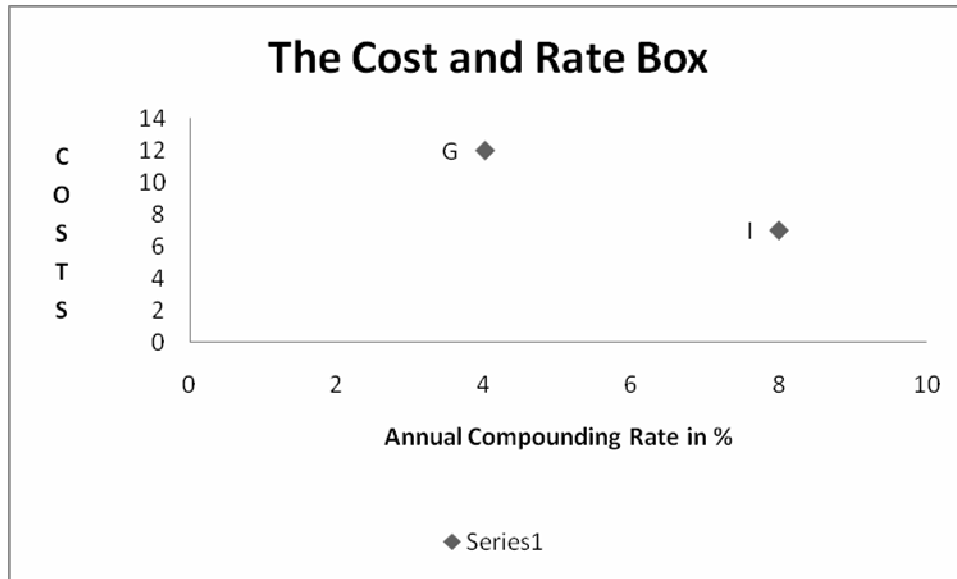


A Way to Compare Apples to Oranges

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PERSPECTIVE

Marketing research consistently shows the importance of presenting information in a manner consumers understand. With respect to life insurance, this finding is especially important. Industry surveys, however, routinely show that consumers and even many agents do not genuinely understand the financial mechanics of life insurance policies. As events have repeatedly proven, these shortcomings have profound significance. The cost and rate box is offered as a solution to these problems.

The performance of a typical cash-value life insurance policy, whether illustrated or actual, can be summarized in terms of two basic performance variables: cost and compounding rate. Systemic present value analysis is a method

for measuring these two basic performance variables without distorting either. The fundamental requirement of systemic present value analysis is that the policy's or illustrated system's compounding rate be used as its discount rate to convert the illustrated future values and flows into meaningful and comparable present values. This analysis preserves the actuarial identity that measured in terms of present values: premiums equal cash value plus costs.

The cost and rate box is a consumer-friendly presentation tool in that cost and rate are familiar terms. The data for the cost and rate box arise from systemic present value analysis. The table below summarizes the accompanying illustration's systemic present values. Much

understanding of the economics of life insurance can be gained from these types of tables and graphs. For example many conclusions can be drawn about such insurance subjects as the cost of waiting, the cost of rated policies, lapse-enhanced policies, and term vs. permanent comparisons.

In the cost and rate box above, Point I can be understood as representing the illustrated policy's compounding rate and 20 year cost assumptions. No special significance should be attached to this point; its coordinates merely represent the illustration's assumptions. While the cost and rate box is not a divining rod, it provides a valuable framework for informed decision-making.

Illustrated Whole Life Policy*					Systemic Present Value Analysis Table				
<u>Year</u>	<u>Insurance</u>	<u>Dividend</u>	<u>Total</u>	<u>Guar.</u>		<u>Premiums</u>	<u>Cash</u>	<u>Cost</u>	<u>Coverage</u>
1	200116	20	20	0					
5	206466	503	8816	7462	5	\$10,789	\$6,000	\$4,789	\$140,517
10	226662	1216	25836	18926	10	\$18,132	\$11,967	\$6,165	\$104,988
15	258396	2262	51844	32908	15	\$23,129	\$16,343	\$6,786	\$81,457
20	297115	3335	89173	49900	20	\$26,530	\$19,132	\$7,398	\$63,745
25	363473	6394	142066	65718	25	\$28,845	\$20,744	\$8,101	\$53,074
30	450334	10295	216138	82548	30	\$30,420	\$21,479	\$8,941	\$44,753
35	563750	15229	319432	100088	35	\$31,493	\$21,605	\$9,888	\$38,129

*Annual Premium is \$2502 and initial face amount is \$200,000 for a 30 year-old male. Dividend compounding rate is 8% and dividends are applied to additions.

