REPLACEMENTS

A. What recent studies have been made to determine the reasons given by policyholders for making policy loans, for changing to lower premium plans, and for terminating life insurance policies? To what extent has cash value life insurance been replaced by term insurance?

B. How effective in developing information has been the question in the application form relating to the applicant's intention to replace existing insurance? Would the question be more effective if it were asked on a form apart from the application?

After notification of advice of pending replacement, how successful have been conservation efforts by the company whose business is being terminated?

C. Have state regulations been effective in controlling replacements? Does the variety of such regulations by the states cause important difficulties once the procedure for compliance has been set up? Is the general type of regulation more or less satisfactory than the regulation enumerating the items that must be included in a proposal? Is there a need for a "model law" covering replacements? What are the arguments for or against having replacement rules apply to term coverage replaced by permanent insurance?

Jacksonville Regional Meeting

MR. HERBERT L. DEPRENGER: Last December Continental Assurance announced a general procedure for the handling of replacements. The application form now used in all states contains the replacement question and a request for details concerning the replacement if the question is answered in the affirmative. Any application which is incomplete with respect to these items is returned to the agent.

All applications with affirmative answers to the replacement question are referred to the actuarial department for analysis. If coverage of another company is involved, they are so informed and are sent a set of blank comparison forms with a request to complete with respect to the existing insurance. They are also told that, if the completed forms are not returned within ten working days, a comparison will be made in our office from the information available. An exception may be made if the other company's insurance is of a recent issue, and we have knowledge that a proposal was presented to the insured. In this event, we ask that our agent make a comparison based on such proposal, and we inform the other company that such is being done. If our forms are not returned in the allotted time and in our opinion the replacement is not detrimental to the insured, we ask the agent to make a brief comparison and keep such comparison with

his notes in file for two or three years. If it appears that it is not to the advantage of the insured to replace and we have the information available to complete our comparison forms, we do so and send three copies to the agent with instructions to explain the comparison to the applicant and if new insurance is still preferred to have all copies signed by the applicant and himself. One copy, of course, is left with the applicant, the agent retains one copy, and the last copy is returned to the home office. If we do not have the information available to make the comparison, we ask the agent to obtain a signed statement from the insured to the effect that he understands all the facts before the policy is issued.

If individual permanent coverage in our own Company is being replaced, the case is generally treated as a policy change request and formal comparisons may or may not be made, depending on the situation. Generally, the old policy is reissued with appropriate commission adjustments in lieu of a new policy. We often receive rather lengthy letters from agents submitting replacement applications giving the various reasons for change. The popular type of reason involves a change in the insured's financial position.

Parts of this general procedure are not applicable in some states which have specific regulations. For the states of Maryland and Wisconsin, the entire burden for preparation of the proposal or comparison is placed on the agent. The home office, however, will help on request.

For the first four months of 1962, approximately one in eighty life applications had the replacement question answered in the affirmative. The vast majority of these involved the replacement of group insurance or individual coverage, generally term, within our own Company. There are indications that in the states with the more stringent requirements, such as Maryland or New Jersey, either there are very few replacements or the agents have found some way to obtain a negative answer to the replacement question. Wisconsin is the only state where we require that the question be answered on a separate form. Since the change in this state was made just recently, we have no experience.

As can be seen, the main element of our replacement procedure is home office analysis. So far, we have not been able to see a pattern with respect to reason for replacement, nor have we seen any significant change in the frequency of replacement since installation of this procedure. As the various states adopt their own particular rules and regulations pertaining to replacement, we feel that the entire procedure will become much more complex. But it seems that it may be a good idea to postpone "model law" drafting until we have some idea as to what type of regulation is the most effective.

MR. WILLIAM J. TAYLOR: Massachusetts Mutual Life has not recently made any studies as to reasons given by policyholders for making policy loans or for changing to lower premium plans. We have, however, been conducting a continuous study on replacements of business in our Company and extensive indebtedness is currently the most common cause given for replacement of a policy.

Some of the reasons given for replacement have been substantially reduced in frequency and in some cases almost eliminated. About 30% of our replacements used to be caused by the desire to issue a new policy with a rider not available for attachment to the existing policy. The most important riders were our family rider, our children's insurance agreement and the 5th dividend option. We now attach all term riders except level term after issue and this reason has been virtually eliminated. If we extend this question to "Why is the policy not reinstated?" I might comment on another improvement. When new insurance was applied for on the life on which a policy had lapsed within the past few months, we frequently ran into the objection of lack of cash for payment of back premiums plus interest when we suggested reinstatement in lieu of a new policy. The elimination of such premiums and interest by redating, which we introduced in June 1960, has virtually eliminated this reason for replacement. This is accomplished by rewriting the policy and advancing the date by the period for which premiums were not paid. If this results in a change of age, a higher premium will be payable and the insured will be charged 103% of the difference in reserves or, if the policy had been in force for less than one year, the difference in premiums.

