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## COST DISCLOSURE

Moderator: WILLIAM M. SNELL. Panelists: RICHARD V. MINCK,  
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1. Status of required cost disclosure in the United States.
2. Recent commentary on cost disclosure - Moss Committee Report of 1978, Jacoby Study of 1979, and Federal Trade Commission Report of 1979.
3. Elements of a good disclosure system as viewed by the agent, the consumer, and the company.

### State Adoption of the NAIC Model Regulation

MR. RICHARD C. MURPHY: The 1973 Interim Cost Disclosure Regulation was adopted in Arkansas, California, and Texas, while a modified version was adopted in Pennsylvania. Pennsylvania has recently modified their regulation, which I will discuss later.

In New York and Kansas, there are no mandated disclosure regulations, but there are regulations which prohibit the use of any cost method which does not recognize the true value of money. I expect, for that reason and for the need for uniformity among company cost disclosure mechanisms, that many companies are using the interest-adjusted net cost method in conjunction with the preparation of ledger statements for New York and Kansas agencies.

In at least 24 other states, the 1976 model regulation has been adopted. Together with the 4 states adopting the 1973 version, 28 states now use the National Association of Insurance Commissioners (NAIC) cost disclosure indexes and buyer's guide. An additional 5 states have held hearings on the model but have not yet adopted it. Several recent studies indicate that many companies are complying with the model regulation for all of their business. Recent analysis shows that 75% of all policies being sold today are accompanied with buyer's guides and NAIC index information.

The state of Wisconsin has a disclosure mechanism which also requires a preliminary policy summary at time of application. The preliminary policy summary makes use of the surrender index but not the payment index, nor is there any indication of the effect of dividends on the surrender index. This latter problem is handled through presentation of the equivalent level annual dividend in those states having the model regulation.

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State Deviation from the NAIC Model Regulation

Bill Snell will discuss the Wisconsin situation.

In the state of Pennsylvania, a preliminary policy summary is required. This preliminary disclosure statement requires all of the policy facts as to premiums and cash values but does not require presentation of any cost index. This preliminary summary must be presented at the time of application.

Pennsylvania has required the delivery of this preliminary policy summary about 4 years. From conversations with Pennsylvania agents, it appears that very few agents have been delivering this preliminary policy summary. Since the preliminary policy summary must, of necessity, be prepared in the field and delivered at the time of sales presentation, it requires a much greater effort on the part of the field staff and it complicates the sales process. In order to address the problem of non-delivery, the state is now requiring the companies to receive a certification that the preliminary policy summary has been delivered. We are currently in the process of complying with this requirement. Since this must be policed by the individual companies, I have no doubt that the certifications of delivery will be received, but I am not so sure that the preliminary policy summaries will be delivered.

In the state of Maryland, a recently enacted disclosure regulation has two special features. First, there must appear a statement in the disclosure form which warns that any oral statement of the agent should be considered in the purchase decision, but only if it is reduced to writing and given to the applicant. The regulation also requires that the prospect be advised to contact his own attorney if tax savings are a part of the presentation.

Although Florida has not adopted a cost disclosure regulation, it has recently circulated a proposed disclosure regulation. This regulation is almost identical to the proposed regulation of the Federal Trade Commission (FTC). It contains a preliminary policy summary requirement with presentation of Linton yields and a surrender index. Neither of these indexes will contain a quantification of the effect of dividends. The policy summary must also indicate the premium difference between the annual payment mode and other modes available.

MR. WILLIAM M. SNELL: The state of Illinois is having a hearing on October 29 and has proposed in its regulation that the buyer's guide, but not the policy summary, be given out at time of application.

NAIC Activities In Area of Disclosure And Cost Comparison

MR. RICHARD V. MINCK: During this year the NAIC appointed a new task force to review and to reevaluate the subject of disclosure and cost comparison for life insurance. That task force is chaired by Commissioner Hemmings of Michigan and has held the first of a series of scheduled meetings.

There is still in existence a task force that has been dealing with a number of questions related to the 1976 model regulation. That task force has two advisory committees. One is chaired by Thomas Kelley of the New York Insurance Department and is charged with reviewing the potential of manipulation of cost indexes by companies to make products appear more attractive buys than they really are. That committee has held several meetings.

A second advisory committee is chaired by Charles Greeley of the Metropolitan Life Insurance Company. Its duties are to develop methods to measure the effectiveness of the NAIC model regulation on life insurance solicitation. That committee also has held several meetings and has made some progress toward carrying out its assignment.

