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Small Policy Purchases by Seniors

by Andy Hansen

The purpose of this presentation is to discuss the benefits of small policy purchases by seniors, describe the market and distribution for these small face amounts of life insurance, and demonstrate the dimensions of the market. The data in this analysis also illustrate the almost total lack of market conduct concerns with these products at the consumer and regulatory levels. And finally, the data will substantiate the pricing methodology and premium to death benefit ratios.

Benefits of Small Policies

Many consumers arrive in their senior years with limited assets and little or no life insurance coverage. Expenses associated with the cost of a funeral and other final expenses, such as unpaid hospital and household bills can create a significant burden to a decedent's family. These expenses can be managed efficiently and economically through the purchase of a life insurance policy. The policy can have a benefit that will assure the policyholder that his/her family will not be burdened with these specific expenses and provides for an orderly disposition of the final affairs of the insured.

Other benefits of these policies are:

Availability

The limited underwriting used to issue policies to seniors provides coverage to the broadest range of applicants. This range includes individuals who might not otherwise qualify for coverage because of age or physical condition. The varied distribution channels used to market these coverages provide consumers not otherwise served by traditional methods of distribution an opportunity to purchase coverage.

Affordability

The cost per thousand for these small policies may be more than a consumer would pay if they were buying in larger amounts. However, the costs are reasonable in relation to the coverage provided and the greater mortality risk being covered.

Consumer Acceptance

The policies are simple in their design and easy to understand. The needs that are covered by the policies are clear and strongly felt by the policyholders. Millions of policies have been purchased by seniors to pay for pre- planning and other final expenses, with virtually no discernible level of consumer dissatisfaction.

Market and Distribution

The market for these policies is comprised of consumers who wish to be able to personally pay for the cost of final arrangements and other outstanding expenses and debt at the time of death. This would normally include pre-planning the funeral, any remaining household and hospital bills and other small debts. It is the desire of those purchasing these policies that there be specified funds to pay for these final expenses so they will not be passed on to their family. They usually consider the policy they purchase specifically for pre-planning and other final expenses to be separate from other coverages and funds they may have. The face amounts of policies purchased for pre-planning final arrangements and covering final expenses generally average between $3,000 and $10,000.

The age of those purchasing policies for these purposes is understandably high, and is often in the sixty-five to seventy age range. There are also individuals who postpone the planning of final arrangements, including funding considerations, until more advanced ages.

The companies selling in this market consider the span of the age range of prospective buyers to be between the ages of forty-five and eighty-five. This range is made up of approximately 40 million households.

Distribution of these products is through agent sales, funeral homes and direct marketing. There are approximately 100 companies who specify senior life products as a strategic market, and about 50 who comprise the majority of the total in-force and new policies written. There are just over 30 companies that specialize in small amounts of life insurance purchased by seniors.

Market Dimensions

The following information compares industry statistics for total ordinary and total fixed premium whole life insurance to data for fifteen representative companies who specialize in small policies that are purchased by seniors. The data shown for both is for 1998. The industry data is taken from the 1999 Life Insurance Fact Book published by the American Council of Life Insurance. The information from the representative companies is taken from the *1999 A.M. Best Insurance Reports.*

The statistics for the industry and the 15 representative companies indicate that purchases of life insurance policies with a face amount of $25,000 or less represent a significant portion of the total annual purchases. These statistics also show the large volume of small face amount purchases by consumers over the age of 55. Other significant indications are:

– 41% of all individual ordinary life insurance purchases are for fixed premium whole life policies. 21% of the fixed premium policy purchases are through the 15 representative companies.
– One-fourth of all individual policy purchases have a face amount of less than $25,000. (An unweighted sample from the 1997 LIMRA Buyers Study indicates that 32.1% of all individual ordinary policy purchases are for face amounts of $25,000 or less.)
– The 15 representative companies sold 1,024,000 new policies to individuals who are, in the main, age 55 and older. These policies have an average face amount of less than $6,000, and are almost exclusively fixed premium whole life. This represents:
  • 9% of total industry ordinary purchases
  • 22% of total industry fixed premium whole life purchases
– The 15 representative companies have a death benefit to earned premium ratio that is 57% greater than the industry average for individual life insurance policies.

