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Providing Information and Value Customers Deserve • Transforming the Life Insurance Marketplace

January 18, 2011

NAIC President Iowa Insurance Commissioner Susan E. Voss
Iowa Insurance Division
330 Maple Street
Des Moines, IA 50319-0065

Dear NAIC President Voss:

Last August, I invited your predecessor, Commissioner Jane Cline, to join my campaign to fix before year-end the life insurance industry's deplorably inadequate disclosure and problematic sales practices that are terribly costly to consumers. For background, please read my August letter and Commissioner Cline's response before reading any more of this letter. Although a few friends have with tongue in cheek good-naturedly encouraged me to declare my campaign a Complete and Total Success, I know *there is still some work remaining,* and so I am now asking you to complete it. Specifically, I am asking you to fulfill your regulatory responsibilities to enact regulations mandating appropriate life insurance disclosure[i], to create a new and actually useful life insurance buyer's guide, and to implement additional changes as further outlined below to enforce heretofore ignored prudent regulatory practices.

To facilitate your efforts I have recently asked the Society of Actuaries to review my policy disclosure approach and either endorse it or, if deemed necessary, sponsor a competition to see whether any available better approach exists. As you will note from the enclosed copy of my letter to the Society, I am highly confident that they will endorse my approach. While appropriate policy disclosure is an essential step in fixing the life insurance marketplace, compiling and disseminating a list of the common misrepresentations pervasively used by life insurance agents are additional imperative steps. While good disclosure will enable consumers to more readily discern the falsity in misrepresentations – a task, unfortunately, largely unsuccessfully performed by most – accessible authoritative examples of financial misrepresentations will prove to be an invaluable safeguard checklist for consumers.

The NAIC's record, I am sorry to have to say, is that state insurance commissioners have been willfully blind, deaf, and mute about the outrageous, pervasive, and terribly harmful material misrepresentations in the life insurance marketplace. That is not just my opinion, it is fact. Professor Joseph Belth whose newsletter, *The Insurance Forum,* for more than 36 years has extensively documented these misrepresentation has repeatedly stated, "The life insurance market is characterized not only by an absence of reliable price information, but also by the presence of deceptive price information....the deceptive sales practices found in the life insurance industry constitute a national scandal."[ii]

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Belth is hardly alone in his criticism. Citations of other published criticisms could fill a phone book. The second sentence in the chapter on life insurance in *The Wall Street Journal's* book, *Lifetime Guide to Money,* reads, "There are lots of problems in the way it is sold." In their 2008 book, distinguished financial authors Kotlikoff and Burns state, "Life insurance agents have a well-deserved reputation for being hucksters." A must-read April, 2008 *Financial Advisor*[iii] article extensively quotes fee-only advisors who have largely built their businesses around providing truthful information because policy disclosures are so inadequate and agent misrepresentations so pervasive. "This lack of disclosure is a 'sin of omission' by agents and brokers, but is really a 'sin of commission' on the part of the carriers and, indeed, the state regulators," states Advisor David Barkhausen, a former agent, attorney, and state legislator. These facts should not surprise anyone given agents' financial incentives[iv], the absence of readily available reliable information, and consumers' widespread insurance gullibility, ignorance, and/or misplaced trust.

Following the sales practices scandals of the 1990s, the industry created the Insurance Marketplace Standards Association (IMSA) to provide consumers and life insurers a good housekeeping seal of approval. IMSA's first principle states: "To conduct business according to the high standards of honesty and fairness and to render that service to its customers which, in the same circumstances, it would apply to or demand for itself." Given the importance of knowing the cost of any product bought, **and that** as the NAIC's Life Insurance Buyer's Guide states, a cash-value policy's premium is not its annual cost, how do you think agents who sell whole life explain its cost?

When I have pretended to be an ordinary consumer needing life insurance, several agents have explained whole life's costs to me as follows[v]. "The insurance company says, here, we're going to calculate all the mortality factors up-front. Rather than charging you year by year for the odds of you dying, we're going to put that all into the front end and you're going to pay those expenses upfront." Another agent explained, "They have taken out all of the mortality - it's all front loaded, they front load all of the mortality charges." A third agent reiterating this one of his many deceptions stated, "Remember how I said that the mortality costs are taken out upfront." A fourth agent, boasting of his insurer's compliance – having just returned from its annual sales meeting, explained the policy's low early years' cash values by stating "one pays for the guarantees of whole life upfront." When I subsequently expressed skepticism about "paying for guarantees" during a follow-up meeting with this fourth agent and a partner/mentor he had invited to join us, the mentor somewhat haughtily dismissed his colleague's 'explanation' and, upon being informed of what I preferred about a competitor's policy, quickly suggested a different policy from their insurer that provides much better value and much larger cash-values because of its lower commissions. The partner/mentor's suggestion, however, revealed the fourth agent's untrustworthiness because in our prior meetings his colleague had emphasized and assured me that he would act as a fiduciary, which he, clearly and undeniably, had not done.[vi] Please note that I could submit to you several additional pages of legally acceptable evidence documenting ten agents making scores of misrepresentations on a half dozen topics that comprise the main areas of misrepresentation.[vii] Also please note: all but one of the insurers whose agents I met with were IMSA members; and that no one could brand as a rogue any of these many agents as they all are big-producing veteran agents. **I trust you can now see why I have asserted for years that IMSA is and always has been a fraud.[viii] Clearly, these IMSA insurers have not only never fulfilled IMSA's first principle, but they have also failed to even alter or curtail the pervasive, egregiously harmful, and age-old agent misrepresentations.**