The NAIC task force will eventually have the products of these advisory committees together with the suggestions of the staff of the FTC and those of other interested parties to consider in deciding what changes, if any, are needed in the current NAIC model regulation.

MR. SNELL: The NAIC has not determined yet whether they will have an advisory committee to reevaluate the NAIC solicitation regulation. The original regulation was written without an advisory committee. The decision will be made after the hearing in Detroit in November.

#### Wisconsin Task Force

MR. SNELL: In Wisconsin in July 1977, the state held a hearing on the NAIC Model Life Insurance Solicitation Regulation. Most people present suggested that it be adopted. Nothing happened until May 1978, when a new regulation was released for hearing in June. That regulation was drastically different from the NAIC model. It would require a different buyer's guide. It would have also required that the rate of return be provided at the end of 5, 10, 20, and 30 years. Also a preliminary policy summary was to be given out at the time of sale which would include only the surrender cost index. The policy summary would only mandate the surrender cost index, but other data, such as the net payment index, could be provided if so desired.

After lengthy hearings during the summer of 1978, the regulation was promulgated mandating the surrender cost index starting January 1, 1979. Since the rate of return would not have been required until January 1, 1980, a special task force was set up by then Commissioner Wilde to examine this in more detail. The charge was to examine the following:

1. The relationship between the Linton yield and the surrender cost index and the unique values of each for purposes of understanding and comparing the costs of life insurance products.
2. The possibility of giving meaning and context to the surrender cost index which would provide it with independent significance and make it unnecessary to use a rate of return index.

3. The assumptions and context which should be prescribed for all insurers to follow if a rate of return index is to be used, either for cost comparison purposes, or to provide a measure of investment "yield" which is not subject to misrepresentation.

I am chairman of that task force. Other members are Donald Maier of Metropolitan, Bill White of Connecticut General, Steve Rieth of Aid Association for Lutherans, Brad Gile of the Wisconsin Insurance Department, and originally Bill White of the American Council of Life Insurance (ACLI). In July 1979, Tony Spano replaced Bill White as ACLI's representative. In addition, John Lounds of Allstate has attended most meetings. We have met monthly since November 1978, with a break in the summer.

The Wisconsin Insurance Department sent a questionnaire to all companies licensed to write insurance in Wisconsin. That questionnaire solicited data on both whole life and economic plans for issue ages 25, 35, 45, and 55, and for amounts of \$2,000, \$10,000, \$25,000, \$50,000, and \$100,000. The data included premiums, dividends, and cash values for the first 20 years, except for one cell which provided data for the first 30 years.

About 290 companies provided data for at least one cell. We at Northwestern Mutual Life are in the process of drafting a report on the results based on suggestions from the task force. We hope to have a report in rough form for the task force in early January 1980. After revisions are made, the report should be released to the Commissioner in March 1980. In addition to keeping the state of Wisconsin informed of our progress, we are also reporting to the C(3) Cost Comparison Committee chaired by Mrs. Erma Edwards of Nevada.

The data so far shows that the rate of return does not provide a better measure of cost as opposed to the surrender cost index. We are using the low rates from the 1974 Society of Actuaries study the committee that was chaired by Bart Munson. The correlation between the surrender cost index and the rate of return improves slightly if we separate participating business from non-participating business. It is still good, however, if we combine par and non-par.

The surrender cost indexes are very favorable, and the rates of return for the better companies are over 6%. For the cell with data for 30 years, we get rates of return over 7%. I believe that we will be able to show that although the rate of return is good and that it is certainly much better than the FTC claims it is, it does not improve the rank of the company nor is it better than the interest-adjusted cost index in determining from which company one should purchase insurance.

The regulation as originally released on January 1, 1979, was not to include the rate of return but only the preliminary policy summary which would be given out at the time of sale. That regulation was stopped by a court injunction and that is the current status.

A new hearing was held in April of this year. Nothing has come out since that hearing. The mood of the department still is to have some disclosure at the time of sale, but they would like to rewrite the buyer's guide.

MR. MURPHY: One of your charges was to comment on the use of the Linton yields for dissimilar plans and to compare the costs. Has your group made much progress on that issue?

MR. SNELL: We have looked into that and are not ready to comment at this time, but that issue will be part of the report. We are dividing Linton yield into three possible uses:

1. Comparing similar plans
2. Comparing dissimilar plans
3. Comparing whole life with term and a savings fund

MR. MINCK: Have you done any Linton yield calculations for term insurance policies?

MR. SNELL: No, we have not. Of course the Linton yield figures show that the smaller the policy, the better the rate of return. In other words, the results are better if one purchased fifty \$2,000 policies than one \$100,000 policy, because of the way that the policy fee is factored into the calculations.