For instance, the significance of potential dividends or participating returns becomes apparent when the illustration's guaranteed values are represented in the cost and rate box by point G. As most insurance professionals, but not all consumers, know, dividends of a particular size only arise when the cost and rate performances are sufficiently more favorable than those guaranteed. Graphic representation of the superior performance of point I vs. point G promotes a fundamentally important understanding of the mechanics of life insurance policies. In general, preferred performance involves achieving a higher compounding rate, a lower cost or a combination of the two.

Once consumers realize that there is neither magic nor an unfathomable process to comprehend when evaluating policies, they will seek information necessary to draw conclusions about probable cost and rate performance,. Specifically, shopping for a policy will involve evaluating the significance of various information to assess future

performance. This directive's clarity should help consumers avoid becoming sidetracked in such common irrelevant analytical pursuits as simplistically comparing premiums, choosing a policy because of its name or purported type, buying the best illustrations, or analyzing illustration with "sophisticated" but misguided techniques that are more akin to art appreciation than credible, competent financial analysis.

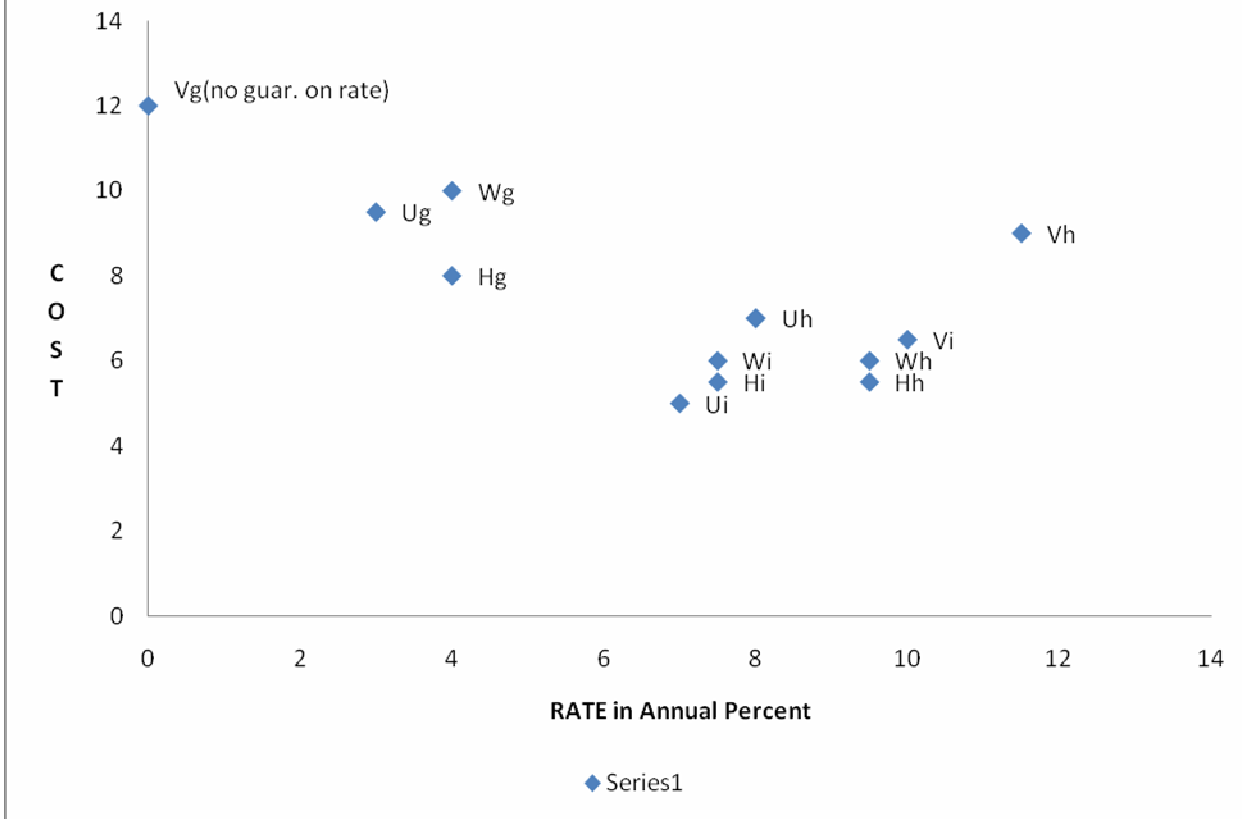
The versatility of the cost and rate box can be seen in the following comparisons of four policies: a **W**hole life, **U**niversal life, **V**ariable life and blended or **H**ybrid ("term/whole mixture") policy. In contrast with prohibitions of comparing dissimilar policies' interest adjusted indexes, the cost and rate box promotes such comparisons because its presents measurements of these policies' basic performance variables. Actual illustrations for these policies have been omitted because illustrations, after all, can be constructed to show anything. Only after policies

are understood in terms of cost and rate will illustrations be used solely in their correct, limited manner.

