

## WHAT PRICE "PRICE DISCLOSURE"? THE TREND TO CONSUMER PROTECTION IN LIFE INSURANCE

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Meaningful price disclosure at the point of sale in life insurance would help to implement one major objective of insurance regulation, protection of consumers against unreasonably high prices. The recent solution of certain technical problems<sup>1</sup> has made such disclosure possible. One question still facing disclosure advocates, albeit a difficult one, is ascertainment of the specific technique of price disclosure that should be adopted.

This study appears now because the Wisconsin Insurance Department has recently promulgated the first price disclosure requirement in the country which is applicable to the initial sale of life insurance.<sup>2</sup> Moreover, a National Association of Insurance Commissioners' Task Force headed by Wisconsin's insurance commissioner is presently working on the problem. Discussion of the subject from a regulatory point of view therefore seems timely, and may aid in the further development of such requirements. This article summarizes the issues and the arguments on the merits of price disclosure in life insurance. It also sketches the background of the current drive for price disclosure, outlines some alternate techniques of price computation, and describes some special problems in implementing price disclosure. A companion article<sup>3</sup> by Professor Joseph M. Belth describes in more detail one approach to life insurance price disclosure.

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1. Electronic computers are required for the elaborate price calculations necessary in a refined price disclosure system. Therefore, the dialogue on disclosure has mainly arisen since there has been almost universal use of the computer in the insurance industry. The theoretical work began earlier. See, W. MATTESON & E. HARWOOD, *LIFE INSURANCE AND ANNUITIES FROM THE BUYER'S POINT OF VIEW* 42-50, 63-75 (1953); Solberg, *A Method for Consumer Valuation Of Life Insurance Policies By Type*, 17 J. OF FIN. 634 (1962); Belth, *A Method for Consumer Valuation Of Life Insurance Policies By Type: Comment*, 18 J. OF FIN. 684 (1963); Solberg, *A Method For Consumer Valuation of Life Insurance Policies By Type: Reply*, 18 J. OF FIN. 688 (1963).

2. WIS. AD. CODE § INS 2.15 (effective Jan. 1, 1973).

3. Belth, *Price Disclosure in Life Insurance*, p. 1054 *infra*. Professor Belth has done much of the theoretical and practical work in developing the more refined techniques of price measurement.

## I. THE BASIC ISSUE: SHOULD THERE BE COMPULSORY PRICE DISCLOSURE?

Since the die seems to have been cast in favor of price disclosure in some form, it may be futile to raise the fundamental question. On the other hand, a review of the arguments for and against any price disclosure may help to bring the debate on the technique to be adopted to a higher level of sophistication.

Life insurance exists basically to serve the public welfare and only incidentally to provide a livelihood to agents and a profit to life insurance companies. The interest of the consumer is the most relevant criterion in evaluating a price disclosure technique.

### A. *Wide Price Variation*

Although life insurance is one of the principal savings media in our society,<sup>4</sup> the layman most often sees it as a vehicle for providing financial protection when death occurs. The savings element in a life insurance policy, however, prevents premiums from being an accurate measure of the cost of the protection element. If the savings aspect of life insurance is explicitly taken into account, the life insurance industry is marked by substantial price differences for similar protection. Belth's exhaustive studies<sup>5</sup> are the principal basis for the assertion that this price variation is very large.

For example, in one study Belth made price calculations for \$10,000 participating straight life policies issued in 1962 to males aged 35 by 88 different companies.<sup>6</sup> The results showed that the twenty-year level prices per \$1,000 of protection ranged from less than \$5.00 to more than \$13.00.<sup>7</sup> The mean twenty-year level price per \$1,000 of protection was \$7.55. Eleven policies were priced at less than \$6.00 per \$1,000 of protection, with one lower than \$5.00. Eight policies were priced at \$10.00 or more per \$1,000 of protection, with one in excess of \$13.00.<sup>8</sup>

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4. Life insurance reserves, policy dividend accumulations, and funds set aside for policy dividends amounted to \$177 billion at the end of 1970. INSTITUTE OF LIFE INSURANCE, 1971 LIFE INSURANCE FACT BOOK 65 (1971). [hereinafter cited as FACT BOOK]. In a significant sense these are as much "savings" as savings accounts in banks.

5. See, e.g., J. BELTH, THE RETAIL PRICE STRUCTURE IN AMERICAN LIFE INSURANCE (1966).

6. *Id.* at 72-77.

7. *Id.* Belth's level-price method of life insurance price calculation is described in detail.

8. More recent analyses of prices confirm the continued incidence of wide price variation. A joint industry committee on life insurance costs prepared interest-adjusted cost figures for 35 large companies. The figures on nonparticipating and participating \$10,000 policies, when read together, show substantial price differences. INSTITUTE OF LIFE INSURANCE, JOINT SPECIAL COMMITTEE ON LIFE INSURANCE COSTS, REPORT 26-31 (1970) [hereinafter cited as SPECIAL COMMITTEE REPORT]. More recently, an analysis by the Pennsylvania Insurance Department calculated prices for

A different study calculated the twenty-year level prices per \$1,000 of protection for \$10,000 participating straight life policies issued to men aged 35 in 1968 by 15 major companies.<sup>9</sup> This study also reported wide price variation. The twenty-year level prices per \$1,000 of protection ranged from a low of \$6.41 to a high of \$10.06. Thus, even among large and well-known companies, substantial price differences exist in the life insurance market.

Such wide price variation for essentially the same coverage is reflected in the differences in the amounts retained by various life insurance companies. "Retention" by the company, as used here, refers to the difference, measured in present expected values,<sup>10</sup> between the premiums the policyholder pays to the company and the sum of the benefits received from the company. In the study of 15 major companies referred to above, company retention for the first 20 policy years ranged from \$276.64 to \$617.98<sup>11</sup> for the \$10,000 participating straight life policies. Expressed differently and less dramatically, the ratio of benefits to premiums of the various policies ranged from .853 to .715.<sup>12</sup>

Manifestly, differences of this magnitude are worth some attention by the law. A \$10,000 policy is not one limited to the affluent, and a potential saving of \$341.34 by buying it from one strong and well-known company rather than another is a price difference a potential buyer of insurance may care to know about. In saying this, we explicitly leave open for now the questions whether the difference is accurately measured and meaningful, and whether other factors might outweigh the difference in price.

#### 1. IS LIFE INSURANCE A SAVINGS MEDIUM?

Belth's calculations (and those of others seeking to refine measures of price) are based upon the assumption that cash value life insurance should be regarded as, in part, a savings medium. It is at

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\$10,000 straight life policies issued by the largest life insurers licensed in the state. The prices were calculated by the interest-adjusted method, using data from the official records of the Department and also from published interest-adjusted figures prepared by The National Underwriter Company. See *COST FACTS ON LIFE INSURANCE* (P. Gaines, Jr. ed. 1969). The Pennsylvania study also showed substantial price differences. *PENNSYLVANIA INSURANCE DEPARTMENT, A SHOPPER'S GUIDE TO LIFE INSURANCE* (charts 1-3) (1972) [hereinafter cited as *SHOPPER'S GUIDE*]. Similar computations and results appear in *AMERICAN INSTITUTE FOR ECONOMIC RESEARCH, LIFE INSURANCE AND ANNUITIES FROM THE BUYER'S POINT OF VIEW*, 46-50 (1966). See text accompanying notes 60-66 *infra* for a discussion of one interest-adjusted technique.

9. See Belth, *Life Insurance Price Measurement*, 57 KY. L. REV. 687, 696-709 (1969). Note especially the table in *id.* at 701.

10. *Id.* at 693-96. The present expected values used in this study are described.

11. *Id.* at 705-06.

12. *Id.* at 703-05. See discussion of benefits-premiums ratio in the text following note 68 *infra*.

this threshold point that the most strenuous objection to refined price disclosure arises. Many industry spokesmen, especially actuaries, assert that separation of life insurance into savings and protection is improper.<sup>13</sup> In their view, life insurance is an inseparable contract and can only be viewed as a whole.

Their view is not the common sense view, but it is not nonsense. It is appropriate for an actuary to regard the savings element as an integral part of an insurance contract. The "savings element" is an indispensable feature of level premium life insurance without which the system would not work. The narrow actuarial perspective, however, does not represent ultimate truth and need not govern others who see the policy from a different and complementary vantage point.<sup>14</sup> The savings element in life insurance is not *exactly* like a savings account. Nevertheless, the cash value is available to the policyholder. All he need do is either terminate the policy, pay interest on a policy loan, or assign the policy as collateral for a loan from a lender other than the insurer, and the cash value is available. For the planning of his personal finances it would be inane to advise a policyholder not to regard his cash value as an asset.