MR. MURPHY: Are you going to look at cost indexes as they might apply to replacements or to the determination of whether to lapse coverages and buy new ones?

MR. SNELL: That is an offshoot of dissimilar plans in the sense that it is different durations. We did look into this briefly with data based on our own companies. For example, we studied the effect on the rate of return of replacing a 10-year-old Northwestern Mutual Life policy with a new Northwestern Mutual Life policy. Better rates of return did result on the older policies. Most of the committee members felt that the rate of return, in this instance, was better than the surrender cost index or the interest-adjusted cost index, but we do not plan to recommend it.

There was a symposium held by the University of Wisconsin in July 1977, at which Clair Lewis presented a very lengthy discussion on the matter of replacement and whether an index could be developed. The interest rate is a very sensitive choice in that calculation as to whether one should or should not replace. What does interest rate mean to the buyer? It is very possible that if, to me, 4% seemed to be a good rate, the calculations might prove that I should replace, whereas if it were 6%, it could go the other way. Then taxes have to be taken into consideration. I think that we will rely on most of the material that came out of this symposium.

MR. MURPHY: It strikes me that the interest rate, a very sensitive determinant in deciding whether to replace or not to replace, is also a very sensitive determinant in deciding whether to buy participating or non-participating insurance.

MR. SNELL: Very true. We noticed, that, in determining the correlation between the surrender cost index and the rate of return, the separation of companies into participating and non-participating does make a big difference.

Moss Committee Report of 1978

MR. JACK E. BOBO: The first of the latest series of reports that created somewhat of an explosion was the Moss Committee Report which was released in 1978. The purpose of that report, in a broad sense, was to evaluate state regulation. Essentially it was nothing more than a continuation of the concerns that had been expressed by the Hart Committee in prior years. Those concerns were whether or not competition was lacking in insurance, why policies with disparate costs were able to compete, whether or not inappropriate policies were being recommended and if that resulted in inadequate coverage, and the problems associated with high lapse rates.

In addition, as far as the purpose of the report was concerned, there was a commentary on the activities of the NAIC dealing with the fact that only 11 states at that particular time had adopted the NAIC model regulation on disclosure, that many of the critics of the industry were not happy with that proposal, and that there was a general lack of commitment on the part of states towards proper regulation.

Additionally there was a commentary on some of the FTC activities, specifically as to the availability and adequacy of disclosure information and the impact of that information on consumers. The FTC at that time was perceived as looking into the NAIC's efforts as defective and was actively lobbying states into inaction until such time as the FTC had concluded its own study.

The issues that were addressed by the report were, first of all, is there a failure in the life insurance market? If there is a failure, what are the indications of that failure, the causes, and the consequences to the consumer? Additionally they raised the question, what are the remedies? Is the NAIC proposal adequate? Does the FTC have an appropriate role to play in this whole subject area, and what remedies do they propose? Questions were also raised concerning the historical perspective and performance of state regulation.

The findings and conclusions, and this is the part that created the explosion, were that there is a shortfall of information, particularly with respect to ordinary life and that consumer experience does suggest that the consumer is not able to adequately determine the suitability of the product, the quality of the product, or the cost of the product. As a consequence, consumers are sustaining losses, and this would be a definite indication of a market failure.

Their conclusion also was that the NAIC solution was not adequate, that the states were much too cautious in this general area, and that the consumer was not being properly represented. The study also reinforced the FTC's efforts as being justified and lawful. I might add parenthetically that there is a considerable body of opinion beginning to surface that feels that their activities under Section 6 of the FTC Act are probably not legal.

The recommendations asked that the policy summary be provided prior to the purchase in order to assist in evaluating whole life versus term with a side investment fund. If this were not done, the alternative would be providing Linton yield figures. To assist in making comparisons, they recommended the use of the company retention method or surrender indexes and suggested that the traditional net cost method be banned altogether. They also recommended that annual ledger statements be provided to consumers, with any years of loss highlighted in red.

The policy summary should provide, in addition to the above information, the interest rate charged for fractional premiums and the policy loan interest rate. The policy summary should be separate from the buyer's guide. The standard format that was prescribed should be provided on request, but its availability should be well advertised and made known to the public. The buyer's guide should discuss the insurance needs of the prospect, the choices between term and whole life, the choices between individual and group insurance, and the differences between participating and non-participating insurance. Also a discussion of the agent and the services he provides, an explanation of the indexes, and mention of the problems associated with underinsurance and high lapsation should be included.

