is interesting.

Dr. BELTH. They are afraid they are going to die prematurely. This is the motivation for buying the insurance, but I do not believe that would be a justification for concealing the price of what they are paying to satisfy these motives.

Mr. COLLINS. He will tell them what every competitor is doing. Competition does more to keep companies alert than anything. Agents are not going to sell a plan that does not represent value. That is my belief. What has been your experience in the field?

Mr. MOSS. Are there other questions?

Mr. SHAFFER. I would like to follow up that last point. In your view, then, even if it could be shown that consumers would never look at any of this cost disclosure material, cost disclosure is still worthwhile because agents will for the first time understand the relative value of the policies they are selling; is that correct?

Dr. BELTH. That is correct. I have the same feeling that Mr. Collins does, that agents by and large are honest and sincere. Until such time as I see strong evidence to the contrary I will continue to assume that. I believe that they will be strongly influenced when the disclosure is finally out there. To the extent that they are really selling high-priced life insurance, they are going to be very

seriously troubled about it, and I think this will have a powerful competitive impact.

Mr. SHAFFER. So it is your belief there are many, many agents out there in the market selling products that they think are good buys but that if they had the Belth disclosure they would be shocked and disturbed to see that the policies they were selling rank poorly compared to their competitors; is that correct?

Dr. BELTH. That is right. I would like to add, it may not be that they thought they had a good buy. They may have kind of suspected that their policy was not really among the best but they have no idea of the magnitude of the differences. What they will begin to find out, the ones that are selling the very high-priced insurance, is just how high priced the insurance is that they are selling.

It appears that the National Association of Insurance Commissioners and the insurance industry have agreed that consumers ought to have more information about life insurance products than the market provides naturally. Since the early 1970's the problem

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The NAIC wholeheartedly supports the proposition that adequate information concerning the terms, costs, and value of life insurance should be made available to the insurance-consuming public.

While a return to a stable economic environment would surely alter disclosure considerations demanding attention today, the long-term nature of life insurance and the virtually infinite combination of circumstances under which policies may mature lead to the result that absolutely no life insurance disclosure system will enable the actual cost of insurance to be determined prospectively.

Only when the insured dies or surrenders his policy can we accurately determine true policy costs. Any other determination or

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Competition in the Insurance Industry

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Now, I am not so sure. 1984 brings us an insurance market that has more complex products and less useful disclosures than the market in 1979 when the FTC published its study. It is true that competition from alternative investment opportunities, like market money funds, certificates of deposit and annuities, has forced the insurance industry to change its ways, but unhappily, the changes don't help consumers make better informed choices about their insurance purchases.

likely to have for the consumers.

Even if agents were inclined to provide consumers useful information, agents themselves often do not have adequate information to compare the costs and benefits of different policies and alternative investments.

The industry's major response to competition from other investment opportunities has been to introduce a new product: universal life insurance. I am told that universal life may be marginally a better investment than whole life. But it is so complex that con-

sumers are likely to have an even harder time deciphering its real investment value. Also, there are a myriad of universal life policies. A company may even compete with itself and sell two or more different forms of the product, offering the agent a higher commission on one but not the other. There is no disclosure mechanism for consumers to use to compare these competing, complex investments.

A quick look at the industry dispels the idea that State regulation has solved the problem of lack of consumer information.

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Insofar as the McCarran-Ferguson Act shields so basic an industry from national standards of fair dealing and informed competition, it remains a symbol of the political power of the insurance industry, not reasoned public policy.

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In calculating premium rates for a policy, the company's actuary must make assumptions about future mortality rates, interest rates and costs of doing business. It is, of course, impossible to predict the future accurately so companies selling participating policies make assumptions they know are quite safe and use dividends to adjust premiums in accordance with actual experience in the future.

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2. Interest Buildup on Life Insurance and Annuity Contracts. Treasury originally recommended to you that the interest earned on the savings element of cash value life insurance and on annuity contracts (issued after the date of our tax reform statute) be taxed to the policyholders. Treasury has withdrawn that recommendation in the face of strong industry opposition and the concern that policyholders might join with insurance agents to oppose this measure. (Of course, the proposal would only apply to future insurance policies.) Treasury also notes that interest on an insurance policy, unlike savings account interest, cannot be withdrawn without borrowing against or cancelling the policy.

The other side of the argument, as the option paper indicates, is that as a matter of equity this interest is the same as any other interest and persons who save via cash value insurance policies should pay no less tax than those who put their money in a savings bank. The tax-exempt status

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of this form of saving gives life insurance companies a competitive advantage over commercial banks and savings and loan associations. In addition, elimination of the capital gains preference may make insurance and annuity contracts the new tax shelter of the future for high bracket taxpayers if we do not subject the interest element to tax.

Accordingly, we recommend that the interest buildup be brought into the tax base for all future insurance and annuity contracts. A middle ground (which may not be technically feasible) would be to tax the interest buildup only on insurance or annuity coverage in excess of \$100,000 per person. If you are unwilling to recommend fully taxing the interest buildup, this middle ground would be a less controversial -- but still meaningful -- reform.