Life Insurance: An Industry Built on Fraud

By: Brian Fechtel, CFA, Agent & Founder of BreadwinnersInsurance.com

On the afternoon of May 21, 2008, Ed Zore, President of Northwestern Mutual Life Insurance Company – the nation's largest issuer of individual life insurance policies - received a long letter via his fax machine from one of the company's agents. Northwestern, according to its industry peers, has been the nation's most admired life insurer every year since Fortune began its annual industry rankings in 1982. The confidential letter, though, had only been faxed, not mailed, to Zore and his fellow Trustees on Northwestern's Board, the agent explained, "as a courtesy to preserve your/Northwestern's option, if desired, to deny receipt." The 36 page, double-spaced letter was entitled "The Opportunities in Northwestern's Life Insurance Market Conduct Problems, Etc." Less than two months later, the agent of 21 years, about whom Northwestern had never received a consumer complaint, had been terminated. Having long advertised itself – to try to stand apart and above the noise of the contested life insurance marketplace full of ever-persistent, fast-talking, and boisterous agents – as "The Quiet Company," Northwestern, it seems was providing new meaning, no doubt unintentionally, to its self-chosen nickname.

Although a huge and old industry, life insurers have largely been in the backwaters of the financial service sector for decades. And certainly, in comparison with its sister industry - health insurance, with its admittedly much more complex and ever-topical issues – life insurers, their regulation, and their products are essentially neglected by the media. While life insurers have diversified in recent years, cash-value life insurance, in particular, remains many insurers' core product. Whole life, the industry's traditional product, has for decades been locked-in battle

with term insurance. Misrepresentations abound by both sides' proponents in this battle between buying whole life versus buying term and investing the difference. It is only a slight exaggeration to say that the contentiousness of this battle's partisans rivals that of warring factions. But the agents of the traditional life insurers have strong financial incentives. Whole life's large and undisclosed commissions (*often ten or twenty times as large as commissions on term coverage*) fuel their rhetoric and energy. Indeed, Upton Sinclair's quote, "It is difficult to get a man to understand something when his job depends on not understanding it," provides insight into agents' fervent advocacy of whole life. But such insight is just a small piece of this story.

That this dispute rages - a dispute which at its core is a straightforward, fact-based issue: which product provides the best value, the most cost-effective solution - is merely proof of the frequently repeated words of two of the national's foremost life insurance authorities, Professor-Emeritus Joseph Belth and actuary Jim Hunt. Belth has stated, **"Life insurers have never provided the necessary and appropriate disclosure of their policies, in fact, they are categorically opposed to such."** Hunt, who is the Consumer Federation of America's life insurance adviser and who in that role over 25 years has consulted with thousands of consumers has stated, "It doesn't take long in the work I do to realize that hardly any policyholders understand how a cash value policy works." This failure to provide proper disclosure creates myriad and pervasive problems best measured in billions of dollars and millions of individuals harmed every year. The industry's inefficient, ineffective, and – to put it mildly - unsavory practices harm everyone. No matter how well or how little you might presently think you know and understand life insurance (the industry or possibly more directly your own policies), this article provides valuable new insights. Such improved understanding provides its own obvious

personal advantages; collectively, this understanding could lead to the critical mass required for positive societal change.

For nearly 50 years, Belth has called for the disclosure of the yearly price of protection (as this is different from these policies' annual premiums, as whole life and other "permanent" policies' premiums contain a portion in their early years which builds savings) and the rate of return on the savings component of cash-value policies. The life insurance industry has vigorously rejected Belth, Hunt and their allies' calls for appropriate disclosure of cash-value life insurance, but does so with such patently fatuous rebuttals as: it is not possible to disclose cash-value policies' costs because the product is too complex. Yet, without appropriate information, the prerequisite conditions of a properly functioning marketplace, consumers cannot act in their best interests. Moreover, in the absence of the necessary information, misrepresentations flood the marketplace, misconceptions foster gullibility, and persuasive and misleading salesmanship prevails. All of these problems, with their origins in inadequate disclosure, would seem to have long been repeated clarion calls for regulatory action. But, **as the record shows, the states' life insurance Commissioners make the SEC look like a regulatory god.**