Cost and rate measurements for each policy are shown below. Current illustrated values are represented with the subscript "i", averages of recent historical results are indicated with "h" and guarantees with a "g". These points represent exactly comparable, constant at risk amounts of coverage, as mathematical techniques can be applied to adjust the irregular patterns of at-risk amounts in the typical sales illustrations. The cost and rate box does not make the process of shopping for life insurance an easy one. Rather, this tool brings direction and focus to the endeavor. The future life insurance buyer will no longer be mired in misconceptions and myths, but will instead face acceptable challenges similar to those individuals regularly confront when making other consumer decisions.

Consequently, objective information deemed useful in the search for a policy with superior

Cost and Rate Box Representations of Four Hypothetical, Dissimilar Policies



combined cost and rate performance will become valuable. Tomorrow's life insurance consumer, similar to today's informed buyers and investors will most likely rely on company /policy track records, management quality and company philosophy, practices and reputation. The results of such assessments might be altered by consideration about service and short-term interests. But in any case, future life insurance shoppers will be better informed, and therefore, capable of making superior decisions.

For a moment, play the role of a typical consumer and make your own assessments about these four policies' future performance. Label them with a subscript "a" and circle your purchase choice or list questions you would want

answered first and then create plausible answers an agent might provide. Think of how such answers might be conveyed to prospective policyholders, recalling that consumers tend to become distrustful of a sales process where they feel too dependent on an all-knowing salesperson. Obviously, there's a vital role in the future life insurance marketplace for sources of relevant and reliable performance-related information. Just as there are sources for automobile MPGs, Dow Jones averages and corporate earnings forecasts, there will be sources for life insurance information such as portfolio compounding rates for insurers and average costs for \$300,000 of coverage for 20 years on a 35 year-old nonsmoking male.

A few important points need to be made about the use of the cost and rate box and its potential effect on the marketplace. First, the evaluation of policies involves consideration of factors beyond cost and rate. For instance, information about policy and insurer structure, such as premium level (whether fixed, flexible or potentially increasing), insurer financial strength, investment management philosophy/expertise, development of new products, persistency bonus practices and adherence to the principles of mutuality are some of the other important factors.

Second, since policy performance is determined by the intersection of these two basic factors, there is an infinite number of combinations of cost and rate

that can produce equivalent performance. Two policies with identical performance after a certain duration might, for example, have been achieved by insurers using different means, one might have been a comparatively superior investor, the other a comparatively superior underwriter and cost administrator.

One such application is the creation of cost and rate performance measurements from insurers' annual statements and their historical interest-adjusted indexes. Transformation of these little used and largely misunderstood indexes is an obvious benefit. Consumers are likely to appreciate the insight this analysis offers into the various cost structures of different policies.

Third, different individuals evaluating the same information often arrive at different conclusions because of their own assessments about the significance of such information or their varying objectives or situations. The assessment of historical information, for example, is just one such area; some find histories compelling, others aren't so sure. Even when individuals concur about the evaluation or assessment of certain information, they can still legitimately reach different conclusions based on their preferences. For instance, while all might agree that a variable policy offers a potentially attractive rate, many investors might not like the inherent investment risks. Others, who might be restricted by situational constraints, such as a tight budget, might prefer or be best served by a term policy.

The cost and rate box could lead to significant and positive changes in the public's perception of the industry and the role of agents. When policies become understood

and the relevant decision making information is properly presented and independently assessed, consumers' perennial complaints about lack of understanding and distrust of the agent will recede. When consumers are no longer deprived of information, they will participate in the marketplace – buying, renewing, and exchanging their policies- with greater confidence. In fact, in an information-rich life insurance marketplace, it is likely that consumers will more readily rely on their agents to gather the relevant decision-making information and assist them in assessing it. In such times, good agents performing careful needs assessments and presenting policies that are understandable will be recognized as the financial doctors they are.