Thus the technically tenable actuarial point of view is, for disclosure purposes, irrelevant. The inseparable contract can be separated conceptually as easily as one can separate into two parts the purchase of a car with extra equipment for a single price. That the conceptual separation is not only possible, but an appropriate way

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13. See, e.g., *Hearings in the Matter of the Creation of Wis. Adm. Code Section Ins 2.14 Before the Dep't of Ins., State of Wisconsin* 45-46, 58, 63-64, 69-70, 72, 87-89, 118-20 (1971). But see M. LINTON, *HOW LIFE INSURANCE CAN SERVE YOU* 11-13, 63-80 (1958).

14. Not all actuaries have taken this narrow view. One distinguished member of the fraternity wrote:

[A] straight life policy consists in essence of two elements. One is the savings or investment element which steadily accumulates throughout the life of the policy. The other consists of term insurance which provides at death the exact amount required to build the then accumulated savings up to the face of the policy. Thus, if at any given time the savings accumulation under a \$10,000 policy should be \$4,000 and death should occur, the insurance element would provide \$6,000, bringing up to \$10,000 the total amount to be paid by the company to the insured's estate.

M. LINTON, *supra* note 13, at 63.

Linton then goes on to argue forcefully the merits of the combined savings (or investment) package as against the notion, current then as now, that one should "buy term and invest the difference." *Id.* at 11-13, 63-80.

The most striking illustration of the value of looking at phenomena from "complementary" viewpoints resulted from the development of quantum theory. As a result, it became useful to consider light sometimes as discrete particles instead of, as was traditional, waves. The choice depends on the purpose for which an inquiry is made and the study techniques used. This notion of complementarity from the hard sciences ought to be readily understood by mathematically trained actuaries. Holton, *The Roots of Complementarity*, 99 *DAEDALUS* 1015 (1970).

to look at cash value life insurance, is shown not only by the fact that it is found in standard textbooks including those of the insurance saint, S. S. Huebner,<sup>15</sup> but even more persuasively by the industry's own readiness to be recognized as a major savings institution when questions other than price disclosure are under discussion. Thus, the Life Insurance Association of America, in a scholarly monograph for the Commission on Money and Credit, published in 1962, had no qualms about a chapter entitled "Policyholders' Saving Through Life Insurance."<sup>16</sup> The study talks of industry efforts to push whole-life and endowment as opposed to term, in the hope of "an augmented flow of savings into life insurance." They further expressed hope that the "declining trend in life insurance savings" would be transitory.

The readiness of the industry to make the conceptual separation whenever it suits industry purposes makes it impossible for us to take the actuaries' objections to the savings notion seriously enough to argue about it further.

## 2. THE ADJUSTMENT FOR INTEREST

Usually, an interest rate of four or five percent is assumed in discounting life insurance cash flows to get present expected values. These rates may be inappropriate for purchasers with a sufficient degree of financial sophistication, especially if the tax advantages<sup>17</sup> of life insurance are a prime concern, or if the buyer's preferences do not fit our simplified model.<sup>18</sup> However, for the great majority

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15. According to S. S. Huebner, in a chapter entitled "Creation of Personal Estates Through Systematized Thrift,"

[t]he principal virtue of life insurance as a promoter of thrift lies in the union of the . . . savings fund throughout the life of the contract and a correspondingly decreasing term insurance. Saving and family protection are wisely tied together . . .

S. HUEBNER, *THE ECONOMICS OF LIFE INSURANCE* 165 (rev. ed. 1944). He goes on to extol the semi-compulsory character of life insurance premium payments as a powerful lever to induce thrift. *Id.* at 166; *see also id.* at 67-71, 158-66; R. MEHR & R. OSLER, *MODERN LIFE INSURANCE* 19-20, 131-33 (3rd ed. 1961). *Contra*, A. PEDOE, *LIFE INSURANCE, ANNUITIES & PENSIONS* 90 (1964). *But see* A. PEDOE, *supra*, at 209.

16. LIFE INSURANCE ASSOCIATION OF AMERICA, *LIFE INSURANCE COMPANIES AS FINANCIAL INSTITUTIONS* 16-39 (1962).

17. *See generally* 1 CCH 1972 STAND. FED. TAX REP. ¶¶ 859-60, 901, 907, 913.

18. An early exchange that raises the question of the analysis of consumer utilities in relation to the insurance product is found in Belth, *supra* note 1, and Solberg, *supra* note 1. This present article follows Belth in seeking an early functional solution by leaving the complications such an analysis would introduce for subsequent dialogue. Belth recognizes the complications a utility analysis would add to the whole matter. Belth, *The Relationship Between Benefits and Premiums In Life Insurance*, 36 J. OF RISK & INS. 19, 35-36 (1969). But while utility analysis may be needed for a full theoretical explication of insurance prices, consumers can only exercise their preferences on the basis of available information. Thus consumers must be supplied with useable figures; operating with them,

of policyholders, four or five percent seems reasonable.<sup>19</sup> Five percent is the rate now generally paid by the conservative savings institutions that are practicably available to most people. Four percent may take more adequate account of the tax advantages of life insurance to the average buyer and thus be a better choice, apart from the danger of double counting of tax advantages mentioned in the next paragraph.<sup>20</sup> The policyholder whose circumstances or utility scales make the assumed rate unrealistic as to him could request that special calculations be made for him. Even if such a special calculation could not be made, a policyholder sophisticated enough to request it will certainly be more satisfied with an assumed rate of four or five percent than if a zero interest rate were assumed, as is the effect of using the traditional net cost method.

There is some risk from the point of view of effective price disclosure in making any adjustment for taxes. That risk is best seen by imagining a sales presentation using interest-adjusted figures with the interest reduced to take account of tax savings. Near the conclusion of his presentation, the agent adds, "and then you must remember also that the interest earned by the insurance company on your 'cash value' is not taxed, as interest would be in a savings bank." This statement is quite likely to be used by many agents—often innocently—but it would lead to double counting of the tax advantage. This danger suggests using the five percent figure, leaving it to the agent to exploit the tax advantage as an independent sales argument.<sup>21</sup>

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those sufficiently sophisticated can use them in expressing their preferences.

There are some built-in limiting considerations even for the preferences of sophisticated buyers, however. One is the rate of interest on policy loans which should lead such buyers to borrow the cash value whenever the aftertax income on other investments they might make would exceed the tax adjusted interest on the policy loan to an extent sufficient to overcome any risk aversion that might be felt. This flexibility inherent in the savings element of cash value life insurance makes it much less necessary to adjust for taxes in determining what interest rate to use for discounting life insurance cash flows in price disclosure.

19. See generally J. BELTH, *supra* note 5, at 55-58; Belth, *supra* note 3. SPECIAL COMMITTEE REPORT at 21; see also WIS. AD. CODE § INS 2.15 (effective Jan. 1, 1973).

20. Any interest rate could be used. The 4% interest rate selected by the Joint Special Committee was considered "a reasonable choice for general use . . . [because it] is a rate close to the aftertax rate readily obtainable over a period of years in accounts in savings institutions." SPECIAL COMMITTEE REPORT 21.

21. In a vitriolic piece attacking the interest-adjusted method of price comparison, one industry spokesman suggests that the return on noninsurance savings should also be adjusted downward to reflect the tax liability on such savings. This suggestion misses the whole point of the exercise, which is not to ascertain aftertax gains from various savings media, but to recognize that life insurance is a savings medium and, after making appropriate adjustments for that fact, find out with reasonable accuracy what the protection element of the insurance then costs. Baird, *The Truth*

### B. *The Consumer Age: Disclosure in General*

The idea of compelling meaningful price disclosure is relatively new in the life insurance industry.<sup>22</sup> Some might view as a strong argument for it the fact that such requirements are already common in consumer financial transactions other than the sale of life insurance.<sup>23</sup> For example, consumer credit transactions are regulated by "truth-in-lending" legislation.