Northwestern sells lots of whole life insurance. Lots of other insurers - such as New York Life whose advertising proclaims its "financial strength, integrity, and humanity" - sell lots of cash-value life insurance as well. The industry typically collects annual premiums on cash-value life insurance policies in the tens of billions of dollars. The typical sales approach, however, involves misleading comparisons with term insurance which prey upon consumers' misplaced trust, gullibility, faulty analysis and irrational and/or unsuitable decisions. Inadequate disclosure sets the stage for all of these problems. Nobel laureate Kahneman, in his seminal behavioral economics research with Tversky, has shown that individuals can routinely make irrational

choices based on the way information is framed or presented, and that they most consistently do so to avert recognizing and/or accepting losses or inevitable costs. This is precisely what currently occurs in the life insurance marketplace. Millions of consumers every year get talked into buying whole life policies, with unacceptably large sales loads, that they really don't understand. And, in fact, their "understanding" of such policies most likely consists of some fundamental inaccuracies; to protect against uncovering such is apparently why no insurer or regulator has ever conducted consumer research with focus groups comprised of recent purchasers. Irrefutable evidence of consumers' widespread dissatisfaction with these policies – policies sold as lifelong products - is that consumers typically decide to discontinue, either lapsing or surrendering, these policies before the policy's twelfth year.

The harmful magnitude of the industry's inadequate disclosure practices can perhaps best be recognized in the candid statements of industry veteran, NY Life's past President, Sy Sternberg. Recall, first, that the first year's premium of a whole life or any cash-value policy is often five, ten or even fifteen times as large as that of an alternative term policy the consumer might have just bought instead. Nonetheless, NY Life's past president has resisted disclosure by stating, "The life sale is a very difficult sale. People have to talk about their mortality, about how much money they really need. It's very complicated. If right in the middle of this discussion, you throw in **'And by the way, there's a 55% commission [not counting bonuses, expense allowances, and compensation for other field management and renewals]' You won't get the sale….." Welcome to the life insurance industry, an industry currently built on financial muggings.** And yet, when the truth about whole life is understood, when the truth that there is nothing about it and other cash-value policies with their huge undisclosed sales loads that justifies their costs, the life insurance industry will have to change.

Several years earlier, at a Society of Actuaries meeting, a Northwestern actuary, John Keller, had explained the company's aversion to checking-on its agents' sales presentations by stating, "I'll respond briefly to the suggestion that we use focus groups to get the consumer point of view. We did consider that early on in our work and rejected it for a couple of reasons. One was the time constraints we were under and the cost of doing focus groups. But probably the most important reason is that if you get 15 people in a room who are recent purchasers of life insurance and then spend an hour or two dissecting the sales process and the use of their illustrations in that sales process, you're likely to have 13 people coming out slightly or greatly disillusioned over what they just did. We found that our field force and our marketing department didn't like that idea at all. So if somebody could think of a way to get to the consumer without causing real problems among recent buyers, who are our most fragile customers, we would like to hear it." Such isolated incidents, where an industry executive has spoken some real truth about the problematic nature of the industry's sales practices, however, have never led to any substantive reform. The life industry's chief regulators have never been known for their initiative nor for their willingness to rock the boat, even when the boat is in clear need of righting.

The last missed opportunity for life insurance industry reform

A convergence of events, however, actually made reform seem at least remotely possible in the 1990s. First there were the insolvencies/bankruptcies of a few leading life insurers: Executive Life and Mutual Benefit. **Then, the American Academy of Actuaries declared that the industry's policy comparison metric – the interest-adjusted index – was defective and should no longer be used**. One would think such a proclamation would have galvanized the

regulators and industry, but the actuaries' report has essentially been ignored. The industry, like its agents, is a master at taking a punch, and then continuing right on its way, knowing that its adversaries have never had the commitment and persistence to match its own; and that nothing else succeeds like persistence.