As you well know, life insurance regulations prohibit misrepresentation. Specifically, all information provided to consumers about a life insurance policy or annuity contract "shall be

sufficiently complete and clear so that it is neither misleading nor deceptive, nor has the capacity or tendency to mislead or deceive." But as I think you also readily know, Alan Press, former president of NAIFA's predecessor, has written, "They [this quoted regulation and others] have simply never been enforced." In fact, when I recently discussed with NY state regulators whether they think that agents make accurate disclosure regarding whole life insurance policies' costs and early years' low cash-values, the responding regulator replied, "I doubt it," and none of the seven other regulators in the meeting objected. I was more than just a little incredulous[ix]; after a long silence the discussion returned to our agenda's topic. No testimony during our industry's 1906 Armstrong hearings or the 1933 Pecora hearings that forever changed the securities industry exhibited any more shocking regulatory indifference regarding marketplace dishonesty and negligent enforcement. While it is understandable that evidence of pervasive market misconduct can be discomforting to regulators, regulators still have an obligation to perform their duties. Please let me be explicit: these and many other similar facts, I contend, show unequivocally that insurance commissioners have not done essential basic tasks of their jobs, they have failed to provide appropriate policy disclosure, a fundamental regulatory responsibility, and they have never effectively enforced industry regulations[x].

Just as there is no joy for most who try working as agents[xi] in the dysfunctional insurance marketplace built without the necessary regulations and enforcement, there is no joy for me in telling you these truths. With respect to these enforcement failures, failures certain to one day be legendary, Kenneth Mann's seminal book[xii] on white collar crime offers the following insightful explanation: "When inculpatory information is embedded in normal social life, that is, when it is not easily identifiable as potential evidence, there is a high probability that the government will not identify it." Indeed, many misrepresentations regarding life insurance are supported by myths and financial misconceptions that abound in our culture, largely verbally these days as insurers have purged their sales and marketing literature following the 1990s sales misconduct scandals. Perhaps one of the all-time best examples of such, and one still very widely relied upon by agents selling whole life, can be found in the NAIC's original Life insurance Buyer's Guide that states there are two types of life insurance term and whole life – a misleading dichotomy terribly inadequately explained, as I've written about in several articles, including one in 2002 in the NAIC's own *Journal of Insurance Regulation*.[xiii] A recent example of the abounding misconceptions – and shocking because it actually appears in print, hence observable by all - is a *National Underwriter* article written by a life insurer's Senior Marketing Communications Specialist who states, "In fact, whole life insurance actually can get less expensive the longer the policyholder holds the policy because the increase in guaranteed cash values and nonguaranteed dividends often exceeds the premium after a few years."[xiv] Another likely explanation of enforcement failures, as the Madoff whistleblower Harry Markopolos repeatedly demonstrated regarding the SEC – long, but apparently quite erroneously, considered the bastion of regulatory excellence - is that the ranks of financial regulators are almost entirely filled with individuals who have neither the real financial expertise nor the actual meaningful marketplace experience and knowledge to conduct effective enforcement.

Insurance commissioners, of course, are not the only party to have failed. Consumerists have woefully failed[xv] in the ineffectiveness of their advocacy; after all, as Belth has stated "the solution to the problem of deceptive practices in the life insurance industry lies in disclosure." Neither consumerists nor financial journalists, though, have ever properly pursued Belth's recommendation[xvi]. Insurance professors treat the subjects of life insurance disclosure and misrepresentation as the third rail to any consulting assignment, have never engaged, aided, or when necessary corrected Belth, and when broaching these subjects have functioned as industry lackeys[xvii].

Financial journalists have never understood that simply advocating term insurance is not a solution because it fails to render ineffective agents' misrepresentations. In failing to expose the specific falsities in agents' misrepresentations and the financial incentives that promote such, the journalists have failed to effectively counter those with opposing views' specious words. That all life insurance is comprised of term insurance is not at all widely understood; hence the typical effectiveness of the previously quoted agent misrepresentations. In failing to correctly distinguish the differences between term and cash-value policies, journalists have unwittingly facilitated the perpetuation of misconceptions and misrepresentations.

Regardless of the explanations or the excuses, the financial hoodwinking and fleecing that pervade the life insurance marketplace, yet which should have been ended generations ago, must stop now. In addition to the pervasive misrepresentations, other proof of the dysfunctions in the life insurance marketplace abound and are manifest in: 1)consumer dissatisfaction revealed by unacceptable lapse rates of policies sold purportedly to be permanent, 2) stagnant, persistently inadequate, and woeful market penetration, and 3) unconscionable operational inefficiencies. And while life insurance eponymously names the industry, this industry's related products of annuities and long term care insurance are also profoundly riddled with serious problems.[xviii] The efficacy of the disclosure solution can be gleamed by simply conducting basic consumer research or by simply recalling the unforgettable *Best's Review* interview in which NY Life's chairman, Sy Sternberg, stated, "If right in the middle of this [sales] discussion, you throw in 'And by the way, there's a 55% commission [not counting bonuses, expense allowances, renewals, and other compensation for field management]' You won't get the sale....."[xix] That is, if the costs of cash-value policies were disclosed, no one would buy the product. Actual proof of disclosure's efficacy will be readily apparent in the overnight eradication of products with excessive sales loads. Insurance industry executives who have never really cared about or understood the problems in the life insurance marketplace, and yet who so vigorously proclaim the virtues of and their allegiance to the competitive market, should have to adhere to their own words and allow informed buyers and genuine economic competition to finally have a chance to function in the life insurance marketplace. **The problems in the life insurance marketplace have persisted, not because they have ever been unsolvable, but simply because insurance commissioners with the authority and responsibility for solving these problems have never done so, and others with public podiums have never held them accountable.**

Strong arguments, I contend, can be made along the following lines. Those who haven't done their jobs shouldn't get paid for it, or shouldn't get fully paid for an incomplete job. More generally, parties to a contract are held accountable for a failure to perform. Also, guarantees are often obtained from one who has an important job, especially when one is being given a second chance to perform. Additionally, wise regulations have recently been sought, in the wake of our nation's 2008 financial crisis, to claw-back executive compensation when it is subsequently discovered that past performance was not what it was purported to have been, that is, when one was paid when he did not actually do the job for which he had been responsible. These are hardly radical ideas.