As far as the timing of this disclosure, the buyer's guide should be provided on the first visit, no premium should be taken until 20 days after the policy summary was provided, and no application should be taken until after the indexes were disclosed. The irony was that none of the foregoing was supposed to necessitate any extra visits by agents. The other disclosure available on request would be the comprehensive data displays, including the net amount at risk, the rate of return on the so-called savings element of the policy, the annual allocation of the premium between savings and risk, and the data provided to age 75. The purpose of this would be to enable states to detect and prevent manipulation and to enable agents to be better prepared and able to explain this information.

In terms of miscellaneous recommendations, the report indicated that both the NAIC and the FTC should study ways to encourage the development of professional insurance consultants who work for a fee, rather than on commission, and the marketing of lower priced insurance products. Again, they suggested that the states be given the opportunity to act first.

The Moss Report did contain a minority view, which essentially disagreed with all of the above. Its main thrust opposed the government dictating the choices to the public.

MR. MINCK: Would you say that it is fair to add that the report was the work of one of the staff members and did not involve any particular thought or action by the members of the committee with the possible exception of the chairman who has since retired?

MR. BOBO: It was obvious that the chairman was retiring, and the man who drafted the report was looking for a job. The report was a rather extensive work, impressive also, and clearly this might have been part of his job-seeking efforts.

MR. SNELL: One thought about the Moss Report is that requiring that costs for both term and whole life be provided when selling insurance products does not seem right in the American marketplace. If the agent wants to do it voluntarily, that is one thing, but to have it mandated, seems to be against our way of marketing products.

MR. BOBO: Certainly from an agent's perspective, we would disagree completely. In the final agenda item, I will have something to say on that specific subject.

MR. MURPHY: Jack, as you mentioned, one of the recommendations was to develop professional insurance consultants working for a fee. A related recommendation was to develop products that had a front-end load and then were purchases of insurance at net rates. With respect to both of these items, do you see anything among agents that is moving in this direction?

MR. BOBO: There was a fairly comprehensive discussion on this point at the Certified Life Underwriters (CLU) forum last week. The panel led by Dave Bragg from the American College discussed the whole subject area of the financial consultant and the nature of any fee structure that might result from it.

There is a discernible move among the field force to separate the contractual services that an agent is required to provide his policyholders from some of the services that an agent would ordinarily provide, for example, as in the estate planning area. These are not contractual services and yet they constitute an enormous amount of time and effort. The pension field would be another example. There appears to be a growing trend and interest among the field force in developing a fee structure for the providing of services above and beyond contractual services.

This is somewhat controversial, because there are strong advocates of both points of view. There are agents who feel that the commission structure as it presently stands is adequate, and any movement to try to generate additional income in this area might provoke a storm of protest or perhaps legislation to reduce the commissions in recognition of the fees. I think there are some companies that are exploiting the fee structure, on the basis that a fee is a deductible expense while a commission built into a premium is not. There are all kinds of abuses that are inherent in this whole subject area. There is a lot of discussion about it, a lot of pros and cons, but I do not see any firm movement that anyone has taken.



Jacoby Studies

MR. MURPHY: During 1978, Dr. Jacob Jacoby of Purdue University performed two studies that were commissioned by the FTC. He released them in 1979. The first study attempted to measure the frequency with which consumers use cost information and the effect that such cost information would have on the ability of the consumer to select the lowest cost policy. According to the summary of the results contained in the FTC Study, premiums, company name, and many other factors were identified and requested more frequently by the insurance purchaser than any other cost information. The savings yield was referenced 10th out of 37 items. The retention cost index and the surrender index were referenced, in order of frequency, 16th and 17th, respectively.

Other elements of Dr. Jacoby's first study indicate that if the potential customer is given a statement indicating that he should reference the cost information in order to select the most valuable policy, he will much more frequently reference the cost information. An analysis of the cost of the policies associated with the frequency of referencing the cost information indicates that, in about 85% of the cases where the individuals reference the cost information, they will select a low cost policy. The difficulty with this statistic is that in about 75% of the cases, individuals referencing no cost information likewise selected the lowest cost policy. The FTC justified this by pointing out that other favorable plan features would have led the client to select the most valued policy even in the absence of cost information.

The FTC concludes from this study that the presence of cost information will improve the quality of the shopper's decision, and the inclusion of trigger statements will, in fact, significantly increase the frequency with which individuals will reference cost information.

The second Jacoby study, the one that is better known, is an amorphous mass with a little bit of something for everyone. The participants in this study were divided into six groups. Each of these groups either received the FTC cost yardstick or did not receive the yardstick. Also each of the groups received a choice of either no buyer's guide or one of three buyer's guides prepared by the FTC, Professor Belth, or the NAIC.