The decade's most serious real reform impetus, though, arose when many life insurers in the mid 90s faced huge class action lawsuits. The lawsuits claimed that the insurers' policies had "failed to live-up to the company's sales illustrations and its agents representations" or that the insurers' agents had "had gone so far in disguising whole life as a supplemental retirement as to fail to inform consumers they were being sold life insurance." While the lawsuits raised questions regarding the industry's disclosure practices, the focus of class action attorneys' efforts were on only a subset of the bigger problem. New York Life capitulated quickly, settling Milberg Weiss' class-action lawsuit for approximately $65 million on a very narrow basis. The company admitted that its policy sales illustrations which showed premiums "vanishing" because they were based on undisclosed assumptions that the high interest rates of the 1980s would last indefinitely were misleading. MetLife and Prudential weren't so lucky; their settlements much more seriously tarnished their reputations, shrunk their sales force, and purportedly cost each insurer over a billion.

The regulators, in light of the lawsuits, having no choice but to appear productive, capable, and virile, launched their own regulatory investigations. The results of their investigations though were not to require life insurers to provide the information that Belth, Hunt, and I have long demanded. No, instead, the regulators merely promulgated new regulations of policy illustrations, which largely resulted in making policy illustrations become 10 page documents with much fine print, including a requirement that each agent affirm that he

or she had not stated anything contrary to what was shown on the illustration. **The regulators, in essence, <u>endeavored to preclude</u> life insurance consumers from ever complaining again.** The regulators' two part approach - the policy illustration's multiple pages of fine print (fine print which is typically not even read, and which while extensive is nonetheless very incomplete with respect to significant and necessary policy operation details) and the agent's unverified affirmation - is simply ludicrous. Only in the eyes of insurers' attorneys or aspiring life insurer attorneys (as they are the ones who typically fill the ranks of the regulators' office of general counsel), could the regulators' actions have possibly been considered acceptable reform.

The life insurance industry also crafted its own solution: IMSA. The Insurance Marketplace Standards Association was created to provide a "good housekeeping seal of approval" to insurers whose auditors attest that the company's sales and service practices met IMSA standards. IMSA's Principal #1 of Ethical Market Conduct requires life insurers "to conduct business according to his standards of honesty and fairness and to render that service to its customers, which in the same circumstances, it would apply to or demand for itself." As written, Principle #1's words, expressing the golden rule and/or philosopher Immanuel Kant's categorical imperative, look pretty good. The challenges or problems arise, of course, in enforcement. NYLife's Sternberg made his above quote in 2005, years after the company and most of its peers had joined IMSA. More specifically, New York Life, Northwestern and their industry IMSA peers, however, do not disclose the necessary policy annual cost information that not only Professor Belth has been requesting for 40 years but that anyone would think is necessitated by Principle #1. It should be interesting when the life insurers' chief executives are deposed and asked, "Is there any product that the company buys which it doesn't demand to know its cost? The industry's persistent failure to provide appropriate disclosure certainly

reaffirms the wisdom of legendary business professor and author, Peter Drucker's, advice "The most important thing in communication is to hear what isn't being said." Having never been willing to say or to disclose its policy's annual costs, the life insurance industry's continuing blatant omissions of such material information after its adoption of IMSA seems tantamount to having stuck its legal neck in the noose. **If IMSA is not a fraud, Madoff is not a crook.**

IMSA's principles, while seemingly straightforward and powerful, were, as knowledgeable industry observers commented in the 1990s, not truly new. Virtually every state, since the Federal government implicitly threatened regulatory action in the 1970s in response to Professor Belth's award-winning academic journal articles documenting of the industry's pervasive sales practices problems, has adopted regulations that prohibited misrepresentations and required complete disclosure. New York's regulations require that all communications with consumers "shall be truthful and not misleading in fact or in implication. The format and content of [all communication] shall be sufficiently complete and clear so that it is neither misleading nor deceptive, nor has the capacity or tendency to mislead or deceive." The life insurance industry has never recognized that without appropriate disclosure its sales culture is built on half-truths and outright misrepresentations. And, again, the regulators have never done anything meaningful to punish the pervasive misrepresentations or to cure the original problem.