The Truth-In-Lending-Act<sup>24</sup> requires detailed disclosure of consumer credit terms. The purpose of the Act is to

assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit.<sup>25</sup>

If one substitutes "life insurance" for "credit," and "prices" for "terms" in the above statement of purpose it becomes clear that the concept of price disclosure at the point of sale in life insurance is an extension to insurance of the spirit of disclosure to consumers exemplified by the Truth-In-Lending Act. However, the case for disclosure in life insurance should stand solidly on its own two feet, not be smuggled in as a poor relative of consumer credit. The argument by analogy to consumer credit, while not conclusive, is not irrelevant. It does show that price disclosure in life insurance is well within the purview of accepted regulatory activity.

### C. *Additional Arguments Against Disclosure*

While the basic argument against price disclosure is the insistence of some actuaries—unjustified, we believe—that life insurance cannot appropriately be regarded as a savings medium, there are other arguments that must be faced squarely.

#### 1. DOES DISCLOSURE OBSCURE POLICY DIFFERENCES?

It is sometimes urged that price disclosure is misleading because it focuses attention exclusively on the price of the product and thereby obscures considerations of quality.<sup>26</sup> The most obvious

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*the Whole Truth and Nothing but the Truth*, FIELDNEWS, Apr. 12, 1972, § 2, at 13-15 (Northwestern Mutual Life Insurance Company).

22. Cf., e.g., W. MATTESON & E. HARWOOD, *supra* note 1, at 42-50, 63-75.

23. See, e.g., Consumer Credit Protection Act, 15 U.S.C. §§ 1601-77 (1970) (consumer credit sales); UNIFORM CONSUMER CREDIT CODE as adopted or under study in various states, for example, Colorado, CH. 207, § 73-1-101 *et seq.* [1971] COLO. LAWS 770-854 (consumer credit sales, consumer loans); 1 CCH CONSUMER CREDIT GUIDE (Conn.) § 4001 *et seq.* (Connecticut price disclosure requirements) (1971).

24. Consumer Credit Protection Act, 15 U.S.C. §§ 1601-77 (1970).

25. *Id.* § 1601.

26. See, e.g., exhibit 22 *passim* submitted in *Hearings In the Matter of the Creation of Wis. Admin. Code Section Ins 2.15, Before the Dep't of Ins., State of Wisconsin*. [hereinafter cited as *Hearings on Ins 2.15*].

case is where similarly priced policies provide different benefits. This does not present a serious problem, for the companies can easily separate the charges for waiver of premium for disability, accidental death and disability benefits, or other such supplementary clauses. If they do not separate them now it is because they see sales advantages in the packaging; price disclosure would only compel them to break the premium down into its component parts. Usually they will already have the data.<sup>27</sup> If the benefits are not such as to involve price differences, there is no problem; exploitation of essentially cost free liberalization by some companies can only lead others to follow suit which would, in general, be advantageous to consumers.

## 2. WILL DISCLOSURE LEAD TO SELF-SERVICE MARKETING OF INSURANCE?

A more serious question is whether price disclosure would lead to self-service life insurance buying, without the aid of professional advice. A well-designed policy, backed by a sound company and sold by a competent agent, which is consistent with the special needs and financial resources of the purchaser is usually important to assure consumers the best value for their insurance dollars. The life insurance buyer needs quality service and of course can get it only if he pays for it. It is undeniable that the potential exists for the obscuring of the value of good agents. But there is also room for skepticism on the question whether the present marketing structure of life insurance, with agents compensated by commission, provides disinterested advice to the buyer. Perhaps compensation by commission is inconsistent with real professionalism. On how many occasions does an agent now advise his potential client to buy his insurance elsewhere?

## 3. INCREASE IN THE TECHNICAL COST OF PROCESSING POLICIES

Some have argued that a resulting increase in technical insurance costs militates against a price disclosure rule.<sup>28</sup> If there is a reasonable prospect of improving consumer behavior, the potential saving is large,<sup>29</sup> while the cost of providing price disclosure is small. On the basis of several discussions with competent company and trade association officials, we estimate a cost of no more than a dollar or two per policy sold, including developmental costs when amortized over a reasonable number of policies. This is, we believe, a generous figure; we received one estimate that was a great deal less. The largest figures received are so small in rela-

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27. Industry sources inform us that price figures for supplementary benefits are prepared for company use.

28. See, e.g., exhibit 17 at 3 or statement of Continental Assurance Co., Chicago, Ill. at 1 submitted in *Hearings on Ins 2.15*.

29. See text accompanying notes 5 to 12 *supra* for an indication of the magnitude of potential savings.

tion to potential savings that cost cannot be regarded as a serious objection to price disclosure, unless disclosure is unlikely to be effective. Industry claims of cost increase should be ignored unless backed up by a detailed and reliable costing of the disclosure process, plus convincing evidence that the long range effect of a disclosure requirement on consumer and industry behavior would be relatively insignificant.

Variation in the price disclosure format from state to state would increase developmental costs but probably not production costs thereafter. If there were only a few patterns among the states, the increase can not be regarded as serious.<sup>30</sup>

#### 4. THE ATTEMPTED REDUCTIO AD ABSURDUM

One criticism of price disclosure is that if an interest-adjusted cost index is required in the sale of life insurance, then it could also be required in the sale of "almost any type of property or investment."<sup>31</sup> Of course, an "alternative use of money"<sup>32</sup> calculation is always possible whenever a person spends money instead of saving it at interest. Indeed, when any sensible person decides to purchase anything, he is aware of the option of saving his money instead. However, this criticism misses the mark altogether, instead of achieving the desired *reductio ad absurdum*.

The need for an interest-adjusted cost figure for life insurance protection does not arise from the notion that a dollar spent for life insurance is wasted. The theory behind the interest adjustment is that the policyholder should know what he is paying for his protection, so that he will not be misled into thinking that he is getting it free—or is even being paid to have insurance protection! The buyer should be able to find out what he is getting for his life insurance premium. A dollar spent for a refrigerator buys one dollar's worth of refrigerator, which the buyer can see before him. But, a dollar paid for cash value life insurance buys less than one dollar's worth of insurance protection. In ordinary life policies the premium dollar goes in large part into the savings element. It is this that creates the need for the interest adjustment in order to represent more accurately the cost of the protection element. It is incorrect to view the interest adjustment as an *addition* to cost.<sup>33</sup> It is an adjustment necessary to *reveal* cost. It allows the purchaser to get a realistic picture of the price of insurance protection, and to compare one insurance product with another.

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30. Technical costs include preparation of computer programs, computer time, paper costs, and the time required to test the computer program and study disclosure in general. Technical costs should be distinguished from possible additional selling costs, which are discussed in the text accompanying notes 83-89 *infra*.

31. Baird, *supra* note 21, at 9-13.

32. *Id.* at 15.

33. *Id.*

D. *Will Price Disclosure Have Significant Effect?*

It is a fair question whether even highly informative and completely mandatory price disclosure is likely to have much effect. Likewise, it seems too early to know whether truth-in-lending legislation will have any.

One provocative small-scale study of consumer behavior in the market for automobile loans in Washtenaw County, Michigan, suggests that knowledge of price differences does not automatically result in selection of the lender whose terms are most favorable. It was based on 1967 loans. At that time there was substantial price competition known to many of the borrowers. The study reached the conclusion, seemingly well supported by the data gathered, that many consumers who knew of the differences failed to seek the lowest cost loan for which they could have qualified, despite a total cost differential over a three year period of as much as \$125. The authors expressed strong reservations about the impact to be expected from truth-in-lending legislation.<sup>34</sup>

We have similar *a priori* skepticism about the early impact of life insurance price disclosure requirements. But we do not know and we think no one else knows what the long term impact will be. There are significant differences between life insurance and borrowing to buy automobiles. In the latter the decision to buy is usually made without considering credit terms, and the tie-in arrangements common in automobile financing can have significant impact. Moreover, because of its potentially lifelong duration, we think a decision to buy life insurance will generally seem a weightier decision, more difficult to reach, than a decision to buy an automobile. Life insurance is a complex financial transaction represented solely by a piece of paper, and its purchase is less likely to be influenced by economically irrelevant considerations than the purchase of an automobile, save for one, the accident of being contacted first, or at the crucial time, by a particular agent. The aggregate amount of money involved in life insurance will seem (and may be) much greater, even when reduced to present values. All things considered, we believe the economic man has a better chance to prevail in life insurance than in automobile financing.