This study is highly criticized because it does not include any allowance for the effect of the agent. The FTC, while recognizing this shortcoming, points out that the study was only attempting to measure the effectiveness of certain disclosure mechanisms relative to other disclosure mechanisms pitting, for instance, the FTC buyer's guide against the NAIC buyer's guide.

I said this study contained something for everyone, so let me point out two areas of apparent contradiction. First, Dr. Jacoby includes the following statement in his conclusion. "While some of the data suggests that subjects exposed to a disclosure system (particularly the FTC buyer's guide) will fare better than those not exposed to such a system, the differences were not as striking nor as conclusive as expected." While this comment has been referenced frequently by my own

company management and by the ACLI, the FTC has assigned its own interpretation to that statement on the basis of subsequent conversations with Professor Jacoby. Their interpretation is that the extensive disclosure system referenced as not being effective was the combination of the yardstick and a buyer's guide, and what Dr. Jacoby was surprised at was the performance of the group that received only the preliminary policy summary. This group received only a brief statement of cost and seemed to select lower cost policies quite frequently. The FTC then takes solace from this conclusion and says that proves their contention that the preliminary policy summary is quite effective.

The second area of obvious conflict in the Jacoby study is with respect to the buyer's choice of the low cost policy. The FTC study points out that 47.2% of the participants who received the FTC buyer's guide and yardstick selected the least expensive policy among the 8 available, whereas only 33% of those receiving the NAIC buyers's guide and cost disclosure materials selected the lowest cost. The ACLI then, on the other hand, points out that the more expensive policies were chosen by 43% of those given the FTC guide and yardstick, while only 30% of those receiving neither a buyer's guide nor a yardstick selected a policy of the more expensive group.

It is important to note, of course, that the least expensive policy was defined as least expensive by the FTC. It was their standards which were employed to choose, from among the available contracts, the one which was "most beneficial" to the consumer.

Dr. Jacoby states in several areas that "consumers exposed to any one of the six different disclosure systems used in this investigation were by and large able to make good purchase decisions" and elsewhere "our subjects reported that the various disclosure systems were helpful."

Temporarily, the Jacoby Study referenced above will be cited by all parties as an authoritative source supporting their point of view. Finally, the counter pressures will negate the study, and it will fade away.

MR. BOBO: With respect to the fact that the Jacoby Study offered something for everybody, one of the things that impressed us was Dr. Jacoby's press release. In it he stated that buyers are able to make decent buying decisions, buying decisions, and questioned the value of the indexes when taking into account the cost/benefit effectiveness and the fact that the consumers are ultimately going to have to pay the cost producing these items. In the light of that press release, would you agree or disagree, at least from Dr. Jacoby's point of view, that the results of his study lean more toward the industry's point of view than the FTC's point of view?

MR. MURPHY: There is probably more in this report for the industry than for the FTC. But after going through each of the tables and after examining some of the detail, one is able to pick out what is quite damaging material for the NAIC buyer's guide and for those indexes. Frankly, this is not something that I would want to cite as a document or a piece of research supporting any of our positions. It has as much damage involved in it as it has support.

MR. SNELL: One thing that I have always thought a cost disclosure system was supposed to accomplish is to hopefully point the prospect toward a good buy and away from a poor purchase. It is not necessary to point him to the "least expensive" product, but instead it is to be sure that what he does buy is not a product that is so expensive he would later regret that decision. Thus, it seems that the greater percentage of cases leaning toward the most expensive policies is a more meaningful figure than the other percentage that you quoted.

MR. MINCK: Bill, does that mean that you do not perceive the future situation where everybody buys a policy that costs much less than the average?

MR. SNELL: Yes.

Federal Trade Commission Staff Report

MR. MINCK: On July 10, 1979, a report on life insurance cost disclosure prepared by the staff of the FTC was presented to the Senate Commerce Committee by the chairman of the FTC.

The report runs 185 pages with ten appendixes requiring another 240 pages. The introduction to the report and the accompanying press release contain the key conclusions reached by the FTC staff. They described their study as an examination of consumer savings through life insurance. The staff had concluded, at the time when they first announced the study, that consumer savings through life insurance earned an extraordinarily low rate of return, and that the low rates of return paid by companies were never revealed to policyholders.