It is with these sensible principles in mind, that I am asking the NAIC and you, as its 2011 President, to provide the American public the following: One: Obtain a $100 million performance bond to guarantee that the NAIC at last fulfills its responsibilities to reform the life insurance industry during 2011 by providing appropriate policy disclosure for which regulators have always been responsible and which consumers have always needed and deserved. Two: Obtain agreements from current and past Insurance Commissioners to the principles of claw-backs and the enforcement of such principles, by an independent body, with respect to the commissioners' past and current

regulatory activities, responsibilities, pay, and pensions; such claw backs to be contributed to fund compensation for policyholders who have suffered misrepresentations enabled by insurance commissioners' repeated failures. Three: Issue a call for all life insurers to disclose the historical performance of representative in-force policies; historical performance of publicly marketed financial products is not proprietary, and the NAIC should have never discontinued its requirement that life insurers fulfill such a basic and fundamental duty.

Should any of your peers object[xx] to these logical and reasonable, albeit unprecedented, requests, please remind them of their unrivaled horrendous regulatory failures; for instance, that the 1980 NAIC task force on policy disclosure abandoned its mission, never issuing a final report. Any and all of their possible objections are, I believe, and I think the public will agree, are outweighed by the public's needs for an effective, responsible, and accountable government.

Let me close on an uplifting note by recalling that problems can often best be viewed as disguised opportunities. Our beloved nation has enormous financial problems. We must really solve them. Misinformation – together with financial incompetence - has played an enormous role in all of these problems. Consequently, there could well be no place better to start to solve our nation's financial problems than the life insurance industry. Furthermore, among all our financial problems, the problems in the life insurance industry are easily the simplest to solve, and their solution – in marked contrast with the painful actions that are involved in other solutions - will produce enormous economic benefits for our society. This industry that has always desired to be the pre-eminent source of financial security for American families must finally begin to operate according to the principles of disclosure which genuinely competitive markets require. Free enterprise is not freedom to misrepresent or withhold material information, nor is it freedom from appropriate regulation. Life insurance ought to be and can be a tremendous and treasured product[xxi]. But it will never be so until life insurance is properly disclosed. The golden age of life insurance can never begin until its products are properly disclosed. Your predecessors have for decades had the power to transform the life insurance marketplace, and they have repeatedly failed. Now you have the power. The inadequate disclosure, distrust, dissatisfaction, inefficiency, misrepresentations, and woeful market penetration that have long characterized the life insurance marketplace can be eradicated. Completing the transformation of the life insurance industry can be your accomplishment. I wish you good luck, but it really doesn't require any luck. Let me know, of course, if you would like any further help from me. You have the power. I look forward to your reply; Americans– I am sure- look forward to your actions.

Sincerely,

R. Brian Fechtel, CFA, Agent, + Founder of Breadwinners' Ins.

Copies: West Virginia's Insurance Commissioner Jane Cline and NAIC Executive Eric Nordman
Attachments: 1) Letters in 2010 to and from then NAIC President Commissioner Cline, and 2) January 2011 Letter to the Society of Actuaries and Attachments

[i] That appropriate disclosure of life insurance policies is even a matter for discussion and implementation in America in the 21st century is practically, itself, an indictment of life insurance regulators. Given that other consumer financial products of less complexity, i.e., loans and mutual funds, have requirements for Truth-in-lending, prospectuses, etc. which explicitly describe the costs and other relevant aspects of such products, while life insurance regulations do not require such, ought to be recognized as unacceptable by anyone concerned with public policy. It is difficult to identify a single, most striking or sample failure, since there are so many examples that demonstrate the failure of life insurance regulators. Perhaps two of the best are: One: that the Society of Actuaries nearly twenty years ago recommended that atop all sales illustrations the

following be printed: "Sales illustrations should not be used for comparative policy performance purposes." There is no such warning on sales illustrations, and consequently they are used unwittingly by consumers precisely for such invalid purposes. Two: that the industry has used an obviously inherently-defective cost comparison method for more than 30 years, in fact regulations mandate its continued use.

[ii] *The Insurance Forum*, Vol. 21. No.8. **Please note: These endnotes are provided for various purposes**, but are not intended as complete, academic quality references.

[iii] "The Right Blend" by Mary Rowland in the April 2008 issue of *Financial Advisor* http://www.fa-mag.com/component/content/article/1-features/1879.html

[iv] The financial incentives in the life insurance marketplace for misrepresentation are, I contend, greater than they are with any other consumer product. There are few combinations of products that are substitutes where the difference in **compensation** to the sales person from selling one versus the other are similar to the differences in compensation paid to the life insurance agent selling whole life versus selling term with a side-fund. This point is not to be confused with the price spectrum of many products, such as cars, blouses, cosmetics, etc. which can be wide-ranging. **First**, all other products have their price prominently displayed; in contrast, recall the difference between a life insurance policy's price/cost and its premium. **Second**, the difference in costs between many substitutes, i.e. women's blouses, can be attributable to significant differences in input materials, i.e., fabrics, design, quality, etc., such that the differences in costs among substitutes are recognized and attributable to factors other than the difference in sales compensation. The difference in price between a $10 shirt and a $100 shirt is not attributable to the difference in compensation that the sales person receives for selling the product. In contrast, the difference in costs between a $500 level term premium and a $5000 whole life premium is directly attributable to the more than $4500 difference in agent compensation these two substitute products provide. For more information on this topic, please see my Table 2 and 3 or my "Policy Disclosure – Press Release" article on my web site, www.BreadwinnersInsurance.com.