The greatest impact of price disclosure may not be on consumer behavior but on agents. No agent will wish to remain with a company whose compulsorily disclosed prices are relatively high. That impact may be slow to develop, however. Successful agents under many agency contracts have nonvested renewal commissions amounting to sums in six digits. An agent in that position can

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34. White & Munger, *Consumer Sensitivity to Interest Rates: An Empirical Study of New Car Buyers And Auto Loans*, 69 MICH. L. REV. 1207 (1971). See also Comment, *The Impact of Truth in Lending On Automobile Financing—An Empirical Study*, 4 U. CAL. DAVIS L. REV. 179 (1971).

hardly be expected to change companies, but it will be more difficult to induce new agents to join a company if it is not competitive. Thus, over time, the agency force of the noncompetitive company can be expected to decline in size and quality.

We do not think the case for disclosure should be rested on short term impact. Price disclosure has great theoretical possibilities and deserves, at the least, a fair chance to succeed. If in the long run it proves not to be useful, it can be, and should be, abandoned. But it should at least be tried.

#### *E. The Basis of Opposition*

One is always tempted to see pocketbook explanations for strong positions taken in economic regulatory matters. From that perspective, it is understandable that some insurers oppose interest-adjusted price disclosure rules because it would show their products in a less favorable light than did the traditional net cost technique. Another fear of some insurers is the impact of disclosure on the agency force.

Conversely it is natural for a company to be more sympathetic to interest-adjusted price disclosure if it shows up well in the more sophisticated price comparisons. Some vigorous opponents of price disclosure, however, represent companies that appear well under either technique.<sup>35</sup>

Some of the opposition to price disclosure is clearly attributable to fear that disclosure of interest-adjusted costs may make all life insurance seem less attractive than alternative investments. All insurers would have similar economic motivation to the extent that they feel such a fear. This can hardly be a justification for withholding the facts from the public, of course. Moreover, such fears are probably groundless, especially in view of the fact that life insurance has tax advantages it can exploit.<sup>36</sup>

One likely basis for some of the opposition which can neither be documented nor measured is fear that additional public exposure of the pricing mechanism of life insurance, and especially the additional emphasis in sales presentations on the tax advantages of "inside interest"<sup>37</sup> it would encourage might lead to loss of a tax advantage. But, it hardly seems reasonable to oppose price disclosure because the life insurance industry may be compelled to justify a tax advantage it enjoys.

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35. See, e.g., Baird, *supra* note 21.

36. See note 17 *supra*.

37. Interest is important in a cash value life insurance contract. In the absence of interest, an insurance company would have to charge higher premiums to cover death benefits, cash values, dividends, and expenses. Thus, as premiums are paid, interest is at work. Interest in this context sometimes is called "inside interest." See J. BELTH, LIFE INSURANCE: A CONSUMER'S HANDBOOK 38 (1973).

In summary, the suggestion that the motivation for opposition to price disclosure is largely economic in character suggests nothing discreditable. Rather, it leads to the conclusion that the life insurance industry is not likely to be the best judge of the public interest.

#### F. Summary

If interest-adjusted figures are accurate and meaningful, then options are available to the life insurance shopper that would make price disclosure particularly well suited to life insurance sales. In view of the widespread ownership of life insurance<sup>38</sup> and the reliance placed upon it by families from all levels of society,<sup>39</sup> adequate price information at the point of sale in life insurance theoretically has great potential, if it can be supplied in a form that makes it understandable and does not distort or conceal other important considerations. When coupled with the absence of convincing reasons for not requiring disclosure, this important potential impact establishes a strong case for compulsory disclosure, provided suitable techniques can be adopted. The question of techniques will be dealt with later. First we examine the source of present price disclosure proposals in the replacement problem.

### II. POLICY REPLACEMENT

Wisconsin is the pioneer in the requirement of price disclosure for the initial sale of life insurance.<sup>40</sup> In Wisconsin, the notion of price disclosure requirements for the initial sale was given special impetus by recent pressure from many insurers to strengthen disclosure requirements in the event of policy replacement. Policy replacement refers to a transaction in which new life insurance is purchased and, simultaneously, existing life insurance protection is either modified or surrendered. Often, the insurance is replaced by a combination of insurance and mutual fund shares. Most insurers have traditionally argued, and it has been widely thought, that replacements are seldom in the best interests of the policyholders.<sup>41</sup>

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38. In a national survey conducted in mid-1969 for the Institute for Life Insurance, "at least one member of 83%" of the families included in the study "had coverage with legal reserve life insurance companies." FACT BOOK 12.

39. According to industry studies, the average size of ordinary (straight life and term) life insurance policies in force in the United States in 1970 was \$6,100. The average amount of life insurance of all types in force per family in the United States in 1970 was \$20,900; in Wisconsin, it was \$19,500. Over 50% of the households with an income under \$5,000 had at least one member insured by individually purchased life insurance. The percentage rises rapidly with income to over 80% for all families with income over \$10,000. *Id.* at 15, 23.

40. WIS. AD. CODE § INS 2.15 (effective Jan. 1, 1973).

41. The large front-end load (consisting of agents' commissions and the

In Wisconsin when replacement occurs,<sup>42</sup> certain written information must be given to the consumer.<sup>43</sup> The information must include the premium for the life insurance shown separately from all other charges and the amount of the death benefit for the life insurance shown separately from any other benefits.<sup>44</sup> In addition, all matters not pertaining to life insurance must be recorded separately from all matters pertaining to life insurance.<sup>45</sup> This, like most other replacement rules, was only a mincing first step toward disclosure and did not even purport to use the advanced techniques that are now possible.

At the hearings on the proposal to strengthen Wisconsin's replacement rule, Wisconsin's Commissioner DuRose reasoned that if disclosure is to be required in replacement sales, it should likewise be required at the point of initial sale.<sup>46</sup> It seemed to him illogical to require disclosure at the time of replacement if the policyholder received no adequate price information when the policy was initially purchased. Previously the Department of Insurance had accepted the distinction between replacement and initial purchase in the belief that replacement should be presumed bad and discouraged unless there was adequate disclosure.

As of March 31, 1972, life insurance replacement regulations were either in force or proposed in 35 states.<sup>47</sup> Although not very sophisticated, they do point toward more effective price disclosure under certain circumstances. While DuRose's a fortiori argument seems to be valid, it appears that public policy now has moved past the question of whether price disclosure is desirable both at the

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initial administrative expenses of the company) must be paid again. Less important in the usual case, most incontestable and suicide clauses are of two year duration; in a new policy, these clauses would be reinstated and claims that would have been paid under the old policy may be denied. Finally, there is no assurance that the new policy will be sold by a lower cost company than the policy already in force. See Kimball & Jackson, *The Regulation of Insurance Marketing*, 61 COLUM. L. REV. 141, 193-96 (1961).

However, replacement may sometimes be in the best interests of a policyholder. See, e.g., J. BELTH, *supra* note 5, at 205-16. One can only know whether it is or not by a careful examination of all the data for both the replaced and the new policy. Price disclosure would make it easier to decide.

42. WIS. AD. CODE §§ INS 2.07 and 2.14 (1972) describe the applicability of these rules.

43. *Id.*

44. See, e.g., *id.* § 2.14(3)(c),(4) and (5). This information need not be provided for credit life insurance or group life insurance. *Id.* § 2.14(2).

45. See, e.g., *id.* § 2.14(3)(c) and (6).

46. *Hearings in the Matter of the Creation of Wis. Admin. Code Section Ins 2.14, Before the Dep't of Ins., State of Wisconsin* 132 (1971). The original replacement regulation in Wisconsin took effect on May 15, 1962.

47. For a summary of these replacement regulations see Ciesielski, *Policy Replacements, Status as of 31 March 1972*, ALC NEWS LETTER, Apr. 11, 1972, at 6, 6-9.

time of initial sale and on replacement. The question now is what is the most accurate, intelligible price yardstick to help life insurance shoppers decide whether to buy insurance or to replace it, and how much and what type of insurance to buy from which company.

### III. THE TECHNIQUES OF PRICE DISCLOSURE

There is nothing new about price disclosure except the development of more sophisticated techniques and the imminence of compulsion. For a long time agents have been disclosing and comparing prices, using the traditional net cost technique.