The agent's faxed letter to Northwestern's President

Northwestern, though, went even further than just joining IMSA; the company adopted a written code of responsibility for its agents. Responsibility #1 is to serve a client's best interest. Responsibility # 2 is to avoid any and all conflicts of interests with clients. In May 2008, the agent had faxed his letter to Northwestern's President Zore because of his concerns that

Northwestern's sales practices – concerns that he had for years repeatedly voiced directly to company executives and published in trade journal articles – had finally been written about by Mary Rowland, a mainstream financial journalist. In essence, his fax not only urged the company to solve these problems on its own initiative and presented ideas on how to do so, but argued that waiting to do so upon what would be inevitably required by either the regulators or the courts would be terribly detrimental.

Rowland's article, "The Right Blend," focused specifically upon the undisclosed discretion that Northwestern agents have regarding the costs the policyholder bears. Northwestern agents, using company approved sales literature and presentation scripts, recommend policies with large sales loads rather than policies with small sales loads. **Virtually none of the company's 7000+ sales force routinely recommend and sell Northwestern's best value cash-value policies, a policy an informed consumer would demand – a policy a consumer, trusting in the company's compliance with its own rules, IMSA, and state regulations, would expect that he or she would at least be shown. Northwestern agents not only do not show the best value policy, they often disparage it should their prospects actually have heard about it.** Rowland's article quotes several life insurance authorities. David Barkhausen, a former Northwestern agent who is now a fee-only life insurance adviser, has stated, "This lack of disclosure [about blending] is a sin of omission by agents and brokers but is really a sin of commission on the part of the carriers and, indeed, the state regulators." Former Northwestern actuary Scott Witt, who has also joined the ranks of the very few fee-only life insurance advisers in the nation, has stated that "agents are in a perpetual conflict of interests where they have to choose between their own best interest and the clients." Fellow fee-only adviser Glenn Daily says he "can't believe that there haven't been lawsuits about this issue."

Despite such condemnations from life insurance experts, Northwestern replied to the agent, "Our considered analysis has never given us any reason to agree with your characterizations or opinions on these 'problems'. Thus your letter does not warrant a specific reply." Three weeks later, Northwestern terminated him.

New York and Wisconsin insurance regulators – who received copies of the agent's May 2008 letter before he was terminated – responded similarly. They said they saw no reason to take action. They asserted Northwestern had done nothing wrong. Regulators did this despite the fact that the agent's faxed letter contained documentation of multiple instances of agents' misrepresentations in emails and actual sales presentations. They did this despite the fact that the agent provided documentation of Northwestern's misleading sales literature. Sales literature which advises consumers, for instance, that "90 Life [a full commission product] is the right choice for consumers when they value both death benefit and guaranteed cash-value." And yet, Northwestern knows that its blended policies can provide significantly better death benefits and guaranteed cash-value for the same premium. The regulators ignored such smoking gun evidence despite the fact that Northwestern's sales conduct regarding blending is exactly analogous with, and several orders of magnitude more costly to consumers than, a mutual fund sales scandal regarding A shares and B shares that rocked that industry several years ago, and upon which that industry's regulator, FINRA – the Financial Institutions Regulatory Authority, took strong action. Despite the regulators acquiescence of such blatant fraud, change may finally be coming to the life insurance industry.

Unintended consequences of Spitzer's investigation of Marsh McLennan

Recall former New York Attorney General Spitzer's 2003 investigation of commercial insurance broker Marsh McLennan. Spitzer uncovered Marsh's commission incentives that led the brokers to commit multiple fraud and failures in serving their clients. Marsh paid fines, forced CEO Jeff Greenberg to resign, and had to institute multiple changes. Following-up on Spitzer's investigations, the New York State's Department of Insurance held hearing in the summer of 2008 on insurance agents' compensation practices. Subsequently, in January 2009, the Department proposed its agent or Producer Compensation Disclosure Regulation (PCD Regs). Suddenly and somehow, an investigation begun six years earlier by an Attorney General into illegal practices in the commercial property insurance marketplace now threatens - depending upon your perspective, either to wreck havoc or to transform - the personal life insurance market.