Life insurance policy cost disclosure that has always been needed but not yet mandated by regulators will drive the excess sales costs out of cash-value life insurance. While a commission disclosure requirement, as is currently required by ERISA on sales of insurance products purchased by qualified plans, could be useful, everyone knows that the most significant single fact about any item anyone buys is its cost. Whether one's buying a diamond or a donut, the most essential information, more important than how much the jeweler or retailer makes on a sale, is the cost of the product. Car dealers post costs, grocery stores post costs, even hedge funds post costs. In contrast, life insurers because of its policies' financial characteristics or construction, and the industry's historically ineffective regulation, have never clearly posted the costs of all its policies. Markets, though, can't properly work without such price/cost information.

When disclosure truly comes to the life insurance marketplace, the industry will no doubt try to portray disclosure as an insignificant event, as something unnecessary because it will claim that its sales people have always provided it and/or always done what was in the consumer's best interest. It will no doubt be seen by some others as inevitable and just another event in society's natural progression. Such perceptions and opinions will totally misunderstand the decades-long battle to bring good disclosure to the marketplace, and the roles that regulators, the industry, journalists, consumerists and others have played throughout this ridiculously protracted public policy disaster. If such perceptions and opinions are widely believed and accepted as accurate, that would become, sadly, just another instance of the public's profound misunderstandings regarding the life insurance industry's age-old problems.

[v] Myriad misrepresentations are made by life insurance agents. Misrepresentations of the costs of whole life policies play a profound role in the marketplace because of the historic and still current significance of whole life. Several of the oldest, largest, and most successful – as measured solely by annual premiums – life insurers still sell more whole life than any other product. For the record, myriad misrepresentations are also made by proponents of term insurance.

No life insurers are named because the problems of inadequate disclosure and misrepresentations pervade the industry, and the mention of specific insurers would presently be distracting. All of the insurers whose agents were surreptitiously shopped are recognized as industry leaders.

[vi] Please note that this fourth agent's insurer has a 'Code of Conduct' which the company and its agent tout in their efforts to build consumer trust. The Code's first two of many rules are: 1) "Representatives must always act in the best interests of the client. Any action taken to further a Representative's self interest above the client's best interest is unethical, against Company policy and, in many cases, illegal," and 2) Any situation with a potential for conflict of interest must be avoided. Examples [include], but are not limited to:..." This mellifluous Code, in addition to being used as a duplicitous marketing tool, also serves as a fortifier of agent conduct and conscience ('I've done it before, the company watches me and said

nothing, therefore it must be right and I can do it again') or an anesthetic simply quelling any agent's possible uneasiness or discomfort.

This insurer, it should be noted, now requires its agents - or at least some of them, as it now does of one of their few agents I surreptitiously shopped - to obtain the client's signature on a long form which last paragraph, entirely in bold print, reads:

> "Important Reminder: Financial Advisors with [this insurer] are capable of delivering a wide range of products and service, including fixed and variable insurance, investment brokerage and investment advisory services, such as financial planning. The responsibilities of your Financial Advisor and your rights may vary depending upon which products and services you obtain. ***In particular, you should understand that your Financial Advisor acts as your "fiduciary" only when offering advisory services***" Bold italicized print added to document the summary sentence immediately below.

In other words, this insurer's Code of Conduct does not apply when its agents sell its products.

[vii] **I have no interest in causing these agents harm**. I believe this documentation of their misrepresentations raises serious and involved legal questions, but the ultimate responsibility for the pervasive misrepresentation in the marketplace rests with life insurance executives and regulators. Executives and regulators, in contrast with the vast majority of the industry's sales force whose actions simply reflect Upton Sinclair's adage, "It is difficult to get a man to understand something when **his job depends on not understanding it,**" have had the responsibility to build and to supervise a properly functioning life insurance marketplace with appropriate and effective cost disclosure.

[viii] **One of IMSA's original auditors of life insurance sales practices was former MA Insurance Commissioner Kay Doughty, who had just been run out of office on ethics violations.** No caring person can be opposed to second chances for those who stray, but Doughty 'ethics' problems were like Al Capone's tax evasion. Doughty's official unpublicized, unconscionable actions in office will live in infamy in insurance regulatory history.

To be clear, it is not just IMSA which is a fraud. As explained in on my web site article, "Life Insurance: An Industry Built on Fraud," the fraudulent practices in the life insurance marketplace are extensive. Many have said that this web site article helped them begin to understand, what they previously would have never suspected or imagined: the extensiveness of fraud in the life insurance industry and marketplace. http://www.breadwinnersinsurance.com/life-insurance-industry-built-on-fraud/

[ix] I was equally incredulous, I must add, with **Commissioner Cline's explanation for declining my invitation** to join my campaign and provide the good disclosure that consumers have always needed and deserved. She wrote,

> "It is not because I do not share your zeal for making appropriate policy disclosure, but rather the need to remain neutral with regard to the various elements of the industry I regulate. As commissioner, I cannot be seen as favoring the interests of insurance producers over those of insurers or vice versa. It is the consumer that I serve. I must avoid even the appearance of having a preconceived notion about the matters that come before me."

Clearly, her reply, I'm sorry to say, is nonsense, pure nonsense; maybe Commissioner Cline was having a bad day when she drafted her reply. I was asking her to act on behalf of consumers, not pick sides between producers and insurers. Her assertion of having "to avoid even the appearance of a preconceived notion about matters that come before me," could be admirable for its possible candid acknowledgment of incompetence, if her text were not so patently ridiculous, exhibiting a misunderstanding of the differences between "notion" and "bias." This was unfortunately not the only other time I have received a nonsensical reply from the NAIC.

For instance, years ago, after I had sent an earlier version of my disclosure approach to the NAIC, the then NAIC executive in charge of the NAIC Working Group on Life Insurance Disclosure replied,

> "The focus of your work appears to be on cost comparisons rather than the current focus of our working group, which is disclosure in connection with life insurance illustrations. In view of this, we will not be reviewing the question of improving the cost comparison methods specifically at this time."