Industry

Number of companies	1,563
Policies:	
- total ordinary purchases	11,522,000
- total fixed premium purchases	4,709,000
- policy purchases under $25,000 face amount	2,880,000
Premium:	
- total ordinary inforce	$93,983,000,000
Death benefits:	
- total ordinary	$24,397,000,000
- percent ordinary premium	26.0

Representative Companies

Number of companies	15
Policies:	
- purchases	1,024,000
- average face amount issued	$6,492
- average face amount inforce	$5,366
Inforce Premium:	$847,000,000
Death Benefits:	$390,432,000
- % of premium	46.1

Market Conduct

Given the sensitivity of the senior market, the numbers of complaints and inquiries received from policyholders of the representative companies is astoundingly low. Fifteen companies contributed data from their 1997 complaint registers, which are based on the NAIC Model Complaint regulation. These registers contain all complaints and inquiries, which include those that are both legitimate and otherwise. In 1997, the fifteen companies collectively received a total of 1,361 complaints and inquiries. That is .0027% of new policies issued in that year by the 15 companies and .0003% of total in force for these companies.

In a 1989 survey (the last available) by the NAIC Life Insurance (A) Committee of all state insurance departments regarding small policy purchases by seniors, none of the states, with the exception of Washington, expressed any particular concern regarding these policies. Nor did they indicate that they were experiencing any measurable problem associated with these policies.

Premium to Benefit Ratios

Much of the concern regarding small face amount policies purchased by seniors is focused on the possibility that a policyholder may pay more in premiums than their beneficiaries would receive in death benefits. Many of those voicing this concern use anecdotal evidence from worst case scenarios to support their positions. Invariably, they fail to recognize the inherent characteristics of the market and the methodologies that must be used in the pricing of these policies. The following points will discuss price and structure relative to the senior market for small face amount policies.

Underwriting and Risk Pooling

Consumers in the senior market have higher attained ages and increased rates of mortality. To make coverage available to the greatest number of individuals, underwriting procedures are much less distinct in delineating standard and substandard risks. Using standard underwriting criteria or narrowing the risk pool range would significantly reduce the availability of coverage to senior consumers.

The use of less selective underwriting criteria results in the acceptance of a broader range of risks that a company doing business in this market will accept. The risk pools developed through sales in the senior market are much more heavily weighted with risks that are generally rated as sub-standard. Consequently, the fifteen representative companies that specialize in this market, and are cited in this analysis, have a premium to death benefit ratio that is 55% greater than the industry average.

Pricing

Some critics of the small policy market offer the opinion that no one should pay more for life insurance than will be paid out in death benefits. In point of fact, premiums of all whole life insurance

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policies from all life insurance companies, accumulated at interest, potentially will exceed the policy death benefit at some time during the life of the policy.

Consider these figures based on the industry standard for valuation and policy comparison*:

Accumulated net premiums will exceed death benefits:

- at age 73, for a policy issued to a 35 year-old male,
- at age 78, for a policy issued to a 55 year-old male, and
- at age 84, for a policy issued to a 75 year-old male.

* 1980 CSO Mortality tables, 5% accumulation rate, 4% net premium rate.

This illustrates that the actuarially prescribed accumulated net premiums must be permitted to exceed the available death benefits at higher attained ages. If insurers could not receive the balance of the net premiums, they would have only a fraction of the funds needed to provide the anticipated benefits. Such a deficiency would eventually lead to insolvency.

Faced with artificial premium-to-benefit relationship requirements, insurers have only two rational alternatives. They can reduce the availability of coverage for those who would have the greatest need (older individuals and those in poorer health) or abandon the market entirely.

Conclusion

- Small policies purchased by seniors to pay for pre-planning and other final expenses provide a valuable service to a segment of the insurance market that is otherwise underserved by traditional distribution methods.
- The policies provide coverage for a need that is clearly perceived by the individuals who purchase them. There is a very high level of consumer understanding and acceptance of small policies which pay for pre-planning and other final expenses.

- Over one million whole life policies with a face amount of $25,000 or less are purchased each year by individuals who are over the age of 55. This accounts for nearly one-fourth of all whole life purchases.
- There is an almost total absence of market conduct concern at either the consumer or regulatory level for small face amount life policies purchased for pre-planning and other final expenses.
- The purchasers of these policies have much higher mortality, and therefore create risk pools that are heavily weighted with sub-standard risks. The result is a premium to death benefit ratio that is 55% greater than the industry average.
- Where free market forces are permitted to operate, insurers can provide products at prices which are actuarially sound, designed to meet specific consumer needs at a price which is consistent with the risks inherent in the market.
- The pricing methodology provides products at affordable rates which are actuarially sound and designed to meet specific consumer needs at a price which is consistent with the risks inherent in the market.

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