#### A. Net Cost Price Measurement

The traditional method<sup>48</sup> of price calculation used in the life insurance industry is the "net cost method." The simple total of the premiums for the period under analysis (usually 20 years) is calculated. Then, the simple total of the dividends for the period, and the cash value at the end of the period are subtracted from the total premiums. The result is divided by the number of years in the period.<sup>49</sup>

A price calculation using the net cost method measures "the excess, positive or negative, of dollars payable to the life insurance company over the dollars assumed payable by the life insurance company."<sup>50</sup> The method has one important attribute, simplicity: It "requires a minimum of data, it can be performed quickly by hand, and it is readily understood by agents and policyholders."<sup>51</sup> Its understandability and simplicity are not advantages, however, for those very qualities make it seriously misleading.

The chief weakness of the traditional method is that "it ignores the enormously important interest factor" as well as "the declining amount of protection contained in most level-premium policies."<sup>52</sup> The lack of an allowance for the time value of money and the gradual buildup of cash values seriously understates life insurance prices.<sup>53</sup> The traditional method can reach "the absurd conclusion"<sup>54</sup> that the average price per \$1,000 of life insurance coverage is *negative*.

Another weakness of the net cost method is that it is meaningful, even on its own terms, only for the precise time period chosen. No

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48. J. BELTH, *supra* note 5, at 7-10; SPECIAL COMMITTEE REPORT 5-7.

49. See Belth, *Life Insurance Cost Measurement*, 72 *BEST'S REVIEW*, Sept. 1971, at 14 (life/health ed.).

50. SPECIAL COMMITTEE REPORT 5.

51. J. BELTH, *supra* note 5, at 9.

52. *Id.* See notes 14-16 *supra*.

53. J. BELTH, *supra* note 5, at 9.

54. *Id.*

information is presented for longer or shorter time periods.<sup>55</sup> Also, the technique cannot compare policies with nonlevel face amounts or various supplementary benefits unless the policies under analysis have identical provisions.<sup>56</sup>

Finally, the traditional method lends itself easily to "window-dressing."<sup>57</sup> For example, if the policy pays larger dividends in the later policy years than in the earlier years, more money remains with the company to earn interest, and in addition the company does not pay the larger dividends at all to policyholders who die or otherwise terminate the policy in the early policy years.<sup>58</sup> A policy thus constructed appears in a more favorable relative position on a net cost index than on more sophisticated indices.

### B. Interest-Adjusted Methods

The principal distortion in the net cost method results from the failure to take account of the time value of money—in effect it assumes a zero interest rate.

Various price indices adjusted for interest and sometimes for other factors have been developed that in varying degrees meet the objections to the net cost method.<sup>59</sup>

#### 1. THE INTEREST-ADJUSTED METHOD

Though all the more refined methods adjust for interest, one proposal is called the interest-adjusted method.<sup>60</sup> It begins, like the net cost method, with the selection of either a 10 or 20 year period for analysis. An interest rate of four percent compounded annually is assumed. The annual illustrated dividends are accumulated at interest to the end of the time period chosen, and the cash

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55. *Id.* The method of price disclosure proposed by Belth, *supra* note 3, provides prices of protection and other information for the first 20 policy years and quinquennially thereafter, in addition to summary aggregate information for the whole expected duration of the policy.

56. J. BELTH, *supra* note 5, at 9.

57. *See id.* at 9, 21-31; *see also* W. Scheel, A Critique of the Interest-Adjusted Net Cost Index § 5, June, 1972 (unpublished paper on file at the Wisconsin Law Review).

58. Statement of Joseph M. Belth, Professor of Insurance, Graduate School of Business, Indiana University, Prepared For Submission To the Securities and Exchange Commission As a Part Of The Proceeding With Respect To Petition For Issuance And Amendment Of Rules Requesting Exemption Of Certain Variable Life Insurance Contracts and Their Issuers From the Federal Securities Laws 12, May, 1972.

59. *See* J. BELTH, *supra* note 5, at 7-20; SPECIAL COMMITTEE REPORT 9-19.

60. The interest-adjusted method illustrated is the technique of cost comparison that the Joint Special Committee on Life Insurance Costs concluded was most suitable for general use. SPECIAL COMMITTEE REPORT 21. This method is also the basis of the price disclosure regulations proposed in Nevada and New Hampshire and promulgated in Wisconsin.

value at the end of the period is added to the dividend accumulation. This sum is divided by a predetermined interest factor.<sup>61</sup> The resulting figure, which represents the sum of the accumulated dividends and cash value expressed as a level annual amount adjusted for four per cent interest, is then subtracted from the annual premium. The result of this last calculation is divided by the number of thousands in the face value of the policy.<sup>62</sup>

The interest-adjusted method, which is used in the Wisconsin regulation, provides a price per year per \$1,000 dollars of the face amount of the policy, adjusted for the value of money over time. If the interest rate is reasonable, it reflects relative values better than the traditional method, and is more reliable as an index of the price of a policy. Moreover, it is based on figures generally present in published data.

One serious weakness is that this method takes no account of the gradual reduction of the amount of insurance protection provided. Another drawback is that it lends itself to "window-dressing," though somewhat less easily than the net cost method does.<sup>63</sup> Furthermore, if a choice of time periods is provided, there is a possibility that purchasers will be misled by comparing 10-year prices on one policy with 20-year prices on another. The promulgated Wisconsin rule requires indices for both 10- and 20-year periods and is less vulnerable to criticism than the proposed Wisconsin rule, which gave the option of using either a 10- or 20-year period. In addition, the interest-adjusted method must be modified in order to compute prices for policies with nonlevel premiums. Also, it is not suitable

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61. If the period selected for analysis is 10 years, this factor is 12.486. For a 20 year analysis, the figure is 30.969. This interest factor represents 1 per annum accumulated at an interest rate of 4% compounded annually to the end of the time period chosen. See SPECIAL COMMITTEE REPORT 21.

62. The interest-adjusted method described here applies to policies with a level premium. For policies with a nonlevel premium, "an equivalent level premium is determined by accumulating the premiums at interest to the end of the period and dividing the result" by the appropriate interest factor. Otherwise, the calculations described in the text are followed. *Id.*

63. See text accompanying notes 57-58 *supra*; W. Scheel, *supra* note 57. Although the interest-adjusted method accounts for time of payment, more weight is attached to dividends than to cash values, except for the final one. Therefore, to appear more favorably on an interest-adjusted index, a company can "shift emphasis" from cash values to dividends. *Id.* The proposed price disclosure rules in Nevada and New Hampshire are even more vulnerable to "window-dressing" because cash value and dividend scales need be shown only for each of the first 5 policy years and quinquennially thereafter until the 20th policy year (cash values must also be shown at one or more attained ages between 60 and 70). The rule adopted in Wisconsin requires calculations only for the 10th and 20th policy years. However, the calculations are not required for any year "beyond the end of the premium payment period." WIS. AD. CODE § INS 2.15(4) (effective Jan. 1, 1973). Thus, the rule adopted in Wisconsin is also vulnerable to "window-dressing."

for comparing policies with dissimilar coverages, including non-level face amounts.<sup>64</sup>

One criticism of the interest-adjusted technique rests on an unfortunate misconception. It is claimed that any computation for a fixed number of years yields a surrender comparison between policies rather than a price comparison.<sup>65</sup> The rationale is that in the event of the early death of the policyholder, the payment of the death benefit results in a price for protection that is wholly different than the interest-adjusted price computed for a later policy year. It is true that the price of protection, relative to the benefits received, will differ from the interest-adjusted price if death occurs earlier than the year for which the interest-adjusted price figure is prepared.<sup>66</sup> However, the notion that death changes the price of insurance, *up to the time of death*, misconceives the whole nature of insurance. If one buys a \$100,000 term life insurance policy for a premium of \$1,000, the price of protection is exactly \$1,000 whether the insured dies or not.

The suggestion<sup>67</sup> that the term "Price Index" should be replaced by "Surrender Comparison Index" is based on this misconception. "Surrender Comparison Index" or "Surrender Value Cost Comparison Index" as it appears in the Wisconsin rule, is not incorrect but means the same thing as "Price Index". It measures the price paid for the protection, whether the insured event occurs at or near the moment of comparison or is delayed beyond that time. The phrase "Surrender Comparison Index," however, has the special disadvantage that it distracts attention from its intended purpose of disclosing the price of insurance protection. It is unfortunate that the Wisconsin rule falls into this error. However, in spite of the drawbacks of the interest-adjusted method, it does provide a price index.