The extent of cash value life insurance being replaced by term insurance has not exhibited any definite trend in our Company over the past three years. This represents about 15% of all replacements in our Company.

We feel that the question in the application relating to the intention to replace existing insurance has been reasonably effective. We do use a separate form on all of our Executive Protection issues and this has not been significantly more effective than the question in the application. Our separate form is completed and signed by the agent. Our experience would indicate that if significant improvement is to be obtained by the use of such a form it must be signed by the insured. However, we are not at all sure this is a wise move. In our Company, this would mean something over 99% of our applicants answering and signing the questionnaire, which might reflect negatively on the integrity of the agent, in order to improve the accuracy of reporting of something less than 1% of the applications. Furthermore, it is a moot question as to how much the accura-

cy of reporting would be improved. The distressing part about this matter is that, although the extent of inaccurate reporting is not very great, almost every occurrence is in connection with a serious and troublesome case.

One of the items we stopped keeping score on was the number of cases saved, since it was a detriment to the morale on those working on replacements. We do have the impression that some improvement has been made. Perhaps we are saving something less than 10% of the cases now. We are convinced that the real improvement comes from eliminating the replacement activity. We are pleased to note that the level of the replacement activity in our Company has declined about 50% in the past year.

Although we have made progress in controlling replacements, it is difficult to say how much of the improvement can be attributed to the various state regulations. On August 3, 1961, we instituted our own regulations which are generally stiffer than all of the states except Wisconsin. Although the variety of state regulations has not as yet caused any important difficulties in administering the procedures for compliance, certainly the extension of this to all states would produce a chaotic situation. If many states intend to enact legislation, certainly a "model law" would be in order. However, we hope that this problem can be solved without going to this extreme.

We have always felt that replacement of term insurance should not be included in the same category as replacement of permanent insurance. We have felt that when a policyholder has his term insurance replaced by permanent insurance, the agent has performed a valuable service. We stress conversion of term insurance in our Company very strongly. In fact, over the past several years, about 50% of our term policies and riders have been eventually converted. The major disadvantages of replacing term insurance in one company with permanent insurance in another are the possible loss of a conversion credit and the introduction of new suicide and incontestability clauses.

MR. PAUL T. ROTTER: Recently, Mutual Benefit Life made a study of 35 policies of at least $25,000 each, which terminated during the period January 1960 to April 1961. This sample would not qualify as a statistically significant one, but the results might be of interest.

Two hundred policies which terminated during this period were selected in order to get a cross section by age at issue, geographical location, and policy duration. Data on these policies were then given to a prominent firm in the opinion survey field. That company then selected 35 policies from this group and conducted depth interviews with each of

these former insureds. The questions devised for use in starting the interview dealt primarily with various aspects of personal financial planning, and the person interviewed was presumably not aware of the background which led to his being among those chosen as part of this survey. Some of the interviews were tape recorded, and evidently this did not interfere with a frank response. A summary of the salient features of the interviews was prepared in a report given our Company. We did not, however, know which cases were involved.

On the whole, the report confirmed the standard reasons for terminating or replacing these policies, but it would appear that, at least for these cases, a different emphasis emerged related to these various causes.

It was evident from these interviews that the agent has a substantial influence on persistency. This seems to be the case not only at the time of the initial sale, but also after the sale. It appeared that, for these larger policies at least, a considerable amount of service was expected by the policyholder over the years.

Within the first few years after issue, external facts, such as a change in job, were given as reasons for termination. The burden of premium payments was felt to decrease in importance as duration increased. It was believed that in a number of these cases the policyholder could have been dissuaded from terminating his policy. Six of the 35 stated that their decisions were not irrevocable. In all of these cases the policyholders stated that they felt the size of the policies warranted a personal communication by the Company. In such cases there appeared to be a shift in emphasis from the agent to the company when the policyholder discussed what might have been done to conserve the insurance. On the other hand, most of these interviews indicated that policyholders are loyal to their agents but somewhat indifferent to the insurance carrier. It was surprising to us that so many of these policyholders were rather vague about the company which carried the insurance they had terminated.

Another thing which appeared more frequently than I am sure many of us would have anticipated was that replacement, when it occurred, was at the suggestion of the agent and that the client considered this good service. In several of the cases it was evident that this "modernizing" of the coverage was an important part of the service which the client expected from his agent. It was evident that most of the policyholders who replaced coverage felt they did not suffer a financial loss by this action.