The FTC staff made several related claims. The claim that received the most publicity was that the average "rate of return" paid by the industry in 1977 was 1.3%. The derivation of this figure was explained in Appendix II by the following calculations:

1. The FTC staff estimated policyholder savings at the beginning and end of 1977 as the sum of 90% of the reserves for the individual life insurance line plus 76% of dividends on deposit. (The first ratio is intended to estimate aggregate cash values. The second ratio was used because the FTC staff understood that 76% of the dividends paid by life insurance companies went to individual policyholders.)
2. Using the above estimates to determine the increase in policyholder savings during the year, by subtracting the beginning of the year figures from the end of the year figures. the FTC staff then allocated premiums received during the year into a part corresponding to dividends paid to policyholders, a part corresponding to benefits other than death benefits, a part corresponding to the cost of "pure insurance," and concluded that the remainder of premiums constituted a savings deposit.

3. Since the "increase in savings" as defined by the FTC staff amounted to \$7.8 billion and since the portion of premiums determined by the FTC staff to be a deposit to savings amounted to \$6.0 billion, the FTC staff concluded that only \$1.8 billion of interest was credited to savings. Since the average value for savings as defined by the FTC staff was \$139 billion, the resulting "rate of return" was, therefore, 1.3%.

This calculation is remarkable in several respects. First, the FTC staff was able to determine a "rate of return" on the "savings" in the individual life insurance line without ever referring to the interest actually credited to that line of insurance - which was, in fact, \$12.4 billion. Second, in determining the premium for "pure insurance," the FTC staff developed a third formula in addition to that used in the text of the report and the formula used in the suggested changes to the NAIC model regulation. They clearly demonstrated that the lower the assumed cost of "pure insurance" the lower the resulting "rate of return."

The FTC staff report also claimed that many new policies offer "rates of return" far lower than alternative investments, that many old policies offer even lower rates of return, that there are severe penalties for early withdrawals and such penalties are unannounced, and that the lack of disclosure of rates of return permits companies paying less than 2% to compete with companies paying two or three times as much. The staff report also expressed concern that commission scales and inadequate or improper training were causing agents to sell cash value policies rather than term insurance.

The FTC staff report recommends changes in the NAIC model regulation to require the use of the Linton yield cost index for cash value policies, the use of 20-year surrender cost indexes for all policies, and changes in the buyer's guide designed to make sure that buyers consider term insurance and savings as an alternative to whole life insurance.

The publication of the FTC staff report gave rise to newspaper stories, television programs, and various types of advertising or promotional material suggesting the replacement of existing policies or the use of term insurance and some sort of investment as a substitute for whole life insurance.

People with books or investments to sell have, of course, been making such suggestions for many years. What was new was the endorsement given to the idea by the federal agency charged with protecting consumers.

The ACLI requested the opportunity to testify before the Senate Commerce Committee in order to rebut many of the assertions contained in the FTC staff report. That opportunity was granted on October 17. A group representing the Council and the NALU testified at length on the subject. Copies of that testimony have been distributed to all companies that are members of the Council. If you would like a copy, simply drop me a note.

MR. SNELL: I would like to add that Northwestern Mutual Life's purpose in the life insurance business is to provide death benefits to policyholders. Although our sales might be 30% term in a given year, we have approximately 20,000 death claims yearly, and only 84 of those claims are term insurance policies, with the rest being permanent cash value policies. The last time we studied this, we presented the results to the FTC.

MR. MURPHY: A few months ago some members of our staff were eagerly awaiting the release of the report of the General Accounting Office. The report was to include remarks to the effect that no federal intervention would be allowed in the area of insurance because of the effective or somewhat effective jobs of the state regulators. Somewhere between that draft and the end, something changed. I am not sure exactly how the General Accounting Office report came out, because I have not seen it and it is relatively new, but can you discuss it?

MR. MINCK: The General Accounting Office did a study and circulated their preliminary report some months ago to various people. After that was circulated, they got some advice from the staff of some senators suggesting that more background be given in the report. The report, as it finally came out, could be categorized that way. It is a fairly lengthy report aimed very heavily at personal lines, casualty business, automobile insurance, homeowners, etc., and the pricing problems and the regulation of premium rates by the states.

It still would support the same two conclusions, that is, that there is a wide variety of effectiveness in state regulation and that there is no particular reason to favor federal intervention at this time. The substance of the report is still much the same and not terribly damaging. After the Commerce Committee hearings in the Senate, there is a chance in this Congress of additional hearings both in the Senate and the House and likelihood that the FTC will appear at them. I do not imagine that the FTC's position will change drastically. It will probably be a replay. I talked to the economist of the FTC after our hearing last Wednesday. The FTC had heard from a number of people since then but had not changed their minds that 1.3% is a reasonable way to measure the rate of return credited on life insurance policies in 1977.