To assert, as this NAIC executive did, that there is a meaningful difference between the task of proper disclosure of life insurance illustrations and the question of cost comparison methods is a shocking and profound failure to comprehend: 1) the way sales illustrations are used in the marketplace, and 2) the paramount purpose and importance of disclosure being to facilitate the consumer's ability to compare products. The two go together like hand and glove.

Let me just add, that I know that there are good and smart people at the NAIC and its state affiliates. In fact, I have been assisted during my campaign by a few who are, and the two whose letters I have criticized might possibly, based on their entire work, be included in such a group. **But there is obviously something so terribly sick with the NAIC and its affiliates' culture which has let regulators acquiesce for decades with their marketplace's profound, fundamental, and obvious problems that** it seems imperative to conduct a review of their operations according to the practices of world renowned quality expert Professor Deming. The NAIC's unacceptable performance in the life insurance marketplace must be recognized for the national calamity that it is.

[x] The SEC and FINRA which share regulatory responsibilities regarding variable insurance products have demonstrated no better record than insurance commissioners; in fact, their management of their responsibilities strikingly resembles the Office of Thrift Supervision's oversight of AIG's credit default swaps. One clear example of these organizations' failures is the typical prospectus used for variable insurance products. Aside from the record demonstrating that consumers do not use them, these prospectuses by failing to disclose the policy's total costs in a simple and straightforward fashion actually facilitate misrepresentations. Variable products have both an account value and a surrender value, the difference between the two being labeled a contingent deferred surrender charge. There is, however, nothing genuinely <u>contingent</u> about such charges; the sales charges that this regulatory construct allows to be classified as contingent are, in fact, inevitable. That these prospectuses do not simply, straightforwardly, and fully disclose the costs one inevitably incurs in purchasing these products is both a testament to the regulators' problematic acquiesce with insurer's objectives to obscure sales costs and their lack of understanding of how agents can and do misrepresent something labeled "contingent deferred surrender charges" to circumvent a consumer's curiosity about such.

[xi] More than 4 out of 5 recruited to be agents fail from the business within a few years. One life insurer with a sales force of more than 7000 full-time agents, has annually recruited 1500 to 2000 new agents each year for more than 20 years, and yet has had no growth in the number of its agents; as alluded to in my letter to the Society of Actuaries, the recruits <u>are classified as</u> independent contractors, <u>although managed</u> as employees, to avoid their inclusion in the unemployment insurance system. (This is just another way life insurers avoid fully accepting the total social costs of their operations.)

I have seen dozen of good men and woman fail as agents, and not for lack of effort or ability. Such failures are financially costly to these individuals, their families, and their clients– the few clients whom they were able to convince, typically with some misrepresentation, to buy a policy with excessive sales costs. Misrepresentations may well occur in almost all sales situations – that at least was my experience when working in an agency office and thereby regularly hearing and hearing about agents' sales presentations. As the statistics show, most recruits do not learn how to navigate making sales and fail from the business, having never fully understood - almost to a person - the products or the business. Any I have known who have had an inkling of the industry's irreconcilable practices have either feared their own liability or felt the system couldn't be changed because of the industry's power.

In light of the industry's turnover among its agents, the conventional advice regarding looking for a good agent is to look for one who has been in the business for many years. Ironically, and unfortunately, as again I believe my surreptitious shopping indicates, those who succeed in this marketplace could well just be those who are most successful in making misrepresentations. Many agents do not recognize their own misrepresentations, and those that have some inkling about the matter typically have their own justifications. Clearly, successful agents have rejected Sophocles dictum: "Better to fail with honor than to succeed by fraud."

Indeed one successful agent I surreptitiously shopped actually stated, "What I'd like to start with is a little basic life insurance theory, if you will. This is just a very simple graphic way to explain how life insurance works. **Cause it is kind of confusing, and I think to some extent life insurance companies want to keep it that way cause it keeps me in business**." This agent is in fact correct, at least to an extent. The confusion in the life insurance marketplace is instrumental to the extraction or appropriate of excessive costs from uninformed consumers. Along such lines, Belth has stated that he has been gold by life insurance executives that the industry could not survive good disclosure. Of course, such hyperbole and implicit warning/threat of catastrophe ought to be simultaneously recognized both as proof of my argument and yet as an unpersuasive attempt to defend the broken status quo.

Another telltale sign of the problems in the current marketing of life insurance is that the typical life insurance agent does not sell one life insurance policy a week. Admittedly, agents also sell annuities, long-term care insurance policies, and in recent years some other financial products such as mutual funds, but for many agents and insurers, life insurance is still their primary business. The above-mentioned life insurer with 7000 agents typically only annually sells a total of approximately 300,000 policies – and that's counting all life, disability and long-term care policies; its core businesses. Per agent, that's less than 44 policies sold per year, and yet this insurer is regarded as having a highly productive sales force.

No one should conclude from this industry's sales forces' abysmal productivity, that such high compensation per sales is justified and necessary because of the difficulty of its work. Lots of jobs are difficult. It is not the ease or difficulty of a job that determines the compensation. If the life insurance industry believed that its agents' compensation on the sale of a whole life policy could be justified, it would have never had any problem disclosing such. After all, that which can be justified can be sustained. But the industry has – at least at some level or in some way always really known – despite the difficulties selling – that its sales compensation could never be justified because no informed individual would accept them. This is just merely another way of looking at the source of this dysfunctional industry's age-old problem. It is truly an incredibly simple problem, when it is clearly seen. Somehow, though, it has been allowed to continue for generations.