MR. WILLIAM K. KRISHER: At Connecticut Mutual we feel that the question in the application relating to replacing existing insurance has been of some value in developing information regarding impending re-

placements of existing policies. Although we have no accurate check, relatively few cases have come to our attention where the question was answered "no" and we have learned later that it should have been answered "yes."

Perhaps a form separate from the application might be a little more effective by drawing special attention to the question; we might even go so far as to require that the answer be notarized. As a practical matter, though, we feel it is better simply to urge the field as part of general company policy to be honest in completing applications. Immediate action should be taken against any specific agent who we find is not being honest.

Usually, by the time we are told of a replacement, the decision has been rather definitely made and efforts at conservation are not very successful.

It is too early to tell whether the various state regulations will prove to be effective in stopping unjustified replacements. Many of our terminations are due to competition from other forms of investment which are not subject to control by insurance regulations. Also, the professional twister will be able to find ways of defeating the purpose of the regulations without actually appearing to violate them.

Probably the greatest value of such regulations is their contribution toward creating an awareness on the part of agents and their clients that replacements are usually not in the best interests of the policyowner. If these regulations serve to cause agents to present a more complete picture than would otherwise be the case, then they will have been helpful in reducing the number of replacements which, while probably not deliberately, may have been based on incomplete facts or misleading comparisons.

Uniformity of regulations is, of course, desirable, although the present situation has not caused any serious administrative problems. Perhaps Wisconsin and Maryland have gone too far in enumerating all the items which must appear in every proposal. The nature of the problem itself is such that often a clear-cut answer is not apparent even after all available figures have been gathered together. Therefore, it seems that the general type of regulation might be more appropriate and certainly more flexible in handling the many different kinds of situations which might arise. For much the same reasons, we would prefer to see this problem handled at the level of regulations rather than through a "model law," which, once enacted, could not easily be changed.

Due to the temporary nature of term coverage, there is often more cause to replace current term policies with new permanent insurance to meet the client's long-term needs. This can be demonstrated both with figures and by an analysis of the client's program, including the need for cash values to complete the program if death does not occur. Therefore,

it does not seem as if the same standards ought to apply to the replacement of term as for permanent.

On the other hand, when term in another company is to be replaced, the policyowner should be made fully aware of any conversion credit which might be available from the original company and also of any differences in contestable and suicide provisions.

MR. VICTOR E. HENNINGSEN: It should be recognized that in the United States it is not illegal to replace an existing policy. No state prohibits replacement as such. Perhaps the insured's action is not well founded, perhaps he simply doesn't like the agent or the company; whatever his reasons, he has the inherent right to replace his policy with that of another company. What is prohibited is the offense commonly known as "twisting." This is bringing about a replacement by means of misrepresentation or a misleading or incomplete comparison.

Canada has taken an entirely different approach to the replacement problem. Legislation prohibiting replacement was passed by all Canadian provinces about 1935, as a result of the recommendations of the Association of Superintendents of Insurance. These laws make it an offense, punishable by a fine, for an agent to induce, directly or indirectly, an insured to lapse, forfeit or surrender a contract with one insurer in order to take out a contract with another. Only in Nova Scotia does the element of false or misleading statements enter into the offense. From information available there have only been four prosecutions under these statutes since 1935.

There are a few related points about Canadian practices which should be mentioned. A booklet published in 1961 by the Life Underwriters Association of Canada brings out the point that replacement of an existing term policy may, in the opinion of the Association, not be improper. Also, the agents licensing law of Canada provides for single company representation in all provinces except Quebec. Thus an agent in Canada can represent but one company, which gives the companies control over replacement of their policies by their own agents. As a final comment, it has been noted that a substantial part of replacement activity in the United States is in connection with financed insurance. There seems to be a certain cannibalistic flavor here—once the agents involved have tasted it, they like more of it, and as the loans pile up they develop more of a replacement attitude. However, in Canada, there is a wholly different tax situation in that interest on policy loans is not deductible on tax returns. Hence part of the incentive for financed insurance is lacking there, which presumably then somewhat alleviates the replacement problem.

Chicago Regional Meeting

MR. JOSEPH C. SIBIGTROTH: My discussion is limited to section A, namely the reason given by policyholders for terminating life insurance policies. The New York Life recently sent out a questionnaire to about 7,500 people who had taken out insurance during one calendar year. About 4,500 of these people had continued premium payments until the time of delivery, while 3,000 had lapsed their insurance during the first policy year. As is typical in these surveys, replies were rather limited, running at about 45% for inquiries with existing policyholders and at about 10% for the letters sent out to lapsing policyholders.