Lobbyists for New York State's life insurers (LICONY) and life insurance agents (NAIFA's New York Chapter) swung into action in February with a litany of arguments. LICONY began by questioning the regulatory need. "[W]e do not understand what problems you identified in the life insurance marketplace that gave rise to the draft [regulation]," and continues, asserting its belief that the drafted regulation "exceeds the Superintendent's statutory authority." Furthering the theme that the marketplace and currently-existing regulations work fine, and there is no need for change, NAIFA continues "If the agent fails to seek out products and investments that best fit his or her clients' needs, the market will take care of their ability to survive in this industry." Moreover, the agents' group continues, "[T]he proposed requirement that the amount of compensation be disclosed – would, we believe, be onerous to the agent, disruptive to the sales process, [and] provide no advantage to the consumer…" LICONY goes even further, "Producers have **<u>no incentive</u>** [emphasis added] to jeopardize these important

relationships that serve as the basis for continuing business and referrals by making inappropriate recommendations based on the compensation they will receive, rather than on the benefit their customers will derive." **If industry advocates can, with a straight-face, assert such in their public statements, then they ought to be able to find work in new careers as actors when they get productively reconnected with reality.**

The lobbyists' argument against Producer Compensation Disclosure regulation actually drives much further into ridiculous territory. NAIFA, in complete contradiction of actuarial pricing formulas, not to mention common sense and economic principles of market dynamics, asserts, "The amount of commission an agent receives has no effect on the premium to the client." LICONY argues that "Customers are unlikely to understand that commissions paid to life insurance producers represent more than just profit to the producers…" Then, to apparently avoid such customer confusion, LICONY proposes redrafting the regulation so that disclosure would be necessary only when actually requested by a consumer, thereby effectively eviscerating the regulation. NAIFA's argument, in fact, goes over the edge, plunging into the abyss of the absurd, when the agents' group inform the regulators that, "[Our members'] clients buy a relationship with an insurance professional. They do not shop for price." Can you imagine NAIFA members using this quote in any future advertising or marketing literature with clients?

Sales compensation, admittedly, is just one part of the total product costs Belth, I, and others have long sought to have life insurers disclose. But, sales compensation is by far and away the largest share of life insurance policies' annual costs in their early years. Indeed, the industry's relentless age-old opposition to appropriate cost disclosure of cash-value policies has fundamentally been an effort to keep consumers in the dark regarding the magnitude of commissions on cash-value policies. While Sternberg's above quote refers to the 55%

limitations imposed by New York's paternalistic regulators more than a century ago following the state's 1906 Armstrong Investigations of corrupt practices of the life insurance industry (fascinating stories for another time) the total first year sales compensation, with actual expense allowances and other bonuses, can exceed 70% in New York, and 100% for insurers in other states not covered by New York regulations. **Compensation disclosure will finally force the life insurance industry to attempt to justify the compensation agents receive when a whole life policy is sold.** To understand why the industry and its agents will ultimately be unsuccessful in their attempt, we will not simply settle for recalling the words of industry executives Sternberg and Keller, but will review agents' typical sales presentations.

Agents' misrepresentations and the false dichotomy

Agents typically instructs prospects that there are two types of life insurance: whole life and term or permanent and term. They continue, almost immediately, to disparage term in many ways. Term is throwing money down a drain. Term is renting coverage, and such rent will increase drastically. In fact, term costs are denounced as becoming unaffordable. (For more on the litany of disparagements, see "Common Misrepresentations.") In contrast, whole life is labeled owning coverage, and as such is made to seem the smarter choice. Whole life, especially as taught in training to Northwestern agents, is a different type of life insurance that purportedly avoids all the problems of term insurance. Agents proclaim that whole life enables the consumer to lock-in a level annual cost for life; and that the sooner or younger one does such, the better. (For more on the assortment of misrepresentations and/or half-truths, see "Buy Now to Lock in a Low Cost – A Sales Tactic of Which To Be Wary.") Agents are taught to suggest that with Whole Life one pays for the long-run costs of coverage up-front, and that doing so - for

some unexplained and indeed unexplainable reason - is more cost-effective than term. Agents are also taught to compare the annual growth in a policy's cash-value with its annual premium, as one way to lead prospective buyers astray with respect analyzing the policy's costs. In fact, the Buyer's Guide, although prepared by the regulators, actually contributes to the confusion regarding a whole life policy's annual costs. Stating that whole life policy's cost is not its premium, the Buyer's Guide then fails to provide information regarding actual costs, diverting consumers' natural questions about such with problematic information on the regulator's terribly-defective interest-adjusted cost indexes. Agents' misleading statements and innuendos regarding the whole life and term dichotomy come in countless variations, but they all have the same objectives – 1) to create an allure of whole life/permanent insurance based on invalid reasons, and 2) to prevent an accurate examination of a cash-value policy's annual costs. Agents' ultimate objective is to sell a whole life or other cash-value policy with their significantly larger commissionable premiums.