## 2. THE RETENTION METHOD OF PRICE DISCLOSURE

A more elaborate method of price disclosure has been proposed by Professor Joseph M. Belth of Indiana University.<sup>68</sup> Described

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64. Policies with varying amounts of insurance would have to vary in the same way for comparisons to be meaningful.

65. See New York Association of Life Underwriters, Report of the Interest Adjusted Cost Method Study Committee, May 19, 1972 (unpublished report on file at the Wisconsin Law Review). This criticism caused Wisconsin's Commissioner DuRose to change the title of the Wisconsin price disclosure index from "Wisconsin Standard Life Insurance Interest-Adjusted Price Index" to "Life Insurance Surrender Value Comparison Index."

66. This suggests the need for a statement of price on a year-by-year basis rather than for a fixed number of years.

67. New York Association of Life Underwriters, *supra* note 65, at 3; *Hearings on Ins 2.15*, exhibit 9, at 3.

68. See Belth, *supra* note 3.

in detail by Professor Belth in this issue of the *Review*, this method offers several advantages over both the traditional method and the less refined interest-adjusted method.

First, while the retention method is an interest-adjusted method, it further refines the comparison by the calculation of a price per \$1,000 of protection for each year the policy is in effect. This overcomes two serious objections to the previous methods—that they ignore the declining amount of protection afforded and that they are valid only for the precise period selected.

Second, the retention method gives a price per thousand dollars of insurance *protection*, rather than face amount of the policy. This makes it possible to compare policies fairly even if they have differing benefits, *including varying amounts of protection*.

Belth's computations take into account not only interest but also probabilities of payment, with adjustments not only for mortality but also for lapse. The assumptions used are based on actuarial data and are no more (nor less) accurate for a given policyholder than the statistical data on which any insurance premium is based.<sup>69</sup>

Furthermore, in Belth's suggested disclosure statement, cash value and dividend information is provided for each of the first 20 policy years and quinquennially thereafter to age 85. This information would discourage "window-dressing" because the consumer can compare the payment plans in detail. He suggests also that premium notices be required to compare actual with illustrated dividends, to discourage overstatement of dividends at the time of sale. Especially significant in Belth's statement are the figures on the declining amount of protection in each of the first 20 policy years and quinquennially thereafter—an informative recognition of the buildup of the savings element in the policy due to the accumulation of cash values.<sup>70</sup>

Belth's price disclosure proposal also provides important summary price information, for the same period (to age 85). Present expected values are given for the premiums, the protection element, the savings element, the illustrated dividends, the company retention, and the supplementary premiums. In this respect it is similar to both the net cost and the interest-adjusted methods, ex-

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69. The lapse assumptions, and conceivably the mortality assumptions, used by Belth might not be considered suitable by an individual policyholder. This would be particularly true if an individual plans in advance to lapse a policy as part of a personal financial blueprint. However, no one can predict his future with certainty, and the use of group averages for mortality and lapse can hardly be avoided any more than an interest assumption can be avoided.

70. See text accompanying notes 13-16 *supra*.

cept for the choice of period and the more comprehensive nature of the information provided.<sup>71</sup>

The calculation of present expected values for supplementary premiums allows meaningful comparison between policies with dissimilar provisions. A policy that includes an accidental death benefit within the basic premium could be compared with another policy that charges extra for such a provision. It is not strictly necessary that the charges be separated, though Belth's proposed system would require it. If it were not required the company with a generous package could still separate its charges if it wished. If the company prefers not to separate charges, it would appear to less advantage in the price per \$1,000 per year in the summary sheet, but its agents would be free to call attention to that fact.<sup>72</sup> Separation would, of course, preclude many misleading statements in the sales presentations.

It is not necessary that the benefits under analysis be comparable. The retention method is designed to isolate the cost of protection, the one element common to all life insurance contracts, and the price factor most important for the consumer to know. This will appear clearly from the disclosure statement, despite variations in the benefits.

The present expected value of company retention presented in the summary information is most important to the consumer. This figure represents the present expected value of the difference between the policyholder's payments to the company and all benefits received from the company over the whole expected life of the contract. It is a telling point of comparison when making a purchase decision among various insurance companies and plans.

Belth's summary information also includes an adjusted benefits to premiums ratio. This ratio provides another important point of comparison among policies. The ratio is adjusted from a total benefits to total premiums ratio to avoid unfair comparisons between participating and nonparticipating policies and between participating policies with large dividends and those with small ones.<sup>73</sup> It is calculated by placing in the numerator the present expected value of protection plus the present expected value of savings. The denominator consists of the present expected value of premiums minus the present expected value of the illustrated dividends. Supplementary provisions are not included in the calculation. Thus

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71. It is assumed in Belth's proposal that the probability of the policy being continued beyond age 85 is zero.

72. Allowing that practice might lead to misrepresentation that would be difficult to detect, so that a disclosure rule might appropriately *require* the separation of charges. Belth would require the separation, but it is not inherent in his basic disclosure method.

73. Larger dividends result in a more favorable benefits-premiums ratio.

the adjusted ratio is not a simple benefits to premiums ratio but a ratio of protection plus savings to premiums less dividends.

One drawback to the Belth approach is that the calculations involved are even more complex than the interest-adjusted method, and are less readily understood. On the other hand, the only method of comparison easily understood by the layman is the net cost method. However, that calculation provides misleading information. Thus, it is better that the consumer rely on complex but accurate information than on simple but deceptive data.

### 3. PRICE SHIFTS WHEN METHODS ARE CHANGED

Major price shifts, and with them shifts in company rankings, occur when any interest-adjusted method is used instead of the traditional net cost method. Much less significant changes take place when changing from one interest-adjusted method to another. An example of these price shifts is shown by Belth in an analysis of \$25,000 straight life policies issued in 1970 to men aged 35 by 10 large insurers.<sup>74</sup> The policies included in the analysis were selected because they exhibit marked rank changes when the method is altered.<sup>75</sup> The traditional net costs for the policies ranged from -\$1.19 to -\$3.46.<sup>76</sup> With an interest adjustment at five percent, the figures changed markedly, showing a lowest price of +\$5.49 and a highest price of +\$7.17.<sup>77</sup> Marked shifts also occurred in the rank order; the first company under the net cost method dropped to seventh under the interest-adjusted method and the seventh company rose to first.<sup>78</sup>

### 4. SUMMARY

There are many other price calculation techniques. They will not be discussed, for it is not the purpose of this paper to try to choose the best. That can best be left for future discussion in which actuaries have a more legitimate role than in the basic question whether to have meaningful price disclosure. Of the three disclosure methods briefly described, Belth's seems to have significant advantages over the other two, and a disclosure requirement based on his method would provide useful and understandable numbers to which a buyer might profitably refer.

We will now discuss some of the problems involved in any attempt to formulate a meaningful price disclosure system, regardless of which method is chosen.

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74. Statement of Joseph M. Belth, *supra* note 58, at 12; see also SPECIAL COMMITTEE REPORT 21.

75. Statement of Joseph M. Belth, *supra* note 58, at 13.

76. *Id.*

77. *Id.*

78. *Id.* at 12-14.

## III. PROBLEMS IN PRICE DISCLOSURE

A. *Should Price Disclosure Be Mandatory?*

Perhaps the most important question in regard to a price disclosure system, aside from the method of calculation, is whether to make disclosure mandatory. The proposed rule in New Hampshire<sup>79</sup> provides for mandatory disclosure, while the Nevada<sup>80</sup> proposed rule provides for disclosure only upon request. The recently promulgated Wisconsin rule<sup>81</sup> provides for mandatory disclosure on delivery and disclosure on request at any earlier date.

A mandatory disclosure requirement has important advantages over disclosure upon request. First, since the goal of disclosure is to provide consumers the information they need to make informed purchase decisions, the goal is seriously compromised if the burden lies on each consumer to request the information. He may not know it is available. In the pressure of the sales interview he may forget to request it, even if he knows he has a right to ask for it. If he does request it, it may be supplied to him partially or in a misleading form, and proof of the violation may not be easy. Agents can be relied on to emphasize price comparisons favorable to them, but would probably be less anxious to reveal unfavorable information. If price disclosure is mandatory, consumers are more likely to learn the significance of the available data, because it will always be available, in the required form.