These facts all show that the distribution model built on inadequate disclosure has been broken for decades. In addition to the regulators' failure to have mandated appropriate policy disclosure, it must be briefly noted that many other life insurance industry regulations are problematic and significant factors that contribute to the industry's dysfunction. Everyone ought to recognize the need to evaluate the constitutionality of such paternalistic prohibitions as those against discounting/rebating commissions when enforcement of manufacturers' suggested retail price practices have been repeatedly struck down. Similarly problematic is the prohibition on agents charging fees in lieu of, or separate from commissions, or seeking a retainer for services to be rendered. These anachronistic regulations stymie the functioning of a competitive market. Consumers must be able to seek discounts, to obtain competitive value, and sellers must also be able to protect their resources, namely their time, from being abused. Doctors, lawyers, accountants, auto mechanics, etc. can all charge and seek payments from patients/ clients/customers, life insurance agents cannot; and the facts do not warrant or justify such inconsistent rules. This particular problem may not seem worthy of consideration to those who have never been an agent, but any such prohibition that creates such a significant and unnecessary problem in the allocation of resources ought to be worthy of review. These various other matters, which obviously warrant and require much further discussion, have only been mentioned to indicate the much broader insurance industry problems of misguided, paternalistic regulations that are separate from that of its inadequate disclosure regulations.

Finally, I must explicitly state here, what I have stated elsewhere, but which prove the life insurance industry's dysfunction. I can both empirically and logically prove that the costs that consumers pay in purchasing whole life and other similar cash-value policies with excessive sales load are unjustified, that is, they cannot be sustained to an informed consumer. Empirical proofs could be simply conducted with consumers or researched by speaking with fee-only advisers about their work, which largely consists of refuting agents' misrepresentation and failures to inform consumers about better value policies. In essence, doing what the actuary cited in my letter to the Society of Actuaries admitted that his insurer was unwilling to do. The logical proof is equally compelling. There is nothing about cash-value life insurance that justifies the sales loads that are extracted from consumers. The fundamental advantages of cash-value policies arise from their tax privileges, but tax privileges are a free non-proprietary input. In a competitive marketplace one cannot extract value from a consumer for a free, non-proprietary input. That the life insurance industry has done so for decades is a function merely of historic practices built and sustained with misinformation. These facts spotlight the unenviable position of modern life insurance agents functioning in a marketplace where consumer distrust is justifiably high and objective information virtually nonexistent. And yet, while spotlighting such, these facts do not excuse the market's dysfunctional history or endorse continuation of its dysfunctional operation.

[xii] *Defending White Collar Crime: A Portrait of Attorneys at Work*, Yale University Press, Kenneth Mann, 1985, p. 234.

There are, in fact, concrete examples of government attorneys not recognizing and/or not understanding the problematic practices in the life insurance marketplace. Fee-only life insurance adviser Glenn Daily, quoted in the *Financial Advisor* article above that "he can't believe there haven't been lawsuits about this" reports that the CT Attorney General's office took no action regarding his referral of a defrauded client. Similarly, fee-only life insurance advisor David Barkhausen has had a client who has received no help from either Oregon insurance regulators or FINRA regarding a problematic sale. I have seen other instances myself.

Some might try to claim that such inaction on the part of legal authorities supports the position that life insurers and their agents have committed no wrongs. There are, however, much more compelling alternative explanations regarding legal authorities' inaction. Recall the SEC's inaction on the Madoff matter, the dot.com pump and dump bubble, and numerous other enforcement actions taken only after the financial crimes had imploded. It is unfair to challenge critics of lax enforcement to prove that those who enforce financial regulations are unqualified or incompetent; no one can prove a negative. On the other hand it is fair and reasonable to expect those charged with enforcement of financial regulations to prove that they understand and can identify financial crimes, and yet regulators have never required such examinations or proof. There is abundant proof that many financial crimes have persisted for years in plain sight without being detected by regulatory legal authorities. And knowing such, especially my knowledge of the life insurance marketplace, I condemn life insurance regulatory enforcement.

Given that President Roosevelt is rumored to have said regarding his nomination of Joseph Kennedy to be the first chairman of the SEC, "It takes a thief to catch a thief," it should not surprise anyone that in this era of sophisticated financial crimes only individuals with sophisticated financial knowledge and experience are able to understand and prosecute sophisticated financial crimes. And, as the regulators' inaction on the Prudential nationwide advertisement mentioned below documents, there is little reason to currently think that any of the insurance regulatory legal authorities have the genuine knowledge of insurance products to understand many of even the most blatant misrepresentations. Given the pervasiveness and harmfulness of financial crimes and frauds in our modern economy, it is practically comatose behavior of financial regulators to have NOT developed rigorous certification standards and testing methods for those charged with financial regulatory enforcement. A society with a multi-trillion dollar economy that spends more on enforcement of parking laws on motorists than it spends on financial regulatory enforcement is incredibly misguided.

[xiii] Insight into the misleading aspects of the NAIC's original Life Insurance Buyer's Guide's statement that there are two types of life insurance, term and whole life, begins when one recalls or learns that **whole life is called whole life because it was originally called "level payment term for your whole life."** And so the NAIC's Buyer's Guide rather than facilitating consumer comprehension of the differences between these products, the fundamental differences arising from cash-value policies tax privileges, relies instead upon the pervasive societal misconceptions that these products are fundamental different in how they operate. No one committed to disclosure would have ever published a Buyer's Guide asserting that there are two types of life insurance: term and level payment term. When informing or educating others about two things it is absolutely critical to identify their similarities and their differences. With disclosure, one readily understands that whole life is merely term insurance with large/unsustainably large sales loads and tax-advantages. More on this subject is explained in my 2002 *Journal of Insurance Regulation* article, available in my web site's Archives. The section, "Marketplace Implications" beginning on page 18 could be very useful supplemental reading. The Archives also contains some of my preliminary thoughts on a new and genuinely useful Life Insurance Buyer's Guide.