#### Elements of a Good Disclosure System - Agent's View

MR. BOBO: The agent is most affected by any kind of disclosure system, because he is the one who ultimately has to face the public. The individual agent has always been mystified by this whole discussion from the earliest days and has perceived it as a thinly disguised attack on cash value insurance. From the agent's point of view, any system makes more sense the farther away that one is from the marketplace. The part that troubles the agent more than anything else is the fact that most systems tend to produce similar results when comparing similar policies. There does not appear to be any substantial difference in the ranking of the companies, whether using the traditional method, the interest-adjusted method, or any of the other methods that have been mentioned. Moreover, the sophisticated sale has always considered the time value of money. To suggest that a major purchase decision is made without consultation with an accountant

or others who are able to take that into consideration, again, ignores the reality of the marketplace. However, the unsophisticated sale has never hinged on esoteric ideas. Many times the introduction of such ideas can destroy a sale. The whole life versus term and invest the difference issue cannot be reduced to simply an economic presentation, because psychological, philosophical, and societal issues sometimes have as much or more bearing on that decision than the economics alone. However, whatever economic information is provided should be accurate and understandable.

The agent also feels that the present system is much better than it is perceived by its critics. For example, the Moss Report recommended that a discussion of insurance needs take place. This is almost a ludicrous suggestion, because people do not buy insurance unless there is a need. Any system which requires an agent to artificially create competition is unrealistic.

There is also a feeling that there is potential danger in disclosure overkill. I could point to the securities business as a case in point. Consider the typical stock prospectus. Who reads it? Who understands it? The big danger, though, is that the prospectus, as a large impressive document on a company listed on the stock exchange or in a mutual fund, implies credibility.

Any agent will tell you that buyers who shop tend to postpone a decision to buy and in fact in many instances wind up never buying. Life insurance is not something that people readily buy or want to buy, and they will tend to grasp hold of any excuse to procrastinate or postpone. Elements of both the Jacoby and the Formisano Studies do support this point of view. We recognize that they do not utilize the best scientific data, but at least they do reinforce some of the loosely held convictions of the average agent.

The NALU, the organization primarily responsible for legislative advocacy, takes the position, on behalf of the agent, of supporting the NAIC model regulation. The regulation initially was nothing more than a cost disclosure requirement. We feel and have always felt that an undue focus on cost alone would ultimately be counterproductive in so far as the public is concerned. No system is perfect, this one included, but at least this one is workable and it does fulfill the one admonition of not interfering with the sales process. That would be our primary reason for continued support of the NAIC system.

MR. MURPHY: Preliminary policy disclosure is a heavy topic and it is being brought up in a number of forums. What does the agent think about this, how does he react to it in Pennsylvania, for instance, and what does the NALU think of it? In addition, it has been argued that perhaps cost disclosure information is not as much for the customer as it is for the agent. Do you see agents refusing to represent higher cost companies now that cost disclosure information is more commonly available?

MR. BOBO: We are not aware of any particular impediment that the Pennsylvania statute has produced, but it is largely because it is not being complied with perhaps in the full spirit of the law. Essentially, the only thing that an agent gets paid for is selling. Obviously, whatever product he represents, he is going to show it in the best possible light with that objective in mind.

In so far as agents refusing to work for high cost companies, there has never been a secret as to what the cost of insurance was. There has always been an awareness of what various companies charged. Some of the discussion taking place today, though, is producing a certain amount of trauma among agents who represented a company for many years and suddenly find that company today a target for replacements. The agent who represented this company finds himself unable to defend the product that he had been marketing for so long. He looks to the company for support, and they cannot give him anything that is helpful. Nobody likes to admit that they have been ripping off the public for 20 or 30 years, and this can cause some tremendous psychological problems. So yes, there is a certain turmoil among the field force today. To summarize this, the primary purpose of disclosure is not to inform agents of the high cost and the low cost products, because they have always been able to find that out. It is really just the pressure that has been put on cost today that is bringing it about, not the current availability of new information.

MR. MURPHY: Do you see any impending changes in the marketing of life insurance because of this increased attention to cost?

MR. BOBO: Yes, the agent, in order for self-preservation, will have to be more mindful of it. There is a greater sense of independence among agents today in that they feel more freedom to move across company lines. A tremendous challenge to the companies in the future will be to remain competitive and to justify the continued loyalty of their field forces.

#### Elements of a Good Disclosure System - Consumer's View

MR. MINCK: We have a committee on consumer affairs that has been struggling with this question. As a consumer myself, I would like to tell what I see as a good disclosure system.