Mandatory disclosure should also encourage price competition. If consumers in numbers were to begin to consider price on the basis of meaningful information, companies offering the best value would have an advantage that would force high priced companies to become more competitive or to exit from the market. Even if consumer behavior were not much affected, companies might improve their prices out of fear of future consumer reaction, or because of pressure from agents or potential agents. Finally, mandatory disclosure is much easier to enforce.<sup>82</sup>

B. *When Should Disclosure Be Made?*

To have maximum effect, disclosure should be made when the prospect is first presented the insurance plan. This would allow the buyer to compare prices and the advantages claimed for his product by the agent. There are serious problems with any such

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79. New Hampshire Standard Life Insurance Interest Adjusted Price Index § 4(a)-(e), (proposed) (Office of Commissioner of Insurance, State of New Hampshire, Concord, N.H.).

80. Proposed Regulation, Use of Interest Adjusted Method For Life Insurance Illustrations And Comparisons (Office of Commissioner of Insurance, State of Nevada, Carson City, Nev.).

81. WIS. AD. CODE § INS 2.15(4) (a)-(e) (effective Jan. 1, 1973).

82. See discussion of enforcement in the text accompanying notes 90-96 *infra*.

requirement, however. The amount of written material the agent would have to carry to meet such a requirement would be prohibitive. Next best, the required information should be provided before agreement is reached between agent and policyholder. That presents the same problem for one-visit sales, which were estimated by one industry official to number perhaps 75 percent of the cases. Even if that figure is greatly exaggerated, the problem is a real one. At the least, however, the information should be provided no later than the time of policy delivery. Although it will be less effective after the sale has been made, the mandatory price disclosure should alert consumers, over a period of time, to the fact that substantial savings are possible if they shop around.

One supplementary device might be considered in connection with a requirement that permitted the disclosure to be made as late as the delivery of the policy. If there were a required cooling-off period during which the policyholder could return the policy for a full or substantially full refund of premium, the price comparison might be effective even after the sale is completed.<sup>83</sup> The period for cooling off might then be shortened or removed altogether in cases where the information was demonstrably provided on first contact, or before the sale. Whether such a contract provision can be mandated by rule or must be statutory will depend on how much discretion the statutes of the state give the commissioner with respect to policy terms. An alternative approach to a mandatory cooling-off period provision would be to mandate disclosure prior to sale, but permit it to be made as late as delivery if a cooling-off provision were inserted in the policy.

### C. *Should Low Face Value Policies Be Exempt?*

If price disclosure were to become the norm, a question arises whether to exempt industrial policies or policies with a low face value.<sup>84</sup> The issue as framed by proponents of such an exception is twofold. First, there is the question whether price disclosure is appropriate for such policies, especially if various supplementary benefits such as waiver of premium for disability, accidental death benefits and guaranteed insurability are included within the basic premium. It is argued that applying a price index to low face value policies would cause consumers to lose sight of the important supplementary benefits because price might be emphasized to the exclusion of important policy provisions.<sup>85</sup>

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83. Cf. WIS. STAT. § 204.31(2)(a)(8) (1969), requiring such a policy provision for accident and sickness insurance.

84. The figure usually mentioned is \$5,000 or less. See, e.g., *Hearings on Ins 2.15*, exhibit 22 at 3.

85. *Id.* A particular supplementary benefit mentioned in this exhibit is a simple additional paid-up insurance dividend, with no dividend illustrations provided. The disclosure requirement on Belth's model would then require the development of illustrations. We doubt that the company in

The argument is not convincing, although it has been accepted in the Wisconsin rule.<sup>86</sup> In the first place, it has nothing to do with the distinctions between large and small policies, or industrial and ordinary, but is equally applicable to all policies. More important, a refined disclosure system can effectively compare different mixes of benefits. Indeed, the effect of the requirement would be to compel or at least encourage companies to reveal how the total premium is made up. That is itself a good, not an evil, consequence of price disclosure. The company could be left free to set its price tag on each component part without unduly oppressive policing, for underpricing one part only compels the company to overprice another.

The more difficult question with respect to industrial and low face value policies is whether the policyholder gains enough from the information he receives to compensate for all increases in technical and sales costs, and thereby in policy prices.

The addition to technical costs per policy, even if the correct figure is as high as \$1.00 or \$2.00 per policy, is not significant.<sup>87</sup> However, it is argued that the requirement would compel a second sales visit. If that is true, the extra selling costs cannot be ignored. While larger policies already may require two sales visits,<sup>88</sup> small policies are more often sold in one. If the law were to compel the agent to provide price information to consumers before the sale is completed, agents would have to return a second time, unless all necessary information could be available in the agent's sales kit, which is not practicable. This increase in agents' time would have to be reflected in higher commissions and higher prices. Yet, the low or moderate income consumer who purchases a small policy is the very person who most needs price disclosure information, to get the most from his limited resources. In view of the substantial savings possible through careful insurance "shopping," the potential benefits of price disclosure seem to outweigh the increase in selling costs that may result. If such purchasers prove, after some experience, not to make use of the information provided,

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question can show convincingly that the cost of preparing such illustrations would be significant. Unless they were, a company's desire to make comparison more difficult by failing to provide them is hardly an argument against the requirement.

86. WIS. AD. CODE § INS. 2.15(2)(b)(9) (effective Jan. 1, 1973).

87. This is discussed in the text accompanying notes 28-30 *supra*.

88. One reason for this is that purchasers of larger policies seem, a priori, more likely to "shop" for life insurance because of the relatively large expenditure involved and because of their (presumed) greater economic sophistication. Also, it is often necessary that either the agent, or the home office, provide a special computer printout to show detailed information for some of the more complicated policies. Finally, an agent is more likely to deliver a large policy in person in order to explain it to the policyholder and cement relations for possible future sales, as well as to try to discourage lapse by establishing good rapport with the customer.

and if more competitive prices are not forced indirectly, the exemption could be created later. But no one can know the actual impact of the disclosure without giving it a reasonable trial.

*D. Should Action Be Delayed Pending a Uniform Law  
or Regulation?*

Concern about cost has occasionally been urged as a reason for having no disclosure requirement, but more often it is used to support opposition to action by individual states, which, it is often asserted, would raise the cost of life insurance unnecessarily.<sup>89</sup>

There is much to be said for, and nothing to be said against, uniformity in insurance regulatory patterns, so long as the uniform provision is sound. It is easy, however, for an effort to achieve uniformity to result in a substantial watering down of requirements, as the price of unity in a large committee. Moreover, a plea by industry representatives to wait for uniform regulation is very often, in reality, a plea to do nothing. If there is to be price disclosure it must begin somewhere. Thus, despite its weaknesses, the Wisconsin rule is a significant and valuable breakthrough. Uniformity can be achieved later. A sound uniform pattern is more likely to develop from some experience in individual states using different techniques; moreover, action in some states would compel a greater degree of cooperation from the industry in developing a good uniform rule. Varied experience would show how price disclosure rules can best be made to work effectively. Indeed, it would provide more adequate information on the cost of price disclosure to the consumer under different models of regulation, as well as on the effectiveness of disclosure. Any legitimate concern for cost or for any other effects of disclosure could then be accommodated in the uniform rule.

It is also a facile but erroneous assumption that a uniform law or uniform regulation produces uniformity in practice. And conversely, independent action by the states will not produce 50 rules; on the contrary, it is likely to follow at most a few principal patterns, so that the burden is less than some are wont to suggest.

One is tempted, indeed, to think that the agitation for uniformity of action reflects less the likelihood of operational difficulties or costs resulting from a few different rules than it does concern for the number of hearings and legislative sessions at which appearances and presentations must be made. The case for delay pending uniform action is a weak one, though the argument that uniformity should soon be sought has much merit.

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89. See, e.g., exhibit 17 at 3 or statement of Continental Assurance Co., Chicago, Ill., in *Hearings on Ins* 2.15.

*E. Will Effective Price Disclosure Create Residual Markets?*

One possible problem of price disclosure, if it is sufficiently effective, is that it may tend to create residual markets. Two equally efficient and well-managed companies may have greatly differing retention figures because the marketing patterns of the companies may have led them to have significantly different socioeconomic mixes of policyholders. Some low-priced companies, for example, have a relatively "elite" market. If price disclosure were to force higher cost companies to be more restrictive in their underwriting practices in order to present more competitively priced policies, residual markets might tend to develop among the less favored classes of the population. While this is a legitimate question respecting the long range viability of price disclosure, the problem is apt to develop slowly if at all. If recognized in time, it could be solved by relaxing present restrictions on price classification in life insurance, or by other means. In any event, it is hardly an argument against telling the public the truth about life insurance prices. The public should know what it pays for life insurance so that shopping is possible; residual markets can be dealt with if they do in fact develop.