The extent of the misunderstanding among the highest level of government officials regarding cash-value life insurance is the Congress' frequent reconsideration of the tax privileges of cash-value policies. In the last 30 years, Congress has extended many new tax privileges to promote individuals taking responsibility for their own and their family's financial security (IRAs, 401ks, Roth IRAs Section 529 Plans, Pre-tax Health Insurance Spending Accounts, the deductibility of LTCI premiums, etc.) The proposals to eliminate the tax privileged inside build-up of cash-value policies seem not to recognize that this "aspect," and virtually this "aspect" alone, is the factor responsible for these policies' genuine advantage. It is not that whole life eliminates, avoids the increasing costs of coverage as one ages, or has some other ineffable magical advantage. Whole life, in essence, was the original tax-advantaged spending account, but because of its historic roots, apparently, its fundamental structure has not been analyzed alongside all the tax-advantaged products created in recent decades. Eliminating whole life and other cash-value policies' tax privileges would be to destroy the policies' fundamental advantage. The fact that discussion of the elimination of such privileges can so regularly and so seriously occur apparently without a simultaneous realization of the extraordinary and drastic impact such would have on the industry is, I believe, nothing but a testament to the pervasiveness of misunderstandings regarding cash-value life insurance at the highest levels of government. Such Congressional proposals only appear threatening until one realizes that those who propose such apparently don't really understand the product nor do they recall the extraordinarily strong, and I contend, entirely justified and defensible social arguments for life insurance's tax privileges. An individual's policy helps take care of his loved ones, i.e., a surviving spouse and children, or his own financial debts or final or end-of-life expenses; all of which, even among those typically opposed to tax privileges, are held worthy of governmental encouragement. (Second-to-die policies' privileges are very different matters and ones worthy of public discussion).

[xiv] The *National Underwriter* article containing the misrepresentation is located at
http://www.lifeandhealthinsurancenews.com/Issues/2010/December-6-2010/Pages/Whole-Life-Insurance-Turns-2000.aspx
My own web site contains my blog about this, my email to the insurer's general counsel regarding the company's employee's misrepresentation, and the insurer's reply.

Perhaps, **one of the all-time most shocking printed misrepresentations is Prudential's nationwide advertisement** in *The New York Times,* December 7, 1997 Sunday Business section, just months after it settled for $2 billion a multi-state regulatory investigation. Prudential declared, "In most situations, the life insurance that you already own is your best buy." This statement is absolutely untenable, on both logical and empirical grounds. Prudential's Chief Actuary declined my invitation to defend his company's hogwash. That no regulator took adverse action against Prudential for this blatant misrepresentation is just further proof not only of the pervasive misrepresentations but also of the astonishing – to speak euphemistically - lack of quality in regulatory enforcement of insurance laws. Anyone who cannot write a 500 word essay expounding upon all the errors in Prudential's ad is absolutely unqualified to participate in life insurance regulatory

enforcement. While no human or human institution is infallible, regulators charged with enforcing insurance laws who demonstrate this truth daily should be replaced; American consumers deserve effective enforcement.

[xv] **One large consumer organization** relies upon a former actuary and insurance commissioner as its consumer advocate. This actuary/consumer advocate has actually recommended greater compensation for agents selling cash-values policies, and that consumers be advised of the cost of terminating a policy. Given that consumers do not knowing accept the current compensation levels, greater agent compensation for selling cash-value policies is not the solution to the industry's disclosure and problematic sales practices. Furthermore, the recommendation that consumers be advised of the cost of terminating a policy is incredibly invalid, virtually fatuous, economic analysis. A forthcoming Breadwinners' Insurance article will expand upon these points.

It should also be noted that this actuary worked for many years as Chief Actuary for a life insurer that conducted a patently unfair demutualization that actually deprived policyholders of their exclusive interest in the insurer's $100 million surplus and future profits. This looting has remained one of the biggest unreported financial crimes in America. If such managerial experience does not disqualify one, or at least curtail a consumer organization's reliance upon such an individual as a consumer advocate, then Jeff Skilling and Bernie Ebbers may have future leadership roles for investor protection groups!

This actuary/consumer adviser also currently charges consumers $80 to perform an analysis of a life insurance policy's sales illustration. Please recall first, that sales illustrations, according to no less of an authority than the Society of Actuaries, **are not to be used for** "comparing the relative cost or performance of life insurance products." So, any analysis – especially one comprised of extensive mathematical analysis of twenty years of illustrated values – is inherently problematic, especially when used, as this advocate does, to calculate a score of measures on which he bases his recommendations regarding the policy's merit. My web site article, "What Breadwinners' Thinks of Others' Approaches," further describes this actuary's/consumer adviser's flawed practice. His analytical approach, the Linton Yield method, is not entirely worthless, but it is an analysis which the NAIC has rejected on multiple occasions as an inadequate disclosure approach. It is also inconsistent with Professor Belth's call for disclosure of information about a policy's annual costs and rate or return, and with Professor Ralph Winter's analysis/proof that a single metric cannot be used to describe a cash-value life insurance policy.

Finally, this consumer advocate, although well-intentioned, does not believe that the life insurance industry can ever be changed and has refrained from challenging IMSA's fraudulent practices because IMSA's President is his friend. Although eligible to be a funded consumer representative at NAIC meetings, he stopped attending approximately 10 years ago because, as he has said and written, "They never listened to anything I said." That life insurance consumers have been served for decades by such an individual who cannot conceive of their mission ever being successful and whose actions have been so problematic and ineffective is most unfortunate. When President Lincoln realized that the Union's Commanding Generals were not winning the war, he replaced them. Why this consumer organization has never considered this actuary in its nearly 30 year affiliation with him is not a question I can answer. It is difficult to imagine, I am sad to have to state, a less effective representative for America's life insurance consumers unless the industry had chosen the representative itself.