In addition to their sales pitches, agents often use several "analytical tools." These tools are typically computer produced spreadsheets, and as such, are perceived as accurate and compelling. These tools routinely compare: 1) a whole life policy with buying term and investing the difference or 2) the results of buying a whole life policy now versus waiting and buying later. These purportedly accurate tools all typically contain undisclosed or misunderstood assumptions that skew the analysis to support the agent's objective of selling the product with the larger commission. For instance, they routinely compare after-tax dollars with pre-tax dollars, unequal death benefits, and drastically different and undisclosed interest rate assumptions. The "results or costs of waiting" analysis often goes so far as to "calculate the cost

of waiting" even one day to buy a Whole Life policy. **Somehow the regulators permit the use of such sales tools, despite regulations that prohibit any sales material "that has the capacity or tendency to mislead or deceive."** When challenged about their acquiescence of such problematic sales tools/materials, regulators typically respond that they have not heard any complaints from consumers about such (a classic catch-22 situation) or that they also have to be concerned with the financial stability of life insurers (apparently, implicitly believing that they cannot prohibit these problematic sales materials without jeopardizing the industry).

While some might recognize the problematic representations or half-truths, no one should doubt that the above sales language and deceptive analytical tools are effective. Agents, after all, come from a breed who can assert to regulators that financial incentives have no impact upon their recommendations, and not only assert such but do so when the evidence of agents' recommendations having been motivated by their own financial interests is irrefutable and overwhelming. Agents' presentations can be very effective, especially in the typical one-on-one selling that occurs in home and offices across the country. Every individual who has ever been an agent has seen first-hand and heard from fellow agents about the effectiveness of various sales presentations' misrepresentations time and again. Such presentations are effective even among those who one would think would be financially, fairly-sophisticated. For instance, **a leading Northwestern agent, who built his business calling on financial professionals, would explain the term versus whole life dichotomy as a way to transform an expense into an asset. Gosh, doesn't that sure sound good? If only it were true. If only it were possible.** But his sales presentations were exceptional effective. In fact, this Northwestern agent's financial abracadabra of turning expenses into assets was so very effective that some years he was among the company's top ten agents in its Eastern Region. Quite simply, the current life insurance

marketplace is build upon sales presentations that rely upon half-truths, innuendos, misrepresentations and worse and which prey upon consumers' misplaced trust, gullibility, irrational wishes (seeking to avoid costs that can't be avoided) and faulty decisions.

The truth about whole life

Just as there was no wizardry in the Wizard of Oz's operations, there is no wizardry in Whole Life or other cash-value policies. In fact, when one buys whole life, he or she has really bought level payment term for their whole life. That is, in fact, precisely how whole life got its name; it was originally called level payment term for one's whole life. This very fact actually reiterates the role that the regulators' original Buyer's Guide has played in fostering the false and misleading dichotomy that agents' sales presentations ultimately rest upon. Consumers, advised by agents not to buy term because of its annually increasing costs per dollar of coverage, are encouraged to buy whole life – a purportedly different type of life insurance - with its large and undisclosed sales loads **and** its own annually increasing mortality charges (a.k.a. term costs) per dollar of coverage. Sure, whole life and other "permanent" policies have cash-value, but that, with its operational ramifications, arises entirely due to the policyholder's level premiums. There is not anything special that the insurer provides, and as such, there is no basis for the excessive compensation that the industry and its agents extract from consumers. They extract such because they portray the differences between term and permanent or term and whole life with a false dichotomy and misleading analogies.