One of the questions asked of lapsing policyholders was "Why did you stop paying premiums on this policy?" About 50% of the people who replied indicated that reduced income was the main reason for lapse; 15% indicated that their need for the policy was less than when it was bought; 10% indicated they never wanted the policy in the first place, and another 10% indicated that they switched to a better policy. Hence, by far the most prominent reason given for termination was a worsening of the financial picture of the insured.

The survey also indicated aspects of the sale or characteristics of the agent or policyholder that seem to have a bearing on lapse. Some of these findings were:

1. Lapse rates were much lower where policyholders owned other insurance at the time of new issue.
2. First year lapse rates were about 30% higher where no cash was received with application than where cash was received.
3. Lapse rates varied directly with number of times agent saw applicant in connection with sale. Where the agent saw applicant three times or more, lapse rates were 50% higher than where the sale was made on one visit. These results seem to raise a question about the reliability of the older adage that starts with "If at first you don't succeed. . . ."
4. Early lapse rates were twice as high on cases where the agent did not deliver the policy in person than where the agent actually made such delivery.
5. Lapse rates were much lower when the agent explained the policy on delivery.

MR. DONALD L. GAUER: The Sun Life of Canada attempts to obtain from the servicing agent a statement giving the reason for each cash surrender or lapse. The reason indicated by this method is naturally subject to certain inaccuracies, but is probally sufficient for the purpose.

These reports are accumulated periodically and analyses are made with the intention of devising more effective conservation measures. Our last study is slightly stale by now, but the results may be of interest. The

study consisted of just under 8,000 terminations in Canada and the United States over a period of almost a year.

For 30% of the cases, no reason was given, while for another 2% the policyholder refused to give the reason. An additional 1% merely stated that they were dissatisfied with the policy. Only 16% of the policies studied gave the disappearance of the need for insurance as a reason. Of these, 2% were pension trust cases terminated when the employee left the company, while another 1% resulted from divorces.

The balance of the study, or just about 50% of the total, represented terminations where part or all of the need for insurance continued. Twenty-four percent apparently still needed full insurance, but needed the cash values more. This group included such reasons as house purchase, investment in own business or elsewhere, medical bills or other emergencies, and education funds. Included in this group of policyholders were 2% who gave as an amazing reason the fact that they were getting married.

Another 12% needed coverage but could not manage to continue premium payment due to a change in circumstances. The most commonly named circumstances were unemployment (3%) and retirement (2%). Ten percent of the terminations were policies which were heavily indebted, so much so that the policyholder chose to cancel rather than attempt repayment. Only 3% of the cases studied gave replacement by another policy as a reason; these were split almost equally between our own and other companies.

We have made only one other smaller study covering replacements of our policies by policies in another company. This was of 57 replacements in the month of November 1960, all in Canadian branches. We were surprised to find that of these 57 policies only 3 were replaced by term policies rather than another permanent plan.

With respect to section B, we feel that it is far preferable to have this question on the application form rather than on a separate piece of paper. We try to keep the number of forms which have to be carried by our agents to a minimum. The hazard of an incorrect answer will exist wherever the question is put. We feel that the best safety device is an agent who is made and kept strongly aware of the Company's policy toward replacements, which is to discourage those which are not in the policyholder's best interests. In a further attempt to disclose replacements, we have an additional question on this subject in our Agent's Report.

With regard to section C, if more states are going to introduce regulations regarding replacements, then perhaps a model law might be advisable, provided it could be kept as simple as possible. We feel the New Jersey law adequately covers the three most important features: first, notifi-

cation of the other company, second, a prepared warning to the policyholder, and third, a comparison of features by the agent. This should be enough to put the insurance buyer on his guard to protect his own interest, and also puts the onus on the agent to prepare an adequate comparison or else risk loss of his license. If more elaborate regulations are to be introduced, I think it should first be demonstrated that the value of the additional unwise replacements which are prevented exceeds the cost of the extra procedures to policyholders as a whole.

MR. FURROKH N. DASTUR: With respect to section B, at Occidental Life we have had this replacement question in the application for a number of years. If this question is answered in the affirmative, then our practice is to notify the other company of the coming replacement.

We have no reason to believe that this question is answered inaccurately because the applicant or the agent has an axe to grind. However, with states like Maryland, Wisconsin, and New Jersey coming out with new regulations concerning replacements, it will not be surprising if some of the agents answer "No" to this question to avoid extra work and red tape, hoping that the applicant will not notice this question. Where this question is included with the main part of the application, it is very likely that the applicant may sign the application without being fully aware of how it is being answered. In order to avoid this as well as to increase the effectiveness of this question, a separate form aside from the application would certainly bring it to the notice of the applicant and he would know more precisely what he was signing.