Let me note that **I have recently been informed that the American Council on Consumer Interests** – a different organization from the one which has relied upon the above mentioned actuary – **has accepted for its 2011 journal and conference my article, "The Disclosure Solution to the Problems Consumers Face in the Life Insurance Marketplace."** I am committed to seeing that the American life insurance marketplace be fixed, if not as a direct result of my campaign before my self-imposed prior deadline of year-end 2010, then during 2011. Something so fixable, yet which so many have allowed for so long to harm so many millions, must be fixed now.

[xvi] Consumers Union (publisher of *Consumer Reports*) and one of its writers produced an article and then a book in the 1980s where it compared and evaluated policies based on insurer's sales illustrations. Such comparisons are akin to admitting students into college based on transcripts they themselves printed. On the basis of this "analysis," this most inherently defective "analysis", Consumers Union listed an Executive Life policy as best. For those unfamiliar with Executive Life, it was a large insurer and leading investor in what where then called junk bonds before it became insolvent in less than five years from Consumer Union's specious ranking.

[xvii] One professor, in fact, has served on IMSA's board, others have published articles that are patently flawed and nothing but the work of a hired gun. For instance, in the early 1980s **following the introduction of universal life, another professor in a *Journal of Risk and Insurance* article (December, 1982) asked, "Why does whole life insurance continue to exist?"** He answered that it must be because whole life provides a valuable "package of options that is not precisely duplicated by any other combination of commonly available financial contracts." This ivory tower hypothesis is

unfortunately devoid of any real world common sense and any genuine life insurance marketplace knowledge. Almost every product can be considered a "package of options." Cuffs can be added to these pants, but not those; some cars come with space for 7 passengers or engines strong enough to tow a trailer, some others don't have such capacities. Asserting that a product is a package of options is hardly a scholarly insight. Moreover, this professor overlooked: 1) the absence of appropriate disclosure of the cost or price of the whole life package (which every other product provides in a straightforward and in a usable form to consumers) and 2) the pervasive misrepresentations that life insurers and agents used and still use to battle universal life.

Universal life is widely considered the creation of James C. H. Anderson, the legendary former Tillinghast actuary who is now in the Insurance Hall of Fall. He had intended for universal life to transform the life insurance marketplace because of its separation of whole life into its term and savings components. Year ago, I sent him a copy of my disclosure approach and an early published article. Although he had retired, he replied with a letter. Subsequently, we had a good discussion on the phone about how the life insurance marketplace needed not just good products but also good disclosure about products, and had scheduled another conversation about an additional second paper of mine he had just received. The next week, on the morning we had agreed, I called to follow-up. His son answered the phone and explained that his father, just a day or two earlier, had suddenly, unexpectedly suffered a fatal heart attack. Naturally, I just expressed my sadness, extended good wishes, and said good buy. Subsequently, though, I have more than once wondered how we might have been able to work together to achieve our shared goal.

[xviii] "A Very Popular Annuity Sales Presentation: What do you think of it?" is, according to several of my blog readers, a highly-readable article that presents a straightforward and alarming analysis of a widespread misrepresentation by annuity salespeople. See http://www.breadwinnersinsurance.com/annuity/

"Long-Term Care Insurance: The Blackest Box" is a forthcoming BreadwinnersInsurance.com article that highlights some fundamental problems with long-term care insurance policies as they are presented marketed. LTCI is essentially a deferred contingent annuity in which the consumer has essentially no real ability to move her/his business elsewhere and yet the insurer possesses/retains the option to increase premiums on previously issued policies without having ever provided the consumer with adequate information. Talk about shooting fish in a barrel. Consequently, there perhaps should have been no surprise with LTCI insurers' premium increases of 20, 30, and 40%, but there has been extraordinary consumer outrage – what would seem to be yet another telltale sign of this marketplace's inadequate disclosures and, at best, miscommunications. As my forthcoming article will show, it is virtually impossible to conduct a due diligence review of long term care insurance policies. Buyer beware, buyer be very aware, is alive and well in the 21st century in America's life insurance marketplace.

[xix] Sternberg full response to the *Best's Review* interviewer is, "The life sale is a very difficult sale. People have to talk about their mortality, about how much money they really need. It's very complicated. If right in the middle of this discussion, you throw in 'And by the way, there's a 55% commission [not counting bonuses, expense allowances, and compensation for other field management and renewals]' You won't get the sale….." It is truly rare to get such a candid admission from a life insurance executive of his belief in the necessity for misrepresentation. The necessity to misrepresent arises in sales situation whenever a consumer asks either directly or indirectly about cash-value policies' low early years cash-values. Agents, as are shown in the quotes from my surreptitious shopping experiences, use a variety of techniques to confront this issue that the industry, but they all fundamentally rely upon misrepresentations or material omissions.

There is profound irony in the industry's conduct. **The life insurance industry touts to its consumers, and its sales agents, that its relationships with its "clients" are built and based on trust. And yet the foundation on which it operates is poured with - comprised of - misrepresentations and inadequate information.** It really is quite a marketplace. And, yet, virtually no one who has not been actively involved in it can fully conceive the enormity of its problems.

[xx] If for any reason you are inclined to defend the NAIC's regulatory history, rather than expeditiously engage in solving these problems, please arrange with news organizations for a forum where we may both thoroughly present facts so the public can evaluate our positions.

[xxi] Life insurance is an insurance product with virtually no claims disputes. To be sure, there are a few, but most of which involve insurers defending against consumer fraud and/or agent complicity. Life insurance can provide extraordinary value and financial protection, that is, provided that it no longer is allowed to remain riddled with all the problems that arise from inadequate disclosure. I trust and hope that you now agree; and that you will now use your power to fix the life insurance industry's age-old and terribly costly problems. **Thank you for your time and consideration; I look forward to your thoughts.**