*F. Publicity and Enforcement Procedures*

If price disclosure is to be effective, there must be good enforcement. Because of the limited resources of most state insurance departments, the system should be self-executing to the maximum extent possible; any active enforcement must depend on complaints from the public to trigger the attention of the departments to violations, not on investigation by the department. This suggests the necessity of a form of disclosure that is automatic and highly visible, and also suggests that extensive publicity should be given to price disclosure requirements to create public awareness. Awareness alone will almost insure full compliance.

The need for high visibility and for automaticity points to the need for compulsory disclosure, at least no later than policy delivery. A "request" rule could be violated with virtual impunity because proof of either the request or of noncompliance would present substantial problems.<sup>90</sup> The Wisconsin rule is a compulsory rule, though it was a request rule when first proposed.<sup>91</sup>

It has often been supposed that it would be futile to publicize price information because it would not be of much interest to buyers.<sup>92</sup> The experience of the well-known Pennsylvania *Shopper's Guide* suggests that the assumption may be wrong. The guide, prepared by the insurance department, presents interest-adjusted

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90. See text accompanying notes 91-96 *infra*.

91. WIS. AD. REGISTER, April, 1972, § INS 2.15(4) (proposed).

92. Cf. text accompanying notes 95-96 *infra*.

price figures for \$10,000 policies sold by the 50 largest companies doing business in Pennsylvania. It also ranks the 10 highest and 10 lowest price companies among 166 larger companies licensed in the state,<sup>93</sup> and contains an introductory section of explanatory material written for the general public.<sup>94</sup> It has received national attention, and is in great demand.<sup>95</sup> The one uncertainty is whether the demand has come mostly from consumers or mostly from the industry.

The Pennsylvania approach is direct and forceful. It is too recent to attempt to measure its impact on sales, however. Whatever its effect there are reasons to think that its preparation and promulgation were premature, however ingenious and attractive it may appear. First, despite efforts in the introduction at explanation, it tends to overemphasize price in relation to the importance of selecting sound, reliable companies and good agents to advise the individual on the best plan and amount of insurance for him. Second, it oversimplifies the comparison among companies by failing to make sufficiently clear the uncertainties involved in dividend illustrations, and by limiting the comparison to certain ages and plans which may but do not necessarily reflect the relative positions of the companies for all plans and ages. Much more deliberation and consultation should have preceded its distribution. Third, it does not include all companies and in the process prejudices those omitted only somewhat less than those given a bad rating. Scrupulous fairness to and among companies is as much an imperative in insurance regulation as is protection of the consumer.

A possible problem of really effective publicity that we strongly suspect is fanciful but, if not, could be catastrophic to large numbers of consumers, is the possible creation of a run-on-the-insurer psychology in policyholders of a company that appears badly in the ratings. If enough of them replaced or cashed in their policies, a large share of the company's assets might have to be liquidated to meet its cash needs, possibly at a time when sales would be at a heavy sacrifice. Insolvency of a sound company is a very unlikely but not impossible consequence. We emphasize the low probability of that event. However, serious consequences are possible if it did occur. Forcing high cost companies from the market may be desirable, but only if the retreat is an orderly one, not a rout.

In thus expressing doubts about the wisdom of the Pennsylvania action at this point of time, we do not suggest any improper motivation—the objective is the same as with any good disclosure

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93. SHOPPER'S GUIDE charts 2-3.

94. SHOPPER'S GUIDE 1-12.

95. See, e.g., FORBES, July 1, 1972, at 48-49; TIME, July 10, 1972, at 80-82; SATURDAY REVIEW, July 1, 1972, at 34, 37. Requests for the *Guide* were reported to be running at about 5,000 per week in July, 1972. *Id.* at 35.

system, and widespread publicity is a necessary part of a disclosure system if it is to be effective.

Another possibility for effective publicity would be a requirement that all advertisements for life insurance include a statement that price disclosure information is not only available but also that it is significant. This would provide notice of the possibility of price disclosure in advance of sales situations, and would be especially useful if the developed rules merely require price disclosure at the request of the applicant. It is not practicable to require disclosure of actual numbers in insurance advertising. In fact, any numbers used in advertising are very likely to be seriously misleading, and perhaps should be altogether forbidden as an unfair marketing practice.

If disclosure is always required and is visible, so that enforcement is possible, ordinary enforcement techniques will suffice. Violations of any Wisconsin rule, for example, are subject to the standard enforcement provisions of the Wisconsin Insurance Code. The provisions include the suspension or revocation of an agent's or insurer's license, substantial forfeitures, and criminal prosecution for willful violations.<sup>96</sup>

#### IV. CONCLUSION

An effective price disclosure regulation should have several important characteristics. First, the method of calculation must be sufficiently refined that consumers may receive meaningful price figures. Interest, at least, must be adjusted for. Probabilities of payment should also be taken into account. Since no individual can predict his future, he is better off to have his costs measured in terms of group averages for lapse and death than not to have these uncertainties taken into account at all. Also, the method of calculation should make meaningful the comparison of dissimilar policies and policies with nonlevel premiums.

Although a simple method of calculation would be desirable, none exists that is sufficiently precise. The use of sophisticated calculations by computer is inevitable. The frequent criticism of refined price disclosure—that it is too complex—is misplaced. Insurance is inherently a complex financial instrument, and the difficulties with disclosure result from that fact, not from the unwillingness of those seeking to provide for meaningful disclosure to make it simple.

At the same time, the information should be displayed in an intelligible and readily comprehensible format. The requirements of refinement and comprehensibility are difficult to reconcile. However, an explanation written simply and concisely can make the

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96. WIS. STAT. § 601.64 (1969).

figures meaningful and useable, even though the technique of calculation is not understood. Such a memorandum, written for the general public, must accompany the disclosure document.

In addition to price information, other information should be required. This information, in tabular form, should include the information Belth's disclosure documents would provide: the annual premium for each year, the amount of protection in each year, and the cash values and the illustrated dividends for each year. Also, figures showing various benefits as a percentage of premiums might be provided in the summary sheet. As a check upon the level of dividend illustrations, which make an enormous difference in the price comparisons, annual premium notices should be required to compare in the clearest fashion the actual with the illustrated dividends. The commissioner should also require frequent reports showing actual dividends in comparison with illustrated dividends; unjustified deviations should be regarded as an unfair marketing practice. Unnecessary information should be prohibited—the useful information can be rendered useless if it is buried in extraneous data.

A technique of price disclosure that seems to us to meet these criteria fairly well is the method proposed by Professor Belth.<sup>97</sup> Belth's proposed exhibits perform a valuable service; they provide the first clear illustration of the most important price information about a life insurance policy, and they are limited to the information that will be revealing. The major drawback to the retention method as Belth has proposed it is the lack of adequate explanation of the information. Nor are his summary sheets necessarily the clearest schematic statement of the information that can be devised.

We do not suggest that Belth's technique, even if improved in the ways suggested, is the last word in life insurance price disclosure techniques. However, it is a springboard from which further analysis can proceed. Pending that analysis, Belth's technique is sufficiently illuminating to use at once, and seems to be the best currently available.

In summary, opponents of price disclosure fail to present convincing arguments against a serious and reasonably long term test of meaningful price disclosure. Although some consumers may find the disclosed information confusing, they are probably already confused by the complexity of insurance policies and by deceptive sales presentations. Effective price disclosure would dispel some confusion for some buyers. That is a clear gain. The absence of widespread public demand for price illustrations does not prove the public would not be glad to have it, as experience with the Pennsylvania *Shopper's Guide* seems to show. The cost of preparing

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97. Belth, *supra* note 3.

price disclosure exhibits is moderate, and would neither unduly burden the insurance industry, nor raise appreciably the cost of insurance. Nor are the arguments convincing for delaying price disclosure pending development of a model regulation.

In short, the question facing the regulators of life insurance is no longer whether price disclosure should be required. Effective disclosure is possible and its time is now. Attention should be directed to adopting as informative and efficient a price disclosure system as possible. It is time to dispel the mystery surrounding life insurance, and especially the myth that most life insurance policies provide about the same thing for nearly the same price. Fear that the myth may be exploded is perhaps the most important single reason for opposition to a meaningful price disclosure technique.