The main elements of the policy should be clearly and conveniently set forth. These include death benefits, nonforfeiture values, premiums, and illustrated dividends. Values of these key elements should be shown at sufficient intervals to represent the policy fairly.

The key to any disclosure system is to have an agent take the consumer through the policy and through the display of these main elements to make sure the consumer knows what he is buying. The active and enthusiastic participation of the agent is imperative for any disclosure system to succeed.

Some basic information about life insurance is also desirable for a disclosure system. Here, a balance has to be carefully reached

between all the things a buyer might be told and the amount of material the average buyer is willing or able to digest. Again, the availability of an agent to answer questions is key to the success of any booklet that might be developed.

Another element of a good disclosure system is the use of simple language in policy forms, booklets, and related disclosure materials, together with good design and careful presentation. While good agents can overcome most problems, if the material left with the consumer is unintelligible, much of the value of disclosure may be lost.

Finally, if disclosure and other considerations lead consumers to want to compare prices of policies sold by different companies, a reliable and simple, if possible, set of cost indexes should be made available. Such indexes can be used to avoid policies that are priced very unattractively. They cannot, of course, be used to ensure that every consumer buys a policy of below average cost. Moreover, the uncertainties about when buyers will die or lapse their policies and about what dividends will actually be paid make it inappropriate to put too much emphasis on any cost indexes.

The NAIC model regulation requires many of the elements I have described as being useful to the consumer. Despite the poor press it has received from the FTC and some Commissioners of Insurance, the regulation has held up remarkably well. It is much easier to criticize it than to improve it. The people who have started to improve it have not really done so.

MR. SNELL: Consumers consist of many people. If there is to be a regulatory system of cost disclosure, it should not be so all encompassing and complicated that only the sophisticated buyer will benefit.

MR. MINCK: With 10 or 12 million policies being delivered each year, it would be a mistake to concentrate on the relatively few sales made under the circumstances that you described.

#### Elements of a Good Disclosure System - Company's View

MR. MURPHY: A life insurance purchase is a purchase that is renewed each year. With this view, a knowledgeable consumer is a better purchaser since it is more likely that he will continue his purchase decision from year to year and be a persistent policyholder. An early lapse means a loss to the company. Data that we have recently extracted from a customer survey indicates that individuals who are aware of cost information and who may, in fact, have compared cost among different companies make for more persistent policyholders. With this view, disclosure is perceived as a factor to be supported, not frustrated.

When studying for actuarial exams, I am sure that we all used to develop mnemonics which would help us to remember, for instance, the requirements for a satisfactory gross premium scale. The mnemonic that



seems to be appropriate for the elements of a satisfactory disclosure system from the company's point of view is "C-sale".

The cost disclosure mechanism must be consistent with the other sales materials and the presentations of the ledger statement. There has to be consistency from state to state. If inconsistencies are allowed in these regulations, small companies will be unable to comply.

It must be simple for the consumer and the agent. Of paramount importance to the company with respect to any disclosure mechanism is that it not interfere with the sales process. We do not wish any disclosure mechanism to interfere with our taking a binder or starting coverage on an individual. The agent should not have to carry around a portable computer to figure out cost indexes. Rather, we want the sophisticated cost disclosure information to come from the home office, while cost information presented during the actual sales process should be limited to that requested and/or felt by the company as necessary for properly informing the consumer.

It must be adequate to make for an informed consumer and should be predictive of true costs.

It must be legal and satisfy all the requirements in the various states. We do not want to develop major computer systems for each state.

Finally, it must be equitable with respect to the various types of policies and policyholders. That is, the method must present the guarantees versus illustrations, it must present the surrendering cost versus the continuing cost, and it must be equally applicable to term policies and to whole life policies. Since we sell participating and guaranteed cost products, the cost disclosure information that we make available should clearly indicate differences between a participating and a guaranteed cost policy. It is necessary to carefully distinguish between these two types of policies so that the consumer understands that dividends are not guaranteed, and, for recent non-participating contracts, that premium discounts are not guaranteed. The consumer should have available a surrender index and a payment index so that he understands his cost at various points in time, whether he surrenders the policy or continues to pay the premiums.

In the broader sense, a disclosure system might include information about the company and policyholder rights. It might be appropriate to include in this disclosure information hotline phone numbers that might be of use to the company.

Slowly, we are developing a standard replacement mechanism. So far, there have not been legislated any replacement cost indexes, yet many people are developing alternative methods for comparison of old and new policies. It would be helpful to the company if this mechanism could be employed, both for new business sales and for policies considered for replacement.