The truth, in fact, is that the fundamental difference between whole Life and term, or permanent insurance and term insurance, arises from cash-value policies' tax privileges. Tax privileges, though, are a free and non-proprietary input. Economic theory demonstrates that

businesses in a competitive marketplace cannot extract value from consumers for a free, non-proprietary input. One can't charge an informed buyer $30 for a $3 loaf of bread. Starbucks, Gucci and Polo extract extra value because of their brand (which, depending upon one's subjective valuation of such, may or may not be warranted). But brands, by definition, are proprietary. Congressionally-granted tax privileges are, however, very different from proprietary inputs. Life insurance agents implicitly extract $30 for a $3 loaf of bread by: 1) asserting that this particular bread is not just simply bread, it is Whole Bread – a drastically better bread because of half-truths X, Y, and Z, and by 2) failing to appropriately disclose the cost of the bread and thereby, almost inevitably in every sales situation, providing misrepresentations regarding whole life's costs and advantages.

Producer Compensation disclosure, just like annual cost disclosure first called for by Professor Belth over forty years ago, will reveal the lies in the selling myths supporting cash-value policies; such as, that whole life policies avoid all that is disparaged about term, and that there is something indescribably better about whole life. Yet, when cash-value life insurance is properly disclosed and explained, what consumer would accept the huge upfront compensation paid to the agent? Certainly, NY Life's former President doesn't think anyone would buy such a product with such unjustified sales costs. Consumers do not allow banks or other financial institutions to appropriate the value arising from the tax-privileges of IRAs and other similar products. Informed life insurance consumers will not allow agents to continue to extract the benefits of the cash-value life insurance once the product is properly disclosed. Again, what consumer would pay the large load for whole life when informed that whole life is actually level payment term for one's whole life?

Whole life and other permanent policies' cash-value just arises as a natural consequence of the level premium payments and the industry's non-forfeiture laws adopted in the 1800s, laws which were designed to make sure that policyholders who lapsed their policies received some value. Regulations adopted in an era of paternalism and intended to safeguard the consumer by providing appropriate value upon lapsing or surrender facilitates the current deceptive marketing practices by creating a duplicitous dichotomy only because of the regulators' subsequent failure to provide appropriate disclosure. While some might try to see this as an instance of the unintended consequences of regulations, it is really the consequence of the absence of appropriate regulation; the absence of appropriate disclosure of a product's costs: what ought to be an unquestionable fundamental requirement of any business wanting to participate in the American free market economy.

The industry's inevitable final attempt at defending the status quo

Defenders of the life insurance industry's current practices may try to continue arguing that whole life is such a unique bundle of valuable products all rolled into one that it is unfair to compare its costs with term insurance and/or that this bundle of valuable products really justifies the greater compensation paid to agents. One of the original "pieces/aspects" of this bundled product was whole life's forced savings attribute, another was the opportunity to borrow, and a third the right to convert the policy into a lifetime annuity stream. None of these attributes or features can justify or warrant the current level of compensation extracted from whole life consumers. This talk of product attributes – all of which are: 1) virtually costless to life insurers that must build reserves and 2) typically no more valuable to a consumer than perhaps the free toaster banks used to give away to new accounts – is absolutely duplicitous as a justification for

the agent compensation extracted from the consumer. Option pricing theory can no doubt demonstrate such. A more empirical proof lies in the answer to the following question: Does anyone think a 30 year-old consumer would consent to being charged $2000 to establish his "savings discipline" or have the option to convert his policy into an annuity at age 65? The sales presentations to 30 year-olds are all designed to encourage them to buy the product at a younger age on the false pretense of "locking-in" a lifetime of lower costs, and yet the undisclosed, implicit costs of a thousand dollars of coverage at, for instance, age 70, are virtually the same whether the consumer bought the policy at age 30 or 37 or 47.