When we are notified by another company of a pending replacement of our insurance, this information is passed on to the agency of record whose job is then to follow up on the case. In such cases, the general opinion of the agents is that it is difficult to conserve this business because the new agent has already gained the confidence of the applicant and the new sale may be an accomplished fact before the original agent has had an opportunity to take any counter-measures.

In connection with replacements, Occidental's philosophy is that switching by agents is nothing but negative selling which should be discouraged with very strict measures. We investigate all complaints that we receive from other sources concerning a replacement to satisfy ourselves that such replacement is not switching. Our Company practice is also not to sign any contracts with mutual fund or equity salesmen.

Occidental Life does not subscribe to replacement of old insurance by new insurance, term or permanent. Such replacement does not provide any additional protection to the insured, it does not tap any new market.

It is simply pirating somebody else's business and does not benefit the industry in any way. By the same token, we feel that it is wrong and damaging to the industry and to the public to replace an old term policy by a new permanent plan with the attendant acquisition costs when the policyholder can obtain such coverage through his conversion privilege without sacrificing the incontestability and any other valuable features of his existing coverage.

MR. NATHAN F. JONES and MR. BERT A. WINTER: Of the strict replacement regulations only New Jersey's has had time to build up any volume of experience. It is difficult to determine whether the New Jersey regulation has had any substantial effect, since for years The Prudential has been notifying, on a nationwide basis, all threatened insurers, and during 1961 we made stricter our compensation controls on internal replacements.

The variety of state regulations has not yet caused important difficulties, but the volume of complaint cases has inevitably somewhat increased in these states. These complaints are *by*, as well as *of*, our agents. Both cause expensive handling, since they now require interpretation under both our company rules (or, sometimes another company's) and the applicable state regulation. We hope and believe this problem is mostly a temporary one.

Draft regulations requiring a proposal with specified items generally mention items which would make it impossible for us to follow our policy of smoothing the way of the conscientious agent. For this and other reasons, we join the majority of the industry in favoring the general type.

We think our own company rules offer the public and the agents of other insurers sufficient protection. If there are no further new strict regulations, the need for a model law is minimal. If there are further regulations, a model law (preferably a regulation rather than a statute) might seem desirable. However, it is difficult to foresee general agreement on a model law strict enough to be acceptable to those supervisory authorities taking the severest view of this matter.

The Prudential has sought to encourage limitation of regulation to replacements of permanent value life insurance. This is on the basis of "first things first." In addition, the contemplation of conversion has traditionally been a lauded feature of the term insurance sale and the term insurance contract. We see no reason, no equity, in demanding for the original writing agent—let alone the original writing insurer—an exclusive on conversion.

However, we recognize that term today often forms a substantial part

of many a portfolio looked upon by its owner as essentially permanent. Certainly replacement of this, even by permanent insurance, often has some of the undesirable aspects of the replacement of permanent value insurance.

MR. RALPH P. WALKER: Of the 12 states in which the Wisconsin National operates, only Wisconsin has adopted a regulation on replacements. It was adopted May 15 of this year. Since this date, we have received no applications in Wisconsin stating that the insurance applied for was to replace existing insurance. It is too early to tell what the effect will be upon the lapse rate. While there may be some temporary improvement as a result of a regulation, I believe no permanent improvement will take place, unless insurance departments invoke penalties against "twisting" agents. I do not believe there is a need for a model law covering replacements. What is needed is better enforcement of misrepresentation statutes.

Traditionally, there has been an open season on term policies by writers of permanent insurance. If the insured plans to use the attained age term conversion privilege, he will receive a new policy, which may be no better in his existing company than with a new company, except with respect to contestability. If all the questions in the new application are answered truthfully and completely, competitive and service considerations would seem to be the most important factors affecting the insured's choice. If he plans to use the original age term conversion privilege, it seems to me that the same considerations are involved as on a permanent plan. If he plans to renew a term policy, I see the situation as comparable to an attained age conversion. If he does not plan to renew or convert, I believe the same considerations are involved as on a permanent policy, but, in most cases, to a lesser degree. In some cases, however, the lack of cash values may prove to be a greater disadvantage on the term plan than under a permanent plan. If the term policy does not fit the needs of the insured and permanent insurance does, I believe we should not promote replacement rules which discourage this change.

MR. VICTOR E. HENNINGSEN repeated the discussion which he had presented at the Jacksonville regional meeting.