Defenders also argue that consumers really understand (and implicitly, accept) whole life and other permanent policies' undisclosed costs. But if that is so, if consumers really understand and truly accept these costs, then why has the industry so vehemently fought disclosure for the past forty plus years? Furthermore, why are all the industry's sales practices designed with the intent of distorting such costs? When the industry's argument is revealed for the fraud that it is, the industry typically continues that "agents need to get paid" (which is true), and that the current undisclosed compensation practices are just the way the industry has to work (which is not necessarily true). But, to assert that the industry's current methods "work" or are effective is to ignore the industry's terrible lapse problems and abysmal market penetration. The industry's age-old approaches are not the only way; the industry's terribly-inefficient sales practices will have to change in an era of appropriate disclosure. Certainly, the industry's belief that such change is impossible cannot be the deciding factor. Consumers are entitled to appropriate disclosure.

The heart of the issue

While agents may well initially continue fighting disclosure – and whether disclosure comes as a result of New York's Producer Compensation Disclosure Regulation or my plan to launch my own website to provide such disclosure – appropriate disclosure of cash-value life insurance policies along the lines first proposed nearly fifty years ago by Professor Belth is inevitable. In fact, when the agents really think about such, some will no doubt recognize that disclosure is the necessary and best way to transform their public image and thereby their practice from that of hustling and double-talking sales representatives into genuine respected professionals compensated for their expertise and service. Aside from the difficulties arising from moving through the period of transformation (confessing for one's sins is always difficult, but sometimes not as difficult as imagined), this transformation to good disclosure will have profoundly beneficial consequences for agents. The life insurance industry's current practices rely upon agents to make, either wittingly or unwittingly, misrepresentations. Few, if any, agents genuinely understand the unmanageable challenges they actually confront: building trusting relationships with clients, spending enormous time and energy to find individuals to whom they can then make recommendations that are inherently problematic all in the hopes of possibly getting paid an unjustified windfall from at least some of the prospective consumers. This process takes an extraordinary toll on agents; it is an absolutely unsustainable business plan in a marketplace of informed buyers or well-educated and ethical practitioners. **Insurers rely on agents to engage in peddling some half-truths or worse to sell a product that the insurers know couldn't be sold as currently priced with its excessive loads if it were properly disclosed. For instance, the typical Northwestern agent currently has well over 60 appointments to sell three or four policies a month. It ought to be unsurprising that four**

out of five individuals who try to become life insurance agents fail. In fact, for over 20 years, Northwestern has had a sales force of approximately 7,000 agents, and yet on average the company recruits about 1500 new agents every year. If twenty percent (20%) of General Motors work force experienced such turnover every year, it would be front page financial news. While the majority of consumers who have purchased whole life products have been, in comparison with their insurance alternatives, financially harmed by policies they have been sold, the thousands of individual agents who annually fail (either leaving the business or continue in it out of hope while only making an unsatisfactory income) who are the overlooked casualties in the current fraudulent life insurance marketplace. But life insurance agent failures are not newsworthy events.

The transformation of the life insurance marketplace is inevitable

Just as the Corvair became unsalable when its spasmodically-uncontrollable nature and flawed safety systems became known, so too will the life insurance industry's cash-value policies with excessive loads. **The transformation of the life insurance marketplace is inevitable. In fact, one of the most surprising aspects of this half century battle is that it has taken so long. For disclosure has always been the solution**, and as such, it could have always been provided by any organization or even any individual with a commitment to such. **When appropriate policy cost information is available, the age-old conflict between whole life and term will be recognized as incredibly foolish. For clearly, the answer is not one or the other, it is a combination of the best of both – and that's precisely what meaningful disclosure will produce**. If anyone doubts such, they would do well to recall that Justice Brandeis viewed as his greatest accomplishment his creation of a life insurance organization that

provided exactly such a product. But that's another life insurance industry story of real significance for another time.

The End

Note: Again, the author of this article, Brian Fechtel, is also the same individual, the agent, who faxed Northwestern's President that long letter in May 2008. The above presentation was constructed to use the story of the fax for its "intrigue," while at the same time endeavoring to maintain the reader's focus upon the critical issues arising from the industry's inadequate disclosure practices. The disclosure problem costs consumers billions of dollars a year, but again, it costs unwitting individuals who become or try to become agents, in so many ways, so much more. For those who truly care about the economic progress of all Americans, it would seem that the time to contribute to solving the disclosure problem in the life insurance industry is now.

Brian Fechtel 2